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Dear Clients and Friends:

2009 Economic Recovery Act—Business Income Tax Provisions

The *American Recovery and Reinvestment Act of 2009* (the Recovery Act) contains a few tax provisions aimed at small businesses. They are not many in number but they are potentially powerful. Here is an overview of the key tax changes affecting businesses.

Section 179 expensing. The 2008 increase in the Section 179 expensing amount to \$250,000 and the increase in the phase-out threshold to \$800,000 are both extended by the Recovery Act for new or used fixed assets acquired through 2009.

Bonus depreciation. The Recovery Act extends the 50% first-year bonus depreciation through 2009 (through 2010 for certain transportation property and aircraft) for new fixed asset additions.

The election to accelerate AMT and general business credits that are research credits in lieu of taking the bonus depreciation is also extended to qualifying property placed in service through 2009. Special rules apply to taxpayers who had already made this election for property placed in service in 2008.

Here is an example of Section 179 expensing combined with bonus depreciation:

	Tax basis	First year depreciation
Cost of qualifying <u>new</u> property in a year	\$ 700,000	
Section 179 expense	-250,000	\$ 250,000
Subtotal	450,000	
Bonus depreciation @ 50% of the above	-225,000	225,000
Amount subject to MACRS depreciation	\$ 225,000	
First year depreciation (e.g., 7 yr MACRS rate for “half year” convention is 14.29%)		32,153
Total first year depreciation expense		\$ 507,153

Carryback of small business NOLs. Under the Recovery Act, eligible small businesses (C Corporations, Partnerships, and Sole Proprietorships with net operating losses) are allowed to carry their 2008 NOLs back to any year(s) within the five prior years instead of just two prior years. An eligible small business is one that has average gross receipts of \$15 million or less.

Small business estimated taxes. “Qualified individuals” are now allowed (for 2009 only) to make estimated tax payments that equal 1) 90% of their preceding tax year liability instead of 100% (or 110%) of their preceding tax year liability, or 2) 90% of their current tax year liability. To be a “qualified individual”, the taxpayer must have adjusted gross income (AGI) of less than \$500,000 and more than 50% of the individual’s gross income must have come from a small business (a business with an average of fewer than 500 employees in the prior year).

Work opportunity tax credit: The Recovery Act creates two new targeted groups for the work opportunity tax credit—“disconnected youth” (ages 16 through 24, not in school, not employed and not readily employable) and unemployed veterans (discharged within five years of the date of hire). Employers who hire members of these groups during 2009 or 2010 may be eligible for the credit.

Discharge of business indebtedness: If a business repurchases specific types of debt in 2009 or 2010, the Recovery Act allows certain businesses to recognize cancellation of indebtedness income over five years, instead of all in the year of the discharge, starting in 2014.

Qualified small business stock. The Recovery Act increases the exclusion of gain from the sale of qualified small business stock held for more than five years from 50% to 75%, for stock acquired after February 17, 2009 and before January 1, 2011.

S Corporation “Built in Gain” (BIG) Tax. The Recovery Act shortens the gain recognition period for assets subject to the built-in gains tax from 10 years to seven years for S Corporation tax years beginning in 2009 and 2010. In addition, no tax is imposed on the net unrecognized built-in gain of an S Corporation if the seventh year in the recognition period preceded the 2009 and 2010 tax years.

Limitations on NOL carryforwards. Under the Recovery Act, businesses that have “ownership changes” pursuant to a restructuring plan required by a Treasury loan agreement or line of credit under the bailout provisions of the Emergency Economic Stabilization Act, the IRC Section 382 limitation on loss carryforwards will not apply.

Energy credits. The Recovery Act also includes a number of energy incentives aimed at both individuals and businesses, including increases in the nonbusiness energy property credit, the residential energy efficient property credit, and the business energy tax credit.

COBRA related provisions for COBRA eligible companies and their employees. Under pre-existing law, an employee whose group health coverage had been terminated had the option of continuing the coverage for at least 18 months by paying the former employer the full amount of the premium plus a 2% administrative charge.

The Recovery Act provides that an employee who has been involuntarily terminated is required to pay only 35% of the premium to continue COBRA coverage under a group health plan of the former employer for up to nine months. The employer must pay the other 65%, but the employer will be reimbursed for that 65% payment by the government by reducing the payroll tax payments (federal withholding or FICA) that it makes to the government.

The COBRA premium assistance is not taxable income to the participant. But, there is a recapture provision for premium assistance provided to 'high-income' taxpayers. If their modified adjusted gross income (MAGI) for the tax year exceeds \$125,000 (\$250,000 in the case of a joint return), a portion or all of the premium subsidy must be paid back to the government via a recapture tax.

The provision applies to all individuals who became or who become COBRA eligible anytime from September 1, 2008 through December 31, 2009. Otherwise eligible individuals who failed to elect COBRA prior to the date of enactment of the Recovery Act will have 60 days from February 17, 2009 to do so.

We hope this information is helpful. If you would like more details about this or any other aspect of the new law, please do not hesitate to contact us.

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