

# RSM McGladrey Tax Digest

## Special Edition: The American Recovery and Reinvestment Act of 2009

Feb. 16, 2009

RSM McGladrey Tax Digest, a periodic electronic newsletter, highlights developments of interest to today's companies on the move. To unsubscribe, reply to this email with "unsubscribe" in the subject line.

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*The American Recovery and Reinvestment Act of 2009 favors spending programs over tax incentives. While the Act provides tax relief to some individuals, it falls short on business tax provisions that many hoped would be included to stimulate the economy. Following is our analysis of certain key tax provisions contained in the Act.*

## BUSINESS INCENTIVES

### Bonus depreciation

The bonus depreciation provision allowing additional first-year depreciation of 50 percent of the cost of the asset was extended through 2009. We believe this provision will help many businesses, whether they are struggling to compete or trying to grow their operations. This provision applies to middle market companies, large companies, and small businesses in a variety of industries. The \$8,000 increase in the first-year luxury passenger auto limitation was also extended through 2009 to reflect the continued availability of bonus depreciation and to allow vehicles to continue to be depreciated at a higher level.

### Monetization of AMT and R&D credit carryforwards

Corporations that elect out of bonus depreciation can instead convert part of their alternative minimum tax and research and development tax credit carryforwards into currently refundable credits. This provision, which generally applies to C corporations but can have applicability to some S corporations, has been extended through 2009. This represents a significant opportunity for certain businesses to convert existing carryforwards into cash refunds. [Read more.](#)

### NOL carryback for small businesses

Taxpayers with net operating losses can carry the losses back and apply for refunds of taxes previously paid. The Act increases the carryback period to five years from two years for 2008 tax losses incurred by small business taxpayers with \$15 million or less of gross receipts. By extending the carryback period, the Act allows these taxpayers to recover additional taxes previously paid. It was extremely disappointing that the conference committee took this opportunity to recoup taxes previously paid away from middle market and larger businesses after both the House and Senate bills had included it.

## Energy Incentives

New credit for advanced energy property

Electricity production credit from renewable resources

Energy investment credit

Nonbusiness energy property credit

Residential energy efficient property credit

Plug-in electric drive vehicle credit

Neighborhood electric vehicle credit

Alternative fuel vehicle refueling property

Carbon dioxide capture credit

## S corporation built-in gains holding period

S corporations that were previously C corporations often have built-in gains on assets that appreciated in value during the C corporation period. S corporations were required to hold those assets for ten years or be taxed, but the Act now temporarily reduces the holding period to seven years.

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## Debt cancellation income

Taxpayers that repurchase debt (with cash, for new debt, or for stock) at a discount are subject to income tax on such transactions. The Act has given such taxpayers a period of five years, beginning in 2014, to pay the tax for debt repurchases occurring in 2009 and 2010. This results in a five-year tax holiday on 2009 repurchases and a four-year holiday for 2010 repurchases. The Act provides an additional five years after this deferral period to pay the income tax in equal annual installments.

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## Work Opportunity Tax Credit

The Work Opportunity Tax Credit essentially provides businesses with a \$2,400 credit for each employee they hire in certain targeted groups. This was expanded to include unemployed veterans and certain disconnected youth.

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## Loss limitations for banks

Last year in a notice specifically directed at banks, the IRS eased the rules limiting the use of certain deductions and losses to offset income after an ownership change. For bank ownership changes occurring after Jan. 16, 2009, that notice is revoked, and the use of certain deductions and losses may be limited. However, banks that experience an ownership change as a result of certain deals that were announced by Jan. 16, 2009 will still be able to rely on the notice.

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## Loss limitations for restructured businesses

The rules limiting the use of losses to offset income after an ownership change have been substantially relaxed for businesses restructured under the Emergency Economic Stabilization Act. However, if such restructured businesses are acquired (50 percent or greater ownership), this relief does not apply.

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## Section 179 expensing for capital expenditures

Certain businesses making limited amounts of investments can write-off the entire cost of up to \$250,000 of capital expenditures incurred in 2008. The Act extended the \$250,000 amount for capital expenditures incurred in 2009.

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## Qualified small business stock gain exclusion

Certain non-corporate investors owning qualified small business stock receive a portion of the gain tax-free when they sell it, provided they held the stock for five years or more. The Act increases the tax-free portion of the gain from 50 percent to 75 percent.

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## Withholding on government contractor payments delayed

Governments were expected to begin withholding three percent on payments to government contractors starting in 2010, but this has been delayed to 2011.

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## Individual Incentives

AMT patch

Estimated tax relief

New Making Work Pay  
income tax credit

American Opportunity  
Tax Credit

New homebuyer credit

Deduction for sales and  
excise taxes on new car  
purchases

Earned income credit

Child tax credit

Health coverage tax credit  
rate increase

Computers as qualified  
education expenses

Average unemployment  
benefits now exempt from  
taxation

## Employer-provided transportation

Under the Act, the amount that employees may receive as tax-free fringe benefits for employer-provided transportation and van pool arrangements is the same as the amount they may receive tax-free for employer-provided parking.

## New Markets Tax Credit

Investors in low-income communities receive an income tax credit for these investments. The Act increases the annual maximum national amount for the New Markets Tax Credit from \$3.5 billion to \$5 billion for 2008 and 2009.

## Original issue discount on high-yield debt obligations

Issuers of debt instruments with original issue discount (OID) can usually deduct the OID in the year the debt is issued. This deduction is substantially limited for high-yield obligations (referred to by some as "junk" bonds). Issuers of debt exchanged for debt between Sept. 2008 and the end of 2009 can now take this deduction.

## COBRA premium assistance

Involuntarily terminated employees are, by federal law (called "COBRA"), entitled to continue certain insurance coverage (most notably health insurance) previously provided by their employers for a limited period of time, provided they pay the premiums for that coverage. The Act temporarily subsidizes such premiums by 65%, crediting employers paying the subsidy against their payroll taxes. Persons eligible for this subsidy are those terminated from September 1, 2008 through December 31, 2009. The temporary subsidy ends on the earlier of nine months after the subsidy starts, or whenever normal COBRA protection would end.

## Executive compensation limits for TARP recipients

Included in the non-tax provisions of the Act are additional restrictions regarding the payment of bonuses and golden parachutes to senior executive officers of companies receiving taxpayer money under the TARP program.

## ENERGY INCENTIVES

### New credit for advanced energy property

The Act has created a new 30 percent credit for the construction of manufacturing facilities for advanced energy property – renewable energy, energy storage, energy conservation, efficient electricity distribution/transmission, manufacturing facilities to refine/blend renewable fuels, production facilities for renewable energy, energy conservation technologies, plug-in electric drive motor vehicles, and carbon sequestration. Historical energy tax incentives primarily benefitted either producers or consumers of energy, but manufacturers have been largely excluded from these incentives. This 30 percent tax credit is a significant tax incentive for manufacturers to develop and invest in facilities to manufacture the high technology equipment necessary to enable a wide array of energy efficient technologies and processes.

## **Electricity production credit from renewable resources**

A number of renewable electricity generation facilities qualify for a 1.5¢ per kilowatt hour tax credit. This credit has been extended through 2013. The same credit has been extended for wind electric generation, but only through 2012. These extensions will be in effect for property placed in service after the Act's enactment.

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## **Energy investment credit**

The energy investment credit, which can be as much as 30 percent for certain qualified investments in alternative energy property placed in service in a given year, has been altered in three ways by the Act. First, the limit on the credit for small wind energy properties has been eliminated. Second, for two years (for properties placed in service in 2009 and 2010) property for which the production credit might otherwise be available is eligible for the energy investment credit if the owners elect. Finally, to eliminate double dipping, projects receiving Energy Department grants (under a separate section of the Act) are ineligible for the energy investment credit.

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## **Nonbusiness energy property credit**

The nonbusiness energy property credit rewards taxpayers for installing energy efficient residential exterior doors and windows, insulation, heat pumps, furnaces, central air conditioners, and water heaters. The credit rate had been 10 percent, but the Act increases it to 30 percent. The lifetime maximum credit available to a taxpayer has been increased from \$500 to \$1,500 for improvements made in 2009 and 2010 (which also represents a one-year extension of the credit).

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## **Residential energy efficient property credit**

This credit of 30 percent for eligible solar water heaters, solar electricity equipment, fuel cells, qualified small wind energy equipment, and qualified geothermal heat pumps was subject to a yearly limit, and the Act eliminated that limit for all technologies except fuel cells.

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## **Plug-in electric drive vehicle credit**

Owners of plug-in electric drive vehicles are eligible for at least a \$7,500 income tax credit, but the maximum number of vehicles that could qualify was previously limited to 250,000. This maximum has been increased to 500,000. Neighborhood electric vehicles are excluded – they get their own credit (see below). The Act also creates a 10 percent (maximum \$4,000) credit for kits to convert vehicles into plug-in electric drive vehicles, and this "conversion kit" credit is in addition to all other applicable credits.

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## **Neighborhood electric vehicle credit**

The Act creates a new 10 percent (maximum \$2,500) credit for vehicles that generally meet the neighborhood electric vehicle standards of the Department of Transportation, expanded to include two- and three-wheel vehicles. These are generally speed-limited (not greater than 25 MPH) battery electric vehicles.

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## **Alternative fuel vehicle refueling property**

Alternative fueling stations (clean fuels, electric charging stations) are eligible for a 30 percent credit, which the Act has increased to 50 percent, with a maximum for depreciable property of \$30,000, which the Act has increased to \$50,000. Both these increases are for 2009 and 2010 only. Reflecting the greater complexity and cost of hydrogen refueling property, the maximum for this property has been raised to \$200,000.

## **Carbon dioxide capture credit**

The Act clarifies that if a taxpayer uses CO<sub>2</sub> to extract oil or natural gas from a reservoir (as a tertiary injectant), that CO<sub>2</sub> can qualify for the carbon dioxide capture credit (\$10 metric/ton) only if the use results in permanent geologic storage of the CO<sub>2</sub>.

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## **INDIVIDUAL INCENTIVES**

### **AMT patch**

The Act increases the amount of income exempt from the alternative minimum tax (AMT) from \$33,750 (single)/\$45,000 (married filing jointly) to \$46,700 (single)/\$70,950 (married filing jointly) and extends the AMT creditability of certain non-refundable, personal tax credits into 2009.

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### **Estimated tax relief**

Individual taxpayers who pay less than 90 percent of their current year tax obligation during the year, through withholding or estimated taxes, may be subject to a penalty. A safe harbor for relief from this penalty has been available to taxpayers who pay at least 100 percent of their prior year's liability. That safe harbor has been reduced to 90 percent of the prior year's liability for those small business owners with income less than \$500,000, at least 50 percent of which comes from a small business with fewer than 500 employees.

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### **New Making Work Pay income tax credit**

This is a credit in the amount of the lesser of 6.2 percent of earned income or \$400 (\$800 married filing jointly), phasing out over modified adjusted gross income of \$70,000 (single) and \$140,000 (married filing jointly). This credit ends after 2010.

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### **American Opportunity Tax Credit**

The American Opportunity Tax Credit has been added to the Hope Scholarship credit, creating a new \$2,500 higher education (available for the first four years of post-secondary education) tax credit, of which a portion is refundable. Income levels for this credit have been increased as well, and the credit is now allowed against the alternative minimum tax. Required course materials are allowed, as well as tuition and fees.

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### **New homebuyer credit**

For purchases of new principal residences made within one year of the Act, the maximum allowable for this 10 percent credit has been increased to \$8,000 (married filing jointly, with a 36-month holding period to avoid credit recapture).

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### **Deduction for sales and excise taxes on new car purchases**

This is a new, above-the-line (meaning non-itemizers can qualify) deduction applying to new cars purchased after Nov. 12, 2008 and before Jan. 1, 2010. Sales and excise taxes on vehicles (applies to SUVs and light trucks as well, but not over \$49,500 in price) qualify. This new deduction phases out at higher income levels (\$125,000 single, \$250,000 married).

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## **Earned income credit**

For 2009 and 2010, the earned income credit rate is increased to 45 percent for families with three or more children and is slightly increased for married couples.

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## **Child tax credit**

The refundable child tax credit is available to more families for 2009 and 2010 because the “floor” has been lowered to \$8,100.

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## **Health coverage tax credit rate increase**

For taxpayers paying their own health insurance premiums, this credit is now 80 percent of premiums for the taxpayer and qualifying family members.

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## **Computers as qualified education expenses**

Computers and computer technology (including internet access), indispensable in college today, are qualified education expenses for Section 529 plans in 2009 and 2010.

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## **Average unemployment benefits now exempt from taxation**

Under prior law, all unemployment benefits were subject to federal income tax. Average monthly unemployment benefits are \$300, and the Act exempts \$2,400 of such benefits from income tax in 2009.

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