

# ALERT

## Stimulus act provides businesses tax-saving opportunities and other benefits

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 ("the Act"). Although there was much debate in Congress over this stimulus legislation, there's no doubt that the nearly \$800 billion act's government spending initiatives and tax incentives for private spending will benefit many companies. Additionally, the Act provides businesses a multitude of tax-saving opportunities.

### **Spending initiatives will create business opportunities**

Spending initiatives make up approximately two-thirds of the Act's cost. A portion of those dollars will be used to fund education and health care and to provide relief to workers hurt by the recession. But a substantial amount will fund projects that will create significant opportunities for businesses in several sectors. For example, the House appropriations committee reports that the act provides appropriations for investments of:

- \$120 billion in infrastructure and science, such as broadband expansion, highway and transportation improvements, and environmental cleanup
- \$37.5 billion in energy, such as smart power grid development, advanced battery technology, and energy efficiency measures
- \$19 billion in health information technology

Businesses in the construction, energy, science and technology, and transportation sectors will want to start taking steps immediately to prepare for pursuing these projects, because the government wants to get them going quickly.

### **New and expanded bonds also will benefit businesses**

To pursue a variety of goals, ranging from helping struggling state and local governments to encouraging green energy initiatives, the Act creates new categories of bonds and expands and extends existing bonds, including:



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- Recovery zone
- Industrial development
- Build America
- Qualified school construction
- Qualified zone academy
- Tribal development
- High-speed rail
- Clean renewable energy
- Qualified energy conservation bonds

The spending these bonds finance also will provide opportunities for businesses and thus create private-sector jobs as well. Again, businesses will want to start taking steps immediately to prepare for pursuing these projects.

### **New tax breaks for many**

The Act provides some new breaks that will benefit many businesses:

**Reduced estimated tax payment requirements.** For 2009, the Act reduces the estimated tax payment requirements for many small business owners. To avoid penalties, taxpayers generally need to make sure their estimated payments or withholding equals at least 90% of their tax liability for the current year or 110% of the prior year's tax — 100% if their adjusted gross income (AGI) for the prior year was \$150,000 or less. Under the Act, the 110% — or 100% — becomes 90% for qualifying business owners.

Owners generally will qualify for the reduced estimated tax payments if their AGI for 2008 was less than \$500,000 and if more than 50% of their 2009 gross income is generated from a "small business," which is defined as a business that, on average, had fewer than 500 employees during 2008.

Here's how you can benefit: Assume you qualify for the break and your 2008 tax was \$140,000. Before the Act, your 2009 estimated tax would have been 110% of this amount, or \$154,000. It can now be 90% of the amount, or \$126,000, which means a tax deferral of \$28,000. You may end up owing more on April 15, 2010, because you won't have prepaid as much tax. But until then, you'll have the \$28,000 in your pocket to use as you need to keep your business running.

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**Deferral of income from cancellation of debt.** Taxpayers generally must recognize cancellation-of-debt income (CODI) when they cancel — or repurchase — debt for an amount less than its adjusted issue price. In certain situations, the Act allows businesses to defer CODI generated from repurchasing business debt after Dec. 31, 2008, and before Jan. 1, 2011, until calendar year 2014 (five-year deferral for 2009 CODI and four-year deferral for 2010 CODI) and then report the income ratably over the 2014 through 2018 tax years. CODI is the excess of the old debt's adjusted issue price over the repurchase price.

Here's an example of how the deferral works. Let's say that on Jan. 1, 2009, your business recognized \$100,000 of CODI. If you qualified for deferral, you could defer reporting the income until your 2014 tax return. If you were in the 35% tax bracket, this would provide you with \$35,000 in tax savings for 2009. You would then report \$20,000 of income per year for 2014 through 2018. Assuming you remain in the 35% tax bracket, your total tax liability would remain the same, but in essence you'd be getting an interest-free loan on the tax liability.

**S corporation built-in gains tax relief.** Although a C corporation conversion to an S corporation isn't a taxable event, the S corporation normally must hold on to its assets for 10 years to avoid tax on any built-in gains that existed at the time of the conversion. Under the Act, for tax years beginning in 2009 and 2010, there generally will be no tax on an S corporation's net unrecognized built-in gain if the seventh tax year in the recognition period occurred before the 2009 and 2010 tax years.

### **Other breaks expanded**

The act expands some important tax breaks for businesses:

**Net operating loss carryback.** Generally, a net operating loss (NOL) may be carried back two years to generate a current tax refund, providing a cash infusion in times of loss. For 2008 (not 2009), the Act extends the maximum NOL carryback to five years for qualified small businesses with gross receipts of \$15 million or less, making the potential cash infusion even more powerful.

Any loss not absorbed in the carryback period can be carried forward up to 20 years. Businesses also have the option to waive the carryback period and carry the entire loss forward. This may be beneficial if your marginal tax rate in the carryback years is unusually low or if the alternative minimum tax (AMT) in prior years makes the carryback less beneficial.

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**Work Opportunity credit.** Employers can claim a credit equal to 40% of the first \$6,000 of wages paid to employees in certain target groups, such as ex-felons, food stamp recipients and disabled veterans. The Act expands the eligible target groups to include unemployed veterans and disconnected youth.

An unemployed veteran is an individual who was discharged or released from active duty in the Armed Forces during the five-year period before hiring and received unemployment compensation for more than four weeks during the year before hiring. A disconnected youth is an individual between the ages of 16 and 25 who hasn't been regularly employed or attended school in the past six months.

This expanded benefit applies to such workers hired in 2009 and 2010. It is also important to note that the Work Opportunity credit is set to expire after Aug. 31, 2011. Contact your state unemployment office for more information and certification details.

### **Depreciation breaks extended**

To spur additional investment, the Act extends the increase in the Section 179 limit for initial year expensing to \$250,000 (from \$125,000 indexed for inflation). The Sec. 179 expensing election allows a current deduction for newly acquired assets that otherwise would have to be depreciated over a number of years. A business can claim the expensing election only to offset its net income, not to reduce net income below zero.

Because this tax break is designed to benefit primarily smaller businesses, the expensing election begins to phase out dollar for dollar when total asset acquisitions for the tax year exceed \$800,000 (up from \$500,000 indexed for inflation). The new higher limit applies for calendar year 2009 or a business's fiscal year that begins in 2009.

Another depreciation-related provision extends the special allowance for certain property, generally if acquired in 2009. This is in addition to any such property that qualifies for Sec. 179 expensing. For eligible property, the special depreciation amount is equal to 50% of its adjusted basis. The following types of property are qualified for this special depreciation:

- Tangible property with a recovery period of 20 years or less
- Computer software purchased by the business
- Water utility property
- Qualified leasehold improvement property

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For passenger automobiles that are eligible property under the 50% bonus depreciation rules, the \$8,000 increase for the first-year limit on depreciation also is extended to new vehicles placed in service in 2009.

Because both the Sec. 179 limit increases and the 50% depreciation allowance can provide large 2009 deductions, you may want to consider making major asset purchases this year if your business would qualify for these breaks.

Last year, corporate taxpayers were also allowed to accelerate their AMT and research and development (R&D) credits in lieu of taking the 50% bonus depreciation. That break has now been extended through 2009.

Corporations that elect to accelerate AMT or R&D credits in lieu of bonus depreciation will be able to increase the limit (subject to the cap discussed below) on the credits they can claim by an amount equal to 20% of the bonus depreciation they forgo. (Credits can be more valuable than depreciation deductions because they reduce your tax bill dollar for dollar, rather than just reducing the amount of income that is taxed.)

The allowable credit is capped at the lesser of \$30 million or 6% of an amount that's determined using a complex formula based on certain prior R&D credit carryforward amounts and certain minimum tax credits.

### **Energy-related breaks expanded**

The Act creates or expands several energy-related breaks for businesses, such as the:

- Advanced energy investment credit
- Renewable electricity production credit
- Alternative fuel pump tax credit

### **Many more ways to benefit**

We hope we've provided a helpful overview of the Act's key provisions that may affect your business. But the Act is hundreds of pages long and includes many more spending and tax-saving provisions than we could discuss here. So we encourage you to consult with us to learn how to fully take advantage of all the opportunities it may offer your business.