American Recovery and Reinvestment Act of 2009

Acting quickly to jump start the economy, Congress has passed a massive economic stimulus package: the American Recovery and Reinvestment Act of 2009 (2009 Recovery Act). As you probably have heard, the new law weighs in at nearly $800 billion. Roughly one-third is comprised of tax incentives for individuals and businesses. Congress made many of the tax incentives retroactive to January 1, 2009.

The tax incentives in the stimulus package can be broken down into two broad categories: individuals and business. Let's take a look at these incentives.

Individual Incentives

Making Work Pay credit. The 2009 Recovery Act provides a credit against income tax in an amount equal to the lesser of 6.2 percent of the individual's earned income or $400 ($800 for married couples filing jointly). However, income limitations apply.

Seniors and others. Individuals receiving Social Security benefits, disabled veterans and others on fixed incomes will receive one-time payments of $250. If the individual also qualifies for the Making Work pay credit, his or her credit will be reduced by the $250 payment.

First-time homebuyer tax credit. The 2009 Recovery Act removes the repayment requirement for homes purchased by first-time buyers between January 1, 2009 and December 1, 2009. The enhanced credit equals 10 percent of the purchase price of a home up to $8,000 ($4,000 for married individuals filing separately). There are income limitations, which preclude higher-income individuals and couples from taking advantage of the credit.

New car deduction. Automobile sales, like new home sales, have plummeted in recent months. In response, Congress has created a non-itemized deduction for state and local sales taxes or excise taxes paid on qualified purchases of new motor vehicles. The vehicle must be purchased after February 16, 2009, and before January 1, 2010, to qualify for the deduction. Income thresholds and other limitations apply.

AMT patch. Every year, bills are introduced in Congress to abolish the alternative minimum tax (AMT) and most fail. The 2009 Recovery Act increases the AMT exemption amounts and allows taxpayers to take most personal credits to reduce AMT liability for 2009.

Child tax credit. The current $1,000 child tax credit is one of the most popular incentives in the Tax Code. The 2009 Recovery Act increases the refundable portion of the child tax credit for 2009 and 2010. Taxpayers are eligible for a refundable credit equal to 15 percent of their earned income in excess of $3,000 subject to certain restrictions and phase-outs.

Unemployment compensation. Many individuals are surprised to learn that unemployment benefits are taxable. The 2009 Recovery Act excludes up to $2,400 in unemployment compensation from a recipient's gross income in 2009.

Education. The Tax Code includes a number of incentives to help bring down the cost of education. The 2009 Recovery Act expands the current Hope education credit (and renames it the American Opportunity Tax Credit). More individuals will be able to take advantage of this credit because of expanded income phase-outs. The 2009 Recovery Act also raises the maximum credit, extends it over four years of post-secondary school education, and makes 40 percent of the credit refundable. In a related development, the 2009 Recovery Act also permits beneficiaries of qualified tuition plans (known as "529" plan) to use tax-free distributions to pay for computers and computer technology.

EITC. The earned income tax credit (EITC) is a refundable tax credit targeted to lower and middle income wage earners and families. When the EITC exceeds the amount of taxes owed, it generates a refund. The 2009 Recovery Act enhances the EITC for taxpayers with three or more qualifying children and helps eliminate an existing "marriage penalty" across the board.

Energy Incentives. The 2009 Recovery Act enhances several energy tax incentives that reward taxpayers for installing energy-efficient property and alternative sources of energy in their homes. Among the types of energy-efficient property that may qualify for a tax break are certain heat pumps, furnaces, windows and doors. There's also a tax break for purchasers of plug-in electric vehicles.

Business Incentives

Bonus depreciation. Bonus depreciation is one of Congress' favorite mechanisms (along with Code Sec. 179 expensing) to encourage business spending. The 2009 Recovery Act extends 50 percent bonus depreciation that expired at the end of 2008. Businesses can take advantage of bonus depreciation throughout 2009 (and longer for certain types of property). Bonus depreciation is taken on top of regular depreciation. Also good news in applying bonus depreciation to vehicles, the 2009 Recovery Act raises the first-year depreciation cap limits by $8,000.

Code Sec. 179 expensing. Like bonus depreciation, increased Code Sec. 179 expensing expired at the end of 2008. The 2009 Recovery Act revives it for 2009. Under the new law, Code Sec. 179 expensing for 2009 is $250,000 and the threshold for reducing the deduction is $800,000.

Net operating losses. Because of the economic downturn, many businesses are in a loss position. The Tax Code generally allows eligible taxpayers to carry back net operating losses (NOLs) two years with some exceptions. The 2009 Recovery Act increases the carryback period to five years for small businesses (which the new law defines as businesses with average gross receipts of $15 million or less). The treatment is also temporary, applying only to 2008 NOLs.

S Corp Built-in Gain Period Changes

The new law shortens the holding period for S Corp built-in gains to seven years for assets disposed of in 2009 and 2010.

Work Opportunity Tax Credit. The Work Opportunity Tax Credit rewards employers that hire individuals from targeted groups, such as veterans and young people. The 2009 Recovery Act modifies the definitions of eligible veterans and disconnected youth for purposes of the credit.

COBRA coverage. Individuals who are involuntarily separated from employment between September 1, 2008 and December 31, 2009 can elect to pay 35 percent of their premiums for COBRA coverage and will be treated under the 2009 Recovery Act as paying the full amount. The former employer will pay the remaining 65 percent of the premium. In return, the employer will be able to credit its share of this temporary COBRA subsidy against wage withholdings and payroll taxes. The COBRA subsidy is generally only available for nine months. The Department of Labor has issued model notices that employers can send to former employees who are eligible for the COBRA subsidy. The IRS has also issued guidance on what qualifies as involuntary termination for purposes of the COBRA subsidy.

More business incentives. The 2009 Recovery Act also allows qualified individuals to exclude 75 percent of the gain from the sale of certain small business stock. Additionally, Congress shortened the holding period for the S Corp built-in gain period, prospectively revoked a controversial IRS notice affecting NOL limitations on banks, and enhanced the health coverage tax credit. The 2009 Recovery Act also increases the New Markets Tax Credit program, decreases estimated tax payments for certain individuals whose incomes come from small businesses, and delays withholding on government contractors. Congress also enhanced many tax-exempt and tax-credit bond rules to help states and local governments generate revenue.

The scope of the American Recovery and Reinvestment Act is broad. Please contact our office to discuss how the tax incentives in the new law may benefit you.

Please visit our website at www.bayliscpas.com

53 Lake Morton Drive · Lakeland Florida 33801 · 863·688·8841

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