2009

American Recovery and Reinvestment Tax Act
(LONG VERSION)

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INTRODUCTION

On February 17, 2009, President Obama signed the **American Recovery and Reinvestment Tax Act of 2009** (the "American Recovery Tax Act") providing approximately $275 billion of temporary tax breaks and incentives impacting virtually every individual and business taxpayer. Also, late in 2008, Congress passed a law that temporarily waives required minimum distributions from employer retirement plans and IRAs. This letter summarizes selected provisions of the American Recovery Tax Act and the 2009 suspension of the required minimum distributions.

Temporary *Individual* Tax Breaks include: an increased refundable first-time home buyer's credit of up to $8,000, estimated tax payment relief for certain individuals owning small businesses, a deduction for sales tax on the purchase of qualifying vehicles, an increased and partially refundable tuition tax credit (up to $2,500), a refundable income tax credit to offset payroll taxes of low and middle income individuals, a significant expansion of various credits for energy-efficient home improvements, and alternative minimum tax (AMT) relief.

Temporary *Business* Tax Breaks include: a longer carry back period for 2008 Net Operating Losses, an extension of the higher $250,000 section 179 deduction, an extension of the 50% bonus depreciation, an expanded work opportunity tax credit for hiring certain disadvantaged employees, and a reduction in an S corporation's built-in gains tax exposure from 10 years to 7 years.

Since much of this tax relief expires either in 2009 or 2010, **you will need to act timely to obtain maximum benefits from the legislation.**

As you read the following highlights, please keep in mind that many of these tax breaks require quick action. Consequently, pay careful attention to the **effective date** and **sunset date** (if applicable) of each new provision, which we **highlight prominently** in each segment.

> **Planning Alert!** We highlight only *selected* provisions of this new tax legislation. If you have heard or read about any provision not discussed in this letter, feel free to call our office. We will help you determine how the provision impacts you or your business. This letter also contains planning ideas. However, you cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend you call our firm before implementing any tax planning technique discussed in this letter, or if you need more information.

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NEW TAX BREAKS AVAILABLE TO INDIVIDUAL TAXPAYERS–*SELECTED PROVISIONS*

Home Buyer's Credit Expanded And Enhanced. For 2008, first-time home buyers who satisfied certain income thresholds were eligible for a refundable credit of up to $7,500 for purchases of a principal residence after April 8, 2008 and before 2009. However, this credit had to be paid back to the government in equal installments over 15 years, or earlier if the house was sold or if the purchaser failed to use the home as a principal residence.

Caution! These rules (including the 15-year payback requirement) still apply to qualifying home purchases **after April 8, 2008 and before 2009.** However, for **qualifying home purchases after 2008 and before December 1, 2009**, the *new law* expands and enhances the credit by: **1)** increasing the maximum credit from $7,500 to $8,000 (not to exceed 10% of the home's purchase price), **2)** eliminating the 15-year payback requirement, **3)** requiring recapture of the credit upon the sale of the residence or failure to use the residence as a principal residence *only* where the sale or change of use occurs within 36 months of the date of purchase, **4)** extending the deadline for qualifying purchases from **June 30, 2009** to **November 30, 2009**, and **5)** extending the credit for qualifying homes bought with proceeds from a tax-exempt mortgage revenue bond.

Tax Tip. The credit offsets both alternative minimum tax (AMT) and regular tax liabilities, and any excess credit is refunded.

- **Who Qualifies For The New Credit?** If your purchase (i.e., title closing) occurred **after April 8, 2008 and before 2009**, the *2008 rules apply* (i.e., 15-year payback requirement, cap of $7,500). If your purchase occurs **after 2008 and no later than November 30, 2009**, the new *2009 rules apply* (i.e., no payback rule if you satisfy the 36-month rule, and cap of $8,000).

  Tax Tip. If you constructed your qualifying home, your *purchase date* is the date you move in, even though the construction began earlier.

- **How Do The Credit Limits Apply?** Under the *2009 Rules*, the amount of the credit is the lesser of: **1)** $8,000 ($4,000 if you are married filing separately), or **2)** 10% of the home's purchase price. The credit is phased out as your adjusted gross income (AGI) increases from $75,000 to $95,000 if you are single, or from $150,000 to $170,000 if you are married filing jointly.

  Tax Tip. Since the credit is refundable, you will actually get a refund to the extent the credit exceeds your tax liability.

- **Who Is A Qualified First-Time Home Buyer?** You are a "first-time home buyer" if neither you nor your spouse has owned an interest in a principal residence in the U.S. during the 36-month period ending on the date of the purchase of the current residence.

  Tax Tip. Even if you or your spouse previously owned a home, you can still qualify for the credit, if that ownership ended at least three years before the purchase of the current residence.

  Planning Alert! You generally will **not qualify** for the credit if: **1)** you purchase your home from a related party (e.g., certain family members), or **2)** the home is not located in the U.S.

  Tax Tip. Your *principal residence* could include a condominium, houseboat, or mobile home.

- **How Do The New 2009 Recapture Rules Work?** If you purchased a home subject to the *2008 Rules* **(i.e., from April 9, 2008 through December 31, 2008),** you generally must pay back the credit over 15 years. Under the *2009 Rules* (i.e., purchases **from January 1, 2009 through November 30, 2009)**, there is no recapture of the credit *unless within 36 months of the purchase* **1)** you sell the house, or **2)** you (and, if married, your spouse) cease using the house as your principal residence.

  Tax Tip. Even if the home is sold within 36 months of the date of purchase, the credit is only recaptured to the extent of the gain on the sale (after reducing the basis of the residence by any credit allowed). For example, let's assume that you purchased a home for $150,000 in 2009 which qualified you for the $8,000 credit. Even if you sold the home within 36 months, you would recapture the $8,000 credit **only to the extent** you sold the home for more than $142,000 ($150,000 minus $8,000). Also, the homeowner's death will not trigger any recapture. Furthermore, transfers as part of a divorce do not trigger the recapture, however, the spouse who gets the residence will be responsible for the recapture tax on the house.

- **How Are Unmarried Co-Owners Treated?** Two or more unmarried individuals may purchase a residence and qualify for the credit. However, the total amount of the credit allowed to the individuals in the aggregate may not exceed the overall caps (i.e., $7,500 for 2008, $8,000 for 2009). In addition, the IRS says the co-owners may allocate the credit between themselves in any reasonable manner.

  Planning Alert! The IRS warns that no portion of the credit may be allocated to a co-owner who would not otherwise qualify.

  Tax Tip. If one unmarried co-owner qualifies for the credit, but the other does not (e.g., due to AGI limits or previous ownership within 3 years), the IRS says that you can allocate the *entire* credit to the co-owner who qualifies. Also, if you purchase a qualifying home while you are single, you presumably will still qualify even if you later marry a non-qualifying person in the same tax year (assuming that you still satisfy the income phase-out thresholds).

- **If I Buy My First Home In 2009, May I Take The Credit On My 2008 Return?** If you purchase your qualifying residence **after 2008**, and **before December 1, 2009**, you may elect to treat the purchase as made on December 31, 2008. This election allows you to accelerate the tax benefit of your 2009 purchase by one year. You may even make this election on an amended 2008 income tax return. Presumably, if you make this election, any income phase-out will be based on your 2008 income, even though you purchased the home in 2009. Also, if you make this election to take the credit on your 2008 return for a 2009 purchase, you should be exempt from the 2008 15-year recapture provisions and will, instead, be subject to the *2009* 36-month recapture rule.

  Tax Tip. Not only will this election enable qualifying individuals to receive the credit a year early, the election may also provide a larger credit if their AGI is greater in 2009 than for 2008. For example, if an individual graduated from college in 2008, had income below the phase-out threshold for 2008, purchased his or her qualifying home in 2009, and has

2009 income resulting in a phase out of all or some of the credit, electing to take the credit on the 2008 return may result in an increased credit.

- **What If I Purchase My Qualifying Home In The District Of Columbia?** If you purchase a qualifying home **in 2008** that also qualifies for the special *D.C. home buyer's credit*, you do not qualify for the 2008 $7,500 first-time home buyer's credit. Instead, you are allowed only the D.C. home buyer's credit. On the other hand, if you purchase a qualifying residence in 2009, take the credit on your 2009 return, and your qualifying residence purchase would otherwise qualify for the D.C. home buyer's credit, you may only take the $8,000 first-time home buyer's credit. You do not qualify for the D.C. home buyer's credit.

2009 Estimated Tax Relief For Certain Individuals Owning Small Businesses. Generally, if your **2008 AGI** was $150,000 or less, one way you can avoid 2009 underestimated tax penalties is to make your timely 2009 estimated tax payments based on 100% of your 2008 tax liability. If your **2008 AGI** was over $150,000, you can avoid penalties by basing your 2009 estimated tax payments on 110% of your 2008 tax liability. Under the American Recovery Tax Act, if you meet certain conditions, you can avoid 2009 underestimated tax penalties by basing your 2009 estimated tax payments on 90% (rather than 100% or 110%) of your 2008 tax liability. To qualify: **1)** you must have had adjusted gross income below $500,000 ($250,000 if married and filing separate returns) **for 2008**, and **2)** you *must certify* that more than 50% of the gross income on your 2008 return came from a "qualifying small business." For this purpose, a "qualifying small business" is generally defined as a business that employed on average less than 500 employees during calendar-year 2008. When we prepare your 2008 return, we will help you decide if you qualify for this provision for your 2009 estimated tax payments.

Individuals May Deduct Sales Or Excise Taxes Paid On Qualified Vehicle Purchases. For purchases **from February 17, 2009 through December 31, 2009**, you may claim a deduction for sales or excise taxes you pay on the purchase of a "qualified motor vehicle." If you itemize deductions, you may deduct the qualified sales or excise taxes as "taxes." If you do not itemize deductions, you may deduct the qualified sales or excise taxes as an additional standard deduction. A ***qualified motor vehicle*** is a *new* passenger automobile with a gross vehicle weight (GVW) of 8,500 lbs or less, a new motorcycle with a GVW of 8,500 lbs or less, or a motor home. This additional deduction for sales or excise taxes is limited to the sales tax on the first $49,500 of the vehicle's purchase price, and phases out ratably as your modified adjusted gross income (MAGI) increases from **$250,000 to $260,000** on a joint return (**$125,000 to $135,000** on a single return). **For example,** assume that in 2009 you are single with MAGI under $125,000, you purchase a new sedan for $60,000, and you also pay a 5% sales tax of $3,000. For 2009, you should be allowed either an *itemized deduction* or an *additional standard deduction* of $2,475 ($49,500 x 5%).

Tax Tip. Last year's legislation also provides non-itemizers (regardless of income) with an *additional* standard deduction for **2008 and 2009 only** for state and local property taxes (capped at $1,000 on a joint return, $500 if filing single). Also, although the temporary *property tax additional standard deduction* is not available in calculating your alternative minimum tax (AMT), the *new car sales tax additional standard deduction (or itemized deduction)* is deductible for AMT purposes.

Planning Alert! If you itemize deductions, you are allowed to deduct sales or excise taxes paid on qualified vehicle purchases *in addition to* your state and local income taxes. However, if you *elect* to deduct all of your sales taxes (including the qualified motor vehicle tax) in lieu of state and local income taxes, this new provision will not provide an additional deduction.

Expanded And Enhanced HOPE Tuition Tax Credit. For 2008, individuals were allowed a HOPE tuition tax credit (HOPE Credit) for qualifying tuition costs generally for the first two years of college (e.g., freshman and sophomore years). For example, in 2008 you were entitled to a HOPE credit of up to $1,800 per student for qualified tuition and fees paid for yourself, your spouse, or a dependent. However, this credit phased out as your modified adjusted gross income increased from **$96,000 to $116,000** on a joint return (**$48,000 to $58,000** on a single return).The new law changes the name of the HOPE credit to the ***"American Opportunity Tax Credit***," and **for 2009 and 2010** makes five significant changes to the credit: **1) Amount of Credit** – the maximum credit is increased from $1,800 to $2,500 (100% of the 1st $2,000 of qualifying education expenses plus 25% of the next $2,000 of qualifying expenses); **2) Number of Years Credit Allowed** – the number of years that you may qualify for the HOPE credit is increased from *two* years to *four* years; **3) AGI Phase-Out Limits** – the credit is phased out as modified adjusted gross income increases from $160,000 to $180,000 for those filing joint returns ($80,000 to $90,000 for single filers); **4) Partially Refundable** – 40% of the credit is refundable unless the student is subject to the so-called *kiddie tax rules* (i.e., all students under age 18 and most full-time students under age 24); and **5) Qualifying Education Expenses** – course materials are added to the expenses qualifying for the credit (therefore, for 2009 and 2010, expenses qualifying for the credit include tuition, fees, and *required course materials)*.

> **Tax Tips.** If you do not qualify for the *American Opportunity Tax Credit* (formerly the HOPE credit), you may still qualify for the *Lifetime Learning Credit* which has not been changed. The Lifetime Learning Credit is equal to 20% of the first $10,000 (i.e., capped at $2,000) of qualified higher education tuition and fees. Unlike the American Opportunity Tax Credit, the Lifetime Learning Credit is for an unlimited number of years and can be used for graduate or professional degrees. **Caution!** The Lifetime Learning Credit **limitation of $2,000 is per tax return, not per student,** and the income phase-out levels have not been changed by the new law (for 2009, the Lifetime Learning Credit phases out ratably as your modified adjusted gross income increases from **$100,000 to $120,000** on a joint return, **$50,000 to $60,000** on a single return). If your income is too high to qualify for either the American Opportunity Credit or the Lifetime Learning Credit, the IRS says the student (e.g., your child) may claim the credits on his or her return, provided you do not claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent).

> **Caution!** Be sure to check with your health insurance carrier before foregoing the dependency exemption for your child to ensure that failing to claim the exemption will not impair your child's health insurance coverage under your health plan. We will gladly help you decide if your family would derive sufficient tax benefits by allowing your child to claim the education credits.

"Making Work Pay" Tax Credit. For **2009 and 2010**, qualifying individuals are allowed a new refundable *Making Work Pay* tax credit equal to 6.2% of *earned income* (including tax-exempt combat pay received by military personnel) up to $12,903 on a joint return (up to $6,452 if filing single). This translates into a maximum credit of $800 for joint filers and $400 for single filers. However, the credit is phased out as your modified adjusted gross income (MAGI) increases from $150,000 to $190,000 ($75,000 to $95,000 on a single return). Also, the credit is not available if you qualify as someone's dependent, or if you are a nonresident alien. You will not get a rebate check as you did with last year's economic stimulus payment. Instead, Congress has instructed the IRS to revise the official withholding tables so that the credit will reduce your payroll tax withholdings and increase your take home pay.

> **Planning Alert!** If you qualify for this credit for 2009 but you do not have sufficient withholding to utilize all of the credit, you will be entitled to any unpaid portion as a refundable credit when you file your 2009 tax return.

One-Time "Economic Recovery Payment" To Certain Veterans, Social Security Recipients, Etc. If you are currently receiving social security retirement or social security disability benefits; veteran's compensation or veteran's pension benefits; Railroad Retirement benefits; or Supplemental Security Income (SSI) benefits (excluding individuals who receive SSI while in a Medicaid institution); you may qualify for a **one-time payment** of $250. **To receive the payment, you must have been eligible for one of the above four benefit programs for any of the three months immediately preceding February, 2009.** The IRS is to begin making these payments **no later than June 17, 2009. If you are also eligible for the "Making Work Pay" credit, discussed above, that credit is reduced by any "economic recovery payment."**

Tax Tip. These payments are not taxable income.

2009 Refundable Credit For Government Retirees. If **during 2009** you receive a pension or annuity for service performed in the employ of the U.S. or any state, or any instrumentality thereof, and you do not receive an "economic recovery payment" (discussed above) you may be entitled to a refundable credit on your 2009 return. The credit is $250 ($500 if you file a joint return and both you and your spouse are eligible individuals). If you are also eligible for the "making work pay credit," the amount of that credit is reduced by this credit for government retirees.

Expanded Tax Credits For Residential Energy-Efficient Expenditures. There are several nonrefundable credits available for *qualified energy-efficient* improvements to our homes, including: **1)** a lifetime credit up to $500 for various qualified *energy-efficient home improvements*; **2)** an annual 30% credit up to $2,000 for qualified solar water heaters and geothermal heat pumps, **3)** an annual credit of $500 for each 0.5 kilowatt of capacity up to $4,000 for small wind energy property; and **4)** a 30% credit for qualified residential solar electric generating property (e.g. solar PV panels). The American Recovery Tax Act expands and enhances these credits as described below:

- **Up To $1,500 Credit For Qualified Energy-Efficient Home Improvements**. For improvements to your *principal residence located in the U.S.* **placed in service in 2009 and 2010**, the American Recovery Tax Act provides a 30% credit for qualified expenditures with a $1,500 maximum total cumulative credit for the 2009 and 2010 tax years (previously, there was a lifetime credit limit of $500). Also, the credit is allowed even if the improvements are purchased with government subsidized energy financing, and may offset the AMT.

  Tax Tip. If you used all or part of the $500 lifetime credit limitation prior to 2009, this will not reduce your $1,500 aggregate limit for 2009 and 2010.

  Planning Alert! This credit is limited to qualifying improvements to your "principal residence" located in the U.S. (improvements to second homes do not qualify).

  Caution! The credit is not allowed at all for 2008.

  - **Qualified Energy-Efficient Home Improvements** include the following improvements **if the improvements also meet specific energy-efficient guidelines**: metal and asphalt roofs; insulation; exterior windows (including skylights); exterior doors; natural gas and propane furnaces; natural gas, propane, or oil hot water boilers; advanced air circulating fans; electric heat pump water heaters; heat pumps; air conditioners; natural gas, propane or oil water

heaters; and certain stoves burning biomass fuel.

Caution! Each of the items listed must meet specific energy-efficient guidelines or they will not qualify for the credit.

Tax Tip. Before making energy-efficient improvements to your home, you should first check to see if the manufacturer has certified the products as qualifying for the energy tax credit. You can also go to www.energystar.gov and type in "energy credits" for detailed information on whether your planned improvements qualify for the credit. For example, from that website you would find that under current rules, ENERGY STAR labeled exterior windows and skylights automatically qualify, but storm windows require a separate manufacturer certification statement. If you provide that information to us, it will help us prepare your return more efficiently.

Planning Alert! For qualifying energy-efficient **property placed in service after February 17, 2009**, the new legislation modifies and updates the required efficiency standards that must be satisfied for certain property. Before purchasing energy-efficient home improvements **after February 17, 2009**, make sure that the manufacturer's certification (or, any information from a website) reflects the updated standards.

- **30% Credit For Qualified *Residential* Solar Water Heaters, Geothermal Heat Pumps, Wind Energy Property, And Solar Electric Generating Property.** If you install a qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property in your residence located in the U.S., you may qualify for a credit equal to 30% of the equipment's cost (including onsite labor costs). However, before 2009, this credit was capped at $2,000 for solar water heaters, solar electric generating property, and geothermal heat pumps and at $4,000 for small wind energy property. For **qualifying property placed in service after 2008**, the $2,000 and $4,000 caps are removed. So, for example, if after 2008 you place a qualifying solar water heater in service that cost $10,000, you would be entitled to a full 30% credit of $3,000 with no overall dollar cap. Also, under the new legislation, the credit is allowed even if the improvements are purchased with government subsidized energy financing.

  Tax Tip. These credits are allowed to offset the alternative minimum tax as well as regular tax.

  Planning Alert! Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify for this credit.

Alternative Minimum Tax (AMT) Relief Extended Through 2009. Without the *American Recovery Tax Act*, a taxpayer would have received an AMT exemption of only $33,750 (individuals) and $45,000 (married filing jointly) for 2009, and there would have been no AMT offset for many personal tax credits. If these exemptions had not been increased to reflect 2009 inflation rates, IRS says the number of taxpayers paying AMT in 2009 would have increased from approximately 4 million to over 25 million. The new legislation increased the AMT exemption amounts, **for 2009 only,** to **$46,700** (for unmarried individuals) and **$70,950** (married filing jointly). The Act also extended, **for 2009 only,** the ability to use certain personal credits (including the dependent care, child, elderly and disabled, and higher education, credits) against AMT.

Planning Alert! The items that commonly trigger AMT for individual taxpayers include: high state and local taxes, an unusually large number of dependents, large medical expenses, or the exercise of an incentive stock option. If you anticipate having significant amounts of any of these items, contacting us early will increase our chances of helping you minimize your AMT for 2009.

Hybrid And Lean Burn Vehicle Credit Allowed Against Alternative Minimum Tax (AMT). If you buy certain hybrid vehicles or vehicles powered by lean-burn technology, you are entitled to an alternative motor vehicle credit. This credit is reduced once manufacturers produce over 60,000 energy-efficient vehicles. For example, vehicles manufactured by Toyota and Honda no longer qualify for the credit. However, qualifying vehicles manufactured by other companies (i.e., Ford, GM) still qualify**.** Before 2009, the credit did not offset AMT. However, **starting in 2009,** the alternative motor vehicle credit is allowed to offset AMT.

Tax Tip. You can get an updated list of the credit status of all hybrid and alternative fuel vehicles by visiting the IRS website at www.IRS.gov and typing in "hybrid cars and alternative fuel vehicles."

Waiver Of Required Minimum Distributions (For 2009 Only!). During the last weeks of 2008, Congress passed a law waiving required payments (called “required minimum distributions” or RMDs) from employer-sponsored retirement plans and IRAs for **calendar year 2009 only.** Thus, if you have reached age 70½ , or you are a beneficiary of an IRA or employer-sponsored plan whose owner has passed away, you will generally not be required to take a distribution otherwise due in 2009. Without this one-year waiver, many individuals with retirement accounts invested in distressed investments would have had to sell their retirement plan assets at a loss to generate 2009 RMDs.

Planning Alert! Unfortunately, this waiver does not apply to any RMDs that you were required to take in 2008.

- **What If I Reached Age 70½ During 2008?** If you reached age 70½ **during 2008**, and did not take your first RMD in 2008, you generally must take your first RMD **no later than April 1, 2009** to avoid the 50% penalty for failing to make a required distribution. In this situation, your second RMD must be made no later than December 31, 2010.

- **What If I Reach Age 70½ In 2009?** If you reach age 70½ in 2009, you must make your first required distribution **no later than December 31, 2010** (rather than April 1, 2010) to avoid the 50% penalty for failure to make timely distributions.

- **What If I Am Still Working At Age 70½?** If at the time you reach age 70½ you are still working for a company that sponsors your qualified retirement plan (e.g., §401(k) plan), you are generally not required to take an RMD until you retire.

  Caution! This special exception does not apply, however, if you own more than 5% of your employer, or if your retirement account is held in an IRA (including a SEP or SIMPLE IRA).

- **What If I Am Under Age 59½ And Currently Receiving “Substantially Equal Periodic Payments?”** If you are presently receiving *substantially equal periodic payments* to avoid the 10% early distribution penalty (e.g., you are under age 59½), this waiver **will not** apply to your 2009 payment! If you need additional information on this rule, please call our firm.

- **Do I Get An Extra Year If I Am Taking Distributions Under The 5-Year Rule?** If an owner of an IRA or employer-sponsored retirement plan died before reaching age 70½, and you are the beneficiary, you generally have two pay-out options: **1)** take your annual RMDs over your life expectancy, or **2)** take no *annual* RMDs provided that you take the entire retirement balance within 5 years after the year of the owner's death (the "5-year rule"). If you are under the *5-year rule* and the 5-year period includes 2009, you will get to add one year to the distribution period. For example, if your 5-year period would otherwise terminate in 2009, you will now have through 2010 to take the distribution without penalty.

- **Does The 2009 Waiver Apply To My Roth IRA?** If you are a Roth IRA owner, you are not required to take RMDs during your life-time. Thus, this new rule has no impact on you. However, if you have inherited a Roth IRA, you are required to take lifetime RMDs, and the 2009 waiver will apply to you.

- **What If I Have Already Received A Payment In 2009?** If you have already received a payment in 2009 that is not required under the rules discussed above, you may keep it without penalty and simply include it in your taxable income. If you do not want to keep it and include the distribution in income, you may be able to roll the amount distributed into an IRA within 60 days of receipt, and avoid taxation of the distribution.

  Caution! Only one rollover from one IRA to another may be made within a 12-month period. Please call us if you wish to roll these amounts to an IRA so we can assist you with the transaction.

Increase In Earned Income Tax Credit (EITC). For **2009 and 2010,** the new law increases the EITC for taxpayers with at least three children from 40% to 45% of family's first $12,570 of earned income, and increases the income phase-out threshold for married couples filing jointly.

Enhanced Refundable Portion Of Child Credit. For **2009 and 2010**, the new law makes it easier for individuals to qualify for the refundable child credit. For 2009 and 2010, the child tax credit is refundable to the extent of 15% of an individual's earned income in excess of $3,000 (previously $8,500). For example, in 2008 a qualifying taxpayer with one child under age 17 would need earned income of at least $15,167 for the entire $1,000 child credit to be refundable (paid to the individual even if the credit exceeds tax liability). **For 2009 and 2010**, the entire $1,000 child credit will be refundable if the individual has earned income of at least $9,667.

Temporary Tax Relief For Unemployment Benefits (2009 Only). Generally, unemployment benefits are taxable. **However for 2009 only**, the American Recovery Tax Act exempts up to $2,400 of unemployment benefits from federal income taxation. Unemployment benefits exceeding $2,400 will still be taxed.

Section 529 Plans. A person can make nondeductible cash contributions to a qualified tuition program (QTP, or section 529 plan) on behalf of a designated beneficiary. The earnings on the contributions build up tax-free and distributions *for qualified higher education expenses* are excludable from income. Generally, *qualified higher education expenses* include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution. For **2009 and 2010**, the American Recovery Tax Act allows certain computer technology or equipment, **or** internet access and related services to be paid from a section 529 plan (in addition to tuition, fees, books, supplies, etc.) without triggering income.

Highlights **Of Other Miscellaneous Changes Impacting Individuals.** The **American Recovery Tax Act** also includes the following provisions:

- **Tax-Exempt Interest on *Private Activity Bonds* Issued in 2009 and 2010** will not be treated as an item of tax preference for AMT purposes.

- **A Host of Energy Tax Incentives** Impacting Individuals and Businesses Have Been Expanded and Enhanced. Please call our firm if you need additional information on these technical rules.

- **The Monthly Exclusion for Employer-Provided Transit Passes and Vanpooling is increased** to the Same Amount as the Exclusion for Employer-Provided Parking ($230 for 2009) for Any **Month Beginning On or After the February 17, 2009 and Through December 31, 2010**.

NEW TAX BREAKS AVAILABLE TO BUSINESS TAXPAYERS–*SELECTED PROVISIONS*

***Temporary* 5-Year Carry Back Of Net Operating Losses.** If you have an "eligible small business" that is currently generating a tax loss (NOL) but was profitable in prior years, the American Recovery Tax Act may allow you to get a refund of taxes paid in previous years. Under current law, you may generally carry back an NOL and offset taxable income reported in the 2 tax years before the year that the loss arose (the "Carry back period"), and carry it forward to each of the following 20 years. **For NOLs generated by an "eligible small business" in the tax year ending in 2008** (or, instead *at the taxpayer's election,* in the tax year beginning in 2008)**,** the new legislation allows you to "elect" to extend the current NOL carry back period from 2 years to up to 5 years. In other words, a qualifying business may "elect" a 3, 4, or 5-year carry back period. For example, if your calendar year *eligible small business* generated an NOL in 2008, the business may carry back the loss and use it against taxable income as far back as the 2003 tax year (under current law, the earliest carry back year would have been 2006 unless the NOL is a *farm loss* or a *casualty loss*). Generally, a business is an **"eligible small business"** qualifying for this special 5-year carry back rule if it is a corporation, partnership, or sole proprietorship that has generated average gross receipts of no more than $15 million for the 3 tax years (or, shorter period of existence) ending with the tax year of the NOL. A *calendar-year* business is allowed to *elect* the 5-year carry back only for a NOL generated in the 2008 calendar year. If you own a *fiscal-year* business, you generally apply the special 5-year carry back period to your NOL generated in the fiscal tax year that *ends* in 2008; however, you may "elect" to apply the 5-year carry back option for the fiscal year that *begins* in 2008.

> **Planning Alerts!** Any election under these new rules (e.g., the election to extend the 2-year NOL carry back period to 3, 4, or 5 years, or the election to apply the extended carry back period to a fiscal year *beginning* in 2008) must be made by the due date (including extensions) for filing the income tax return for the tax year of the NOL. Once made, the election is irrevocable. However, the American Recovery Tax Act provides transitional rules that could be beneficial for businesses that have already filed their returns for tax years beginning or ending in 2008**. These transition rules generally provide that for an NOL for a tax year either 1) ending in 2008, or 2) beginning in 2008 and ending before February 17, 2009,** the election to extend the 2-year NOL carry back period to 3, 4, or 5 years may be made at any time within 59 days from February 17, 2009. In addition, a business may revoke an election to waive the carry back period for an NOL qualifying for the 5-year carry back election within this 59-day period.

> **Tax Tip.** There are certain NOL carry back filing procedures available that will allow your business to obtain a much quicker refund of taxes paid in the profitable carry back years. If your *eligible small business* anticipates a tax loss for 2008, please call our firm and we will help you file for the carry back refunds as soon as possible.

Increased $250,000 Section 179 Deduction Extended Through 2009. For tax years beginning in 2007, your business could have elected to deduct (under section 179) up to $125,000 of the cost of qualifying depreciable business property (e.g., machinery and equipment). Also, for 2007, this deduction was reduced by the amount of your section 179 property acquisitions in excess of $500,000. Effective for tax years beginning in 2008, Congress increased the maximum section 179 deduction to $250,000, and increased the phase-out threshold to $800,000. The American Recovery Tax Act extends this $250,000 section 179 deduction for one more year. Therefore, the increased section 179 limitation amounts apply **for tax years *beginning in* 2008 and 2009.** Thus, if your business is a *calendar-year* taxpayer, the increased section 179 deduction will be available for qualified property "placed-in-service" **by December**

31, 2009. Generally, "placed in service" means the property is ready and available for use. Therefore, to be safe, qualifying property acquired by calendar-year businesses should be set up and tested **before 2010** to ensure the higher $250,000 limits will apply.

Tax Tip. If you are considering a significant equipment or business vehicle purchase, please call our office. We will help you develop a purchase strategy that gives you maximum depreciation deductions.

Planning Alert! If you have a pass-through business entity (e.g., Partnership, LLC, S Corporation), you must apply the $250,000/$800,000 limitations twice–once at the entity level and again to the owners (i.e., to the S Corporation Shareholders, LLC Members, and Partners). In certain situations with fiscal-year pass-through entities, the $250,000/$800,000 limitations may be reduced. If you own an interest in a fiscal-year pass-through entity and plan to take advantage of these temporary increases in the section 179 deduction limitations, please call our firm. We will help you maximize your section 179 deduction.

Tax Tip. The section 179 deduction generally is not allowed to the extent the deduction exceeds the taxpayer's business taxable income (as determined without the section 179 deduction). Thus, the section 179 deduction generally cannot create a taxable loss (or NOL). For pass-through entities, this so-called *taxable income limitation* is applied at both the entity level, and again at the owner level. However, if wages are paid to 2% (or more) S Corporation shareholders or "guaranteed payments" are paid to owners of a partnership, the S Corporation or Partnership section 179 deduction can actually exceed the pass-through entity's *taxable income*, and create a pass-through loss.

The 50% Bonus Depreciation Also Extended Through 2009. The original bonus depreciation was first allowed following the terrorist attacks of 2001 and generally sunset after 2004. Last year, *Congress* reinstated the 50% bonus depreciation deduction for calendar-year 2008 property acquisitions. The American Recovery Tax Act extends the 50% bonus depreciation for one more year. Therefore, the 50% bonus depreciation deduction is available for **new** "qualifying property" **acquired and placed-in-service during calendar years 2008 and 2009.**

Caution! Property acquired pursuant to a binding contract entered into before 2008 does not qualify.

Tax Tip! IRS says that an option to acquire property is not a binding contract.

Planning Alert! Remember, whether your business uses a fiscal or calendar tax year, the 50% bonus depreciation is allowed only if "qualified property" is "acquired" and "placed-in-service" **during calendar years 2008 or 2009.** To meet the placed-in-service requirement, property must be ready and available for use during 2008 or 2009. Also, the section 179 deduction (discussed above) must be taken before the 50% depreciation. **Alternative Minimum Tax (AMT).** There is no AMT impact with respect to 50% bonus depreciation property unless the taxpayer elects not to take the 50% bonus depreciation.

- **Qualifying 50% Bonus Depreciation Property.** Generally, the 50% bonus depreciation deduction applies only to *new* property that has a depreciable life for tax purposes of *20 years or less* (e.g., machinery and equipment; furniture and fixtures; cars and light general purpose trucks; sidewalks, roads, landscaping, depreciable computer software**,** farm buildings, qualified leasehold improvements, qualified motor fuels facilities).

Planning Alert! These are only *examples* of qualifying property. If you have a

question about property that we have not mentioned, call us and we'll help you determine if it qualifies.

Tax Tip. Make sure you properly classify "land improvements" as "15-year property" (and not as part of the building) since land improvements qualify for the 50% bonus depreciation, and buildings generally do not. Furthermore, property within a new building that is not a structural component of the building (e.g., pursuant to a *cost segregation study*) may be treated as "tangible personal property." If you can *effectively segregate these costs, you may qualify for three favorable depreciation* benefits: **1)** section 179 treatment, **2)** the 50% bonus depreciation deduction, **and 3)** more rapid depreciation write-offs.

Tax Tip. Unlike the section 179 deduction discussed previously, the 50% bonus depreciation has no "taxable income" limitation and, therefore, can create or add to a net operating loss (NOL). Under the American Recovery Tax Act, we can elect to carry back 2008 NOLs for up to 5 years. Thus, if your business incurred a loss for 2008 but has generated healthy profits within the past 5 years, it still may be prudent to take the 50% bonus depreciation for 2008. This would increase the 2008 NOL, which might allow us to recoup more prior year taxes due to the temporary 5-year carry back period. Please call our firm and we will gladly help you determine whether taking full advantage of the 50% bonus depreciation for 2008 will save you and your business taxes.

- **Corporations May Swap 50% Bonus Depreciation For "Refundable" AMT And R&D Credits.** Corporations currently incurring losses may receive minimal tax benefit from the 50% bonus depreciation. However, corporations may elect to treat up to 6% of unused alternative minimum tax (AMT) and research and development (R&D) credits attributable to tax years **beginning before 2006** as refundable credits. **However, if this election is made 1)** the bonus depreciation deduction **does not apply to qualifying property acquired and placed-in-service after March 31, 2008, and** before 2009, and **2)** the corporation must use the **straight-line** depreciation **method for all assets otherwise qualifying for bonus depreciation and placed-in-service after March 31, 2008 and before 2009.** The American Recovery Tax Act generally extends this election to "eligible qualified property" **placed in service through December 31, 2009.**

Tax Tip. If your corporation currently has unused AMT and/or R&D credits and also has existing net operating losses, this election may be beneficial.
Planning Alert! These rules are complex and it will require a detailed analysis to determine whether your corporation could benefit from this election. We will gladly assist you with this analysis.

Bonus Depreciation For Passenger Automobiles. The maximum annual depreciation deduction (including the section 179 deduction) for most *passenger automobiles* used in a business is capped at certain dollar amounts. For example, **for 2008**, the maximum first year depreciation on a business automobile is generally capped at $2,960 ($3,160 for trucks and vans not weighing over 6,000 lbs). However, the *2008 Stimulus Act* increased the first year depreciation cap by $8,000 for passenger autos qualifying for the 50% bonus depreciation in 2008. The American Recovery Tax Act **extends this $8,000 increase to 2009.**

Trucks And SUVs Over 6,000 Lbs. SUVs with loaded vehicle weights over 6,000 lbs are exempt from the passenger auto annual depreciation caps discussed above. However, the section 179 deduction for a "heavy" SUV is limited to $25,000 (instead of $250,000). For example, for a new SUV weighing over 6,000 lbs used entirely for business and placed-in-service in 2008 or 2009: **1)** up to $25,000 of the cost can be deducted immediately under section 179, **2)** 50% of the remaining balance can be claimed as bonus depreciation, and **3)** 20% of what's left can generally be taken as regular depreciation for the first year. Thus, for a $50,000 new qualifying SUV placed in service in 2009, $40,000 could generally be written off in 2009 (assuming 100% business use). Pickup trucks with loaded vehicle weights over 6,000 lbs are exempt from the $25,000 limit imposed on SUVs if the truck bed is at least six feet long.

> **Planning Alert!** If you take the section 179 deduction and/or the first year additional depreciation deduction on an SUV or truck weighing over 6,000 lbs, and your business use percentage later drops to 50% or below, you may be required to bring into income a significant portion of the depreciation taken in previous years. Therefore, it is imperative that the business use of the vehicle exceeds 50% for subsequent years.

New Incentives To Hire Unemployed Veterans And Disconnected Youth. Businesses that employ individuals who are members of certain targeted groups (e.g., designated low income employees, welfare recipients, ex-felons, summer youth employees) are generally entitled to the *Work Opportunity Tax Credit* (WOTC) of 40% of the first $6,000 of wages (up to $2,400 per employee). **For employees who begin work in 2009 or 2010,** the American Recovery Tax Act creates two new categories of individuals qualifying an employer for the 40% WOTC: **1)** unemployed veterans, and **2)** disconnected youth. ***Unemployed veterans*** are generally individuals who have been discharged or released from active duty (after having served for more than 180 days) in the U.S. Armed Forces at any time during the 5-year period ending on the hiring date and received unemployment compensation for at least 4 weeks during the 1-year period ending on the hiring date. ***Disconnected youth*** are generally unskilled individuals from age 16 through age 24 who have not been regularly employed or attended school in the 6 months preceding the hiring date.

> **Planning Alert!** If your business currently employs, or plans to employ, a *qualifying* targeted individual, it must properly certify the employee in order to qualify for the WOTC. You can satisfy this certification requirement if you have the employee complete a *pre-screening notice* (IRS Form 8850) before the employee begins working. Also, no later than 28 days after the employee begins working, you must submit the properly executed notice to the appropriate state employment security agency for certification.

> **Tax Tip.** You can generally find detailed information on each qualifying targeted group in the instructions to **the most recent version of IRS Form 8850** located at **www.IRS.gov.**

S Corp 10-Year Built-In Gain Period Temporarily Shortened To 7 Years. If a regular "C" corporation later elects "S" corporation status (a "Converted S Corporation"), the election itself generally creates no immediate taxation. However, the Converted S Corporation will generally recognize a 35% corporate "built-in gains tax" on the sale of any "built-in gain" asset (i.e., an appreciated asset owned on the effective date of the S election), if sold during the first 10 years following the S election ("10-Year Recognition Period"). This built-in gains tax can also be triggered by certain income recognition events, including the collection of accounts receivable by a business using the cash method of accounting. For **tax years beginning in 2009 or 2010,** the American Recovery Tax Act *temporarily* reduces the 10-Year Recognition Period to 7 years. Thus, for a Converted S Corporation's tax year **beginning in 2009**, there will generally be no corporate *built-in gains tax* exposure if the S election was **first effective for 2002, or before**.

“Qualified Small Business Stock” Exclusion Temporarily Increased From 50% To 75%. For “qualified small business stock” acquired prior to February 18, 2009, if you sell the stock, you can exclude 50% of the gain from your gross income. The remaining 50% of the gain is taxed at a maximum rate of 28%. *Qualified small business stock* (QSBS) is generally stock of a C corporation engaged in a qualifying business, issued after August 10, 1993, held for more than 5 years, and the issuing corporation meets certain active business requirements and owned assets at the time of the stock issuance of $50 million or less. The American Recovery Tax Act provides that for QSBS **acquired after February 17, 2009 and before 2011,** the 50% exclusion is increased to 75%.

> **Planning Alert!** Remember, QSBS does not qualify for any gain exclusion unless it first satisfies a 5-year holding period. Thus, taxpayers who acquire qualifying stock after February 17, 2009 through December 31, 2010, must still hold the stock for at least 5 years before qualifying for the 75% gain exclusion.

Temporary Deferral Of Income Recognition For Repurchases, Acquisition, Or Forgiveness Of Business Debt. Generally, a business has *cancellation of debt* (COD) income where the debt of the business is cancelled or where the business reacquires its debt for an amount less than its face amount. However, under the American Recovery Tax Act, a business may elect to defer COD income resulting from the cancellation or the reacquisition of a debt instrument that was issued by the business **if the forgiveness or reacquisition takes place in 2009 or 2010**. If the election is made, qualified COD income that would otherwise be recognized in **2009 or 2010** will be **deferred until 2014**, and then included ratably in income over the next 5 tax years (i.e., from 2014 through 2018). An election to defer the recognition of COD income is made with the income tax return for the tax year in which the debt instrument is reacquired. These rules are quite technical, please call our firm if you need additional information.

COBRA Premium Assistance For The Unemployed. Under the American Recovery Tax Act, the Federal government will subsidize for up to nine months 65% of COBRA premiums for employees who are involuntary terminated **after September 1, 2008 and before 2010.** This new provision **becomes effective March 1, 2009.** The subsidy is recaptured on the individual’s federal income tax return as the individual’s modified adjusted gross income increases from $125,000 to $145,000, or from $250,000 to $290,000 for married individuals filing joint returns. Plan sponsors will be responsible for administering the new provisions on a timely basis, and will need to work closely with their COBRA administrators to ensure compliance. In most cases, the former employer will pay 65% of the premiums and then take a payroll tax credit for this amount.

***Highlights* Of Other Miscellaneous Changes Impacting Businesses.** The **American Recovery Tax Act** also includes the following provisions:

- Generally **Effective February 17, 2009**, the New Legislation Broadens the Scope of the $500,000 Compensation Deduction Limit on TARP Recipients, and Imposes Restrictions on Other Executive Compensation.

- Effective **February 17, 2009**, the New Legislation Revokes IRS Guidance Exempting Banks from Loss Limitation Rules Following an Ownership Change.

- Effective For **Ownership Changes after February 17, 2009,** Certain Section 382 Loss Limitation Rules Will Not Apply Where Bail-Out Agreement Requires Ownership Restructuring Under the Emergency Economic Stabilization Act of 2008.

- The **American Recovery Tax Act Expands and Enhances a Host of Energy Tax Incentives** Impacting Individuals and Businesses. Please Call Our Firm if You Need Additional Information on These Technical Rules.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and we will gladly discuss any current tax developments and planning ideas with you. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information.

Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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