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Top 10 Tax Provisions in the Stimulus Bill that Every Business Should Know

The American Recovery and Reinvestment Act of 2009, more commonly referred to as the Stimulus Bill, was signed into law on February 17, 2009. The Bill was passed with the intention of providing a stimulus to the economy to counteract the economic downturn. The following are ten (10) tax changes included in the Stimulus Bill that we believe every business should know:

1. Extension of Section 179 Limit Increase.

Generally, Internal Revenue Code Section 179 allows businesses to expense up to $125,000 (indexed for inflation) worth of capital expenditures made in a tax year. Previously, the Section 179 expensing provisions had been temporarily increased to allow businesses to expense up to $250,000 worth of capital expenditures made in the 2008 tax year.

However, the Section 179 expense allowed in a year is limited. For example, in 2008, the $250,000 expense amount is reduced dollar for dollar (but not below zero) by the amount by which the cost of qualifying property placed in service in the taxable year exceeds $800,000. As a result, if a business bought assets of more than $1,050,000 in the 2008 taxable year, the business was unable to use the Section 179 expensing provisions.

Under the Stimulus Bill, the temporary increase of the Section 179 expense amount (to $250,000) has been extended through 2009. However, in 2010 the limitation goes back down to $125,000 and the cap drops to $500,000, both indexed for inflation. In

2011 and thereafter, the limitation is $25,000 and the cap is $200,000, neither indexed for inflation.

2. Extension of Bonus Depreciation Allowance.

Previously, a temporary first-year "bonus" depreciation deduction was created that allowed a deduction equal to 50% of the adjusted basis of qualified property placed in service during 2008. This deduction was applicable after any applicable §179 deductions.

The Stimulus Bill extended the temporary bonus depreciation deduction through 2009, so that is applied to property purchased and placed in service before January 1, 2010.

3. COBRA Subsidy Affects Payment of Payroll Taxes.

The Consolidated Omnibus Budget Reconciliation Act ("COBRA") provides certain individuals the right to temporary continuation of health coverage at group rates by paying their employer the premium plus some administrative costs.

The Stimulus Bill has made a temporary 65% subsidy available for 9 months to those making COBRA premium payments. If the subsidy is to be used, the employee will pay the employer the lowered 35% of the premium (the unsubsidized portion), and the employer will take a credit against its payroll taxes for the amount of the subsidy. Assuming the total subsidies do not exceed the employer's payroll taxes, no actual funds will be exchanged between the employee or the employer and the government.

This subsidy is only available to individuals who qualify for COBRA coverage between September 1, 2008, and December 31, 2009. The subsidy phases out for individuals with modified adjusted gross income between $125,000 and $145,000 ($250,000 and $290,000 for joint filers).

Employers claiming the subsidy amount as a credit against their employment taxes due must maintain supporting documentation for the credit claimed. This includes:

- Documentation of receipt of the employee's 35% share of the premium.
- In the case of insured plans: A copy of an invoice or other supporting statement from the insurance carrier and proof of timely payment of the full premium to the insurance carrier.
- Declaration of the former employee's involuntary termination.

4. **<u>Making Work Pay Credit</u>.**

The Stimulus has created a refundable income tax credit which is available in both 2009 and 2010 to eligible individuals. The credit will be received by taxpayers in increments throughout the year through the adjustment of the withholding tables.

Employers should be aware that the new withholdings tables, adjusted for the Making Work Pay Credit, were effective as of April 1, 2009 and use of the revised tables was mandatory as of that date.

5. **<u>Increased Net Operating Loss Carry-back Period for Eligible Small Businesses</u>.**

Generally, a net operating loss, the amount by which a taxpayer's business deductions exceed its gross income, may be carried back two years and carried forward 20 years to offset the taxable income generated in such years.

The Stimulus Bill temporarily changes the law regarding net operating losses to permit eligible small businesses to elect to increase the carry-back period for an "applicable 2008 net operating loss" from two years to any whole number of years chosen by the taxpayer; provided that the number of years chosen must exceed two, but may not exceed six.

For purposes of this provision, a business is an "eligible small business" for a prior taxable year if the annual gross receipts of such entity for the 3-taxable-year period ending with such prior taxable year do not exceed $15,000,000. Further, an "applicable 2008 net operating loss" is the taxpayer's net operating loss for any taxable year ending in 2008.

6. **<u>Reduction in Required Estimated Tax Payments for Small Businesses Owners</u>.**

Estimated taxes must be paid on income that is not subject to withholding, such as self-employment income. Generally, an individual's annual estimated tax payments are required to equal at least the lesser of 90% of the tax shown on the return or 100% of the tax shown on the return for the prior taxable year (110% if the adjusted gross income for the prior year exceeded $150,000).

Under the Stimulus Bill, for taxable years beginning in 2009, the estimated tax a qualified individual must pay is reduced to 90% of the tax liability shown on the previous year's tax return. For this purpose, a "qualified individual" is any individual whose previous year tax return shows adjusted gross income less than $500,000 ($250,000 if married filing separately) and who can certify that at least 50% of the gross income on the previous year's return was income from a small trade or business. For purposes of determining a "qualifying individual" a "small trade or business" is any trade or business that employed no more than 500 persons, on average, during the calendar year ending in or with the previous taxable year.

7. Temporary Reduction in Recognition Period for Built-in Gains Tax

When a C-Corporation converts to an S-Corporation, any gains of the S-Corporation that arose prior to the conversion, but that are recognized within the "recognition period" after the conversion, are subject to tax at the highest corporate rate. This tax is referred to as a built-in gains tax. Currently, the recognition period extends for 10 years from the date of the conversion.

The Stimulus Bill has temporarily, for tax years 2009 and 2010, effectively shortened the recognition period to 7 years. Now, as long an S-Corporation has completed at least 7 taxable years since its conversion from a C-Corporation, the S-Corporation may, during 2009 and 2010, recognize the built-in gains without being subject to the built-in gains tax.

8. Deferral of Income Recognition on Reacquisition of Debt.

Generally, upon reacquiring a debt instrument, businesses must report debt forgiveness income related to the reacquisition.

However, the Stimulus Bill provides businesses the ability to elect to defer reporting such debt forgiveness income. The provision specifies that, for debt reacquisitions occurring in 2009 or 2010, any resulting debt forgiveness income can be reported ratable over a 5 year period beginning in 2014. In practice, this allows businesses to defer recognition of this income for up to 10 years.

This provision is available to C-Corporations and individuals, but if the taxpayer elects to apply the deferral provision, the taxpayer may not apply any of the major exceptions to debt discharge income contained in the Code (such as for insolvency, bankruptcy, qualified farm indebtedness or qualified real property business debt) with respect to the amount discharged for the tax year of the election or any subsequent year. Additionally, death, liquidation or sale of substantially all the taxpayer's assets, cessation of the taxpayer's business or liquidation in bankruptcy will result in acceleration of the deferred income.

Finally, if the debt forgiveness creates an original issue discount (OID) obligation, the OID deduction is also deferred.

9. Expansion of Work Opportunity Tax Credit.

The Work Opportunity Tax Credit ("WOTC") provides businesses up to a $2,400 credit to hire employees from particular (generally disadvantaged) groups. The Stimulus expands the scope of the WOTC by adding unemployed veterans discharged in 2008, 2009 or 2010 and "disconnected youth," ages 16 to 25, who lack basic skills and have not been regularly employed or in school for the last six months, to the group of employees whose employment qualifies for the WOTC.

10. Delay in Implementation of Government Contractor Withholding.

Under previous legislation, certain payments by government entities to persons providing property or services to such government entities was to begin being subject to a 3% withholding tax. This provision was scheduled to go into effect for all payments made after December 31, 2010.

The Stimulus Bill has delayed the implementation of this provision so that the withholding tax will now be applicable on payments made after December 31, 2011.