



Briefly Stated

Financial News That Counts

Vol. 02 Issue 03
February 2009

A Miller, Kaplan, Arase & Co. Publication

2009 American Recovery and Reinvestment Act Issue How The 2009 Stimulus Plan Can Generate Big Tax Savings



Acting quickly to jump start the economy, Congress has passed a massive economic stimulus package: the American Recovery and Reinvestment Act of 2009 (the 2009 Act). As you have probably 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. This issue of Briefly Stated is dedicated to the 2009 Act with a brief synopsis of each topic. Make sure to check our website for additional updates.

SAN FRANCISCO
180 MONTGOMERY ST., STE 1840
SAN FRANCISCO, CA 94104
TEL: 415.956.3600

LOS ANGELES
4123 LANKERSHIM BOULEVARD
NORTH HOLLYWOOD, CA 91602
TEL: 818.769.2010

LAS VEGAS
330 EAST WARM SPRINGS ROAD
LAS VEGAS, NV 89119
TEL: 702.315.4213

SEATTLE
1942 WESTLAKE AVE., STE 3014
SEATTLE, WA 98101
TEL: 818.769.2010

www.MillerKaplan.com

This publication is intended to provide general information to our clients and friends. It does not constitute accounting, tax, or legal advice, nor is it intended to convey a thorough treatment on the subject matter.

“Making Work Pay” Tax Credit

The centerpiece of the tax package—and at \$115 billion its single largest component—is a “Making Work Pay” tax credit of up to \$400 per year for individuals, or \$800 per year for couples. Here are the details of this new credit:

- Eligible individuals will receive an income tax credit for two years (tax years beginning in 2009 and 2010). The new credit, like other tax credits, will reduce a person’s tax liability on a dollar-for-dollar basis. Wage earners who don’t earn enough to pay income taxes will be able to claim the difference as a tax refund.

- The new credit is the lesser of (1) 6.2% of an individual’s earned income or (2) \$400 (\$800 in the case of a joint return). In other words, for individuals with earned income above roughly \$6,451 (\$12,902 for couples), the credit maxes out at \$400 (\$800 for couples). For the last half of 2009, workers can expect to see perhaps \$13 a week less withheld from their paychecks starting around June. That reduction goes down to about \$9 per week next year.

- Nonresident aliens do not qualify for this credit. Neither do estates, trusts, or individuals who can be claimed as a dependent on someone else’s return.

- The credit is available in full only if AGI (adjusted gross income, with some modifications for highly specialized income) doesn’t exceed \$75,000 for an individual (\$150,000 if you file a joint return). The credit is phased out at a rate of two percent of the eligible individual’s AGI above \$75,000 (\$150,000 in the case of a joint return). So no credit is allowed for individuals with AGI of \$100,000 or more, or for joint filers with AGI of \$200,000 or more.

- Unlike the \$600 per worker lump-sum rebates issued last year, the credit can be received as a reduction in the amount of income tax that is withheld from a paycheck, or through a credit on a tax return.

- Since the credit is based on taxable wages and thus unavailable to many retired people and other whose income does not come from wages, the new law includes a one-time payment of \$250 to retirees, disabled individuals and SSI recipients receiving benefits from the Social Security Administration, and Railroad Retirement beneficiaries, and to veterans receiving disability compensation and pension benefits from the U.S Department of Veterans’ Affairs. The one-time payment is a reduction to any allowable Making Work

Pay credit. Similarly, a one-time refundable tax credit of \$250 is provided in 2009 to certain government retirees who are not eligible for Social Security benefits. This one-time credit is a reduction to any allowable making Work Pay credit.

NOL Carryback Period Extended

As you may know, NOLs can generally be carried back two years and forward 20 years. The carryback and carryover periods are determined by the law applicable to the year in which the NOL arises, rather than any of the years to which it is carried back or forward. An NOL that is not utilized within its statutory timeframe expires without providing any tax benefit.

The 2009 Act provides relief for small businesses by extending the maximum carryback period for 2008 net operating losses (NOLs) from two years to any number of years greater than two and less than six (i.e., three, four, or five years). The number of years selected for the carryback is discretionary within these parameters, but the election must be properly executed in a timely manner and cannot be revoked.

Fiscal-year businesses can apply these rules either to NOLs generated in tax years ending in 2008, or to NOLs generated in tax years beginning in 2008. If a small business has already waived an NOL carryback for the applicable 2008 tax year, the election can be revoked in order to obtain NOL carryback relief under the 2009 Act provisions. However, the prior election must be revoked and the new election executed within 60 days of the legislation’s enactment.

If you sustained an NOL this tax year, these provisions present an opportunity for an immediate refund of prior year taxes paid

Tax Break for New Car Buyers

In hopes of spurring the overall economy in general, and the automobile industry in particular, the 2009 Act includes a new tax break for purchasers of new cars: a deduction for state and local sales and excise taxes paid on new vehicle purchases. Here are the details.

Sales tax is generally not a deductible item for individuals. A limited exception allows taxpayers who itemize their deductions to claim either state and local income taxes or state and local general sales taxes, which mainly benefits taxpayers with a state or local sales tax but no income tax. Under the new law, buyers can claim an in-

come tax deduction for the sales or excise tax they pay on a vehicle purchase. Key details of this new tax incentive include:

- The tax break applies to purchases of passenger cars, minivans, light trucks, motorcycles, and motor homes, but it only applies on \$49,500 of the vehicle’s price and it only applies to new vehicles.

- The tax break covers new vehicles purchased between the date of enactment of the 2009 economic stimulus legislation and the end of 2009.

- You do not have to itemize your deductions to be able to claim the deduction. However, the deduction cannot be taken by a taxpayer who elects to deduct state and local sales taxes in lieu of state and local income taxes.

- Only couples making less than \$250,000 a year, or individuals making less than \$125,000 annually, qualify for the full deduction.

Increased Eligibility for the Refundable Portion of the Child Tax Credit

The Act provides a temporary increase in the refundable portion of the child tax credit for the 2009 and 2010 tax years, which is accomplished by a reduction in the earned income floor for claiming the credit to \$3,000.

In general, individuals with dependent children under age 17 at the close of a calendar year are entitled to a \$1,000 credit per child through 2010, although the credit is phased out with income over certain threshold amounts. For 2008, individuals were eligible for a refundable credit (the additional child tax credit) equal to 15 percent of their earned income in excess of \$8,500, up to the child credit amount, if the total amount of their allowable credit exceeded their total tax liability (regular and AMT).

Families with three or more children may determine the additional child tax credit under an alternative formula if this results in a larger credit. Under this formula, the additional child tax credit equals the amount by which the taxpayer’s social security taxes exceed the taxpayer’s earned income credit.

The 2009 Act changes the minimum earned income threshold for 2009 and 2010 to \$3,000, and therefore extends the benefit of this credit to a greater number of families than previous law afforded.

To get a digital version of this newsletter or to read previous issues visit: www.millerkaplan.com/briefly-stated

Expanded college credits

The 2009 Act includes a measure aimed at making college more affordable for low and moderate-income students. The new provision temporarily enlarges the Hope tax credit (renamed the American Opportunity tax credit) for students from middle-income families and partially extends this tax credit for the first time to students from lower-income families. Here are the details.

- The new law creates a new American Opportunity tax credit for 2009 and 2010, replacing and expanding the Hope tax credit for those years.

- The maximum amount of the American Opportunity tax credit is \$2,500 (up from a maximum credit of \$1,800 under the Hope credit). The credit is 100% of the first \$2,000 of qualifying expenses and 25% of the next \$2,000, so the maximum credit of \$2,500 is reached when a student has qualifying expenses of \$4,000 or more.

- While the Hope credit was only available for the first two years of undergraduate education, the American Opportunity tax credit is available for up to four years.

- Under the Hope credit, qualifying expenses were narrowly defined to include just tuition and fees required for the student's enrollment. Textbooks were excluded, despite their escalating cost in recent years. The American Opportunity tax credit expands the list of qualifying expenses to include textbooks.

- The Hope credit was nonrefundable, i.e. it could reduce your regular tax bill to zero but could not result in a refund. This meant that if a family didn't owe any taxes it couldn't benefit from the credit, which prompted critics to argue that the credit was thus denied to the very families most in need of help affording college. The American Opportunity tax credit addresses this criticism to a degree by providing that 40% of the credit is refundable. This means that someone who has at least \$4,000 in qualified expenses and who would thus qualify for the maximum credit of \$2,500, but who has no tax liability to offset that credit against, would qualify for a \$1,000 (40% of \$2,500) refund from the government.

- The Hope credit was not available to someone with higher than moderate income. Under the credit's "phaseout" provision, taxpayers with adjusted gross income (AGI) over \$50,000 (for 2009) saw their credits reduced, and the credit was

completely eliminated for AGIs over \$60,000 (twice those amounts for joint filers). Under the American Opportunity tax credit, taxpayers with somewhat higher incomes can qualify, as the phaseout of the credit begins at AGI in excess of \$80,000 (\$160,000 for joint filers).

Residential Energy Credits Modified

The 2009 Act provides benefits to homeowners by reinstating the Credit for Non-business Energy Property (CNEP) for 2009 and 2010, and enhancing the Residential Energy Efficient Property (REEP) credit.

As you may know, the CNEP can be taken when qualified energy efficient improvements or expenditures are made for your principal residence, including new insulation; replacement windows, skylights and doors; central air conditioners; certain water heaters, furnaces or boilers; and a new metal or asphalt roof specifically treated to reduce heat loss. The CNEP, which was not available for the 2008 tax year, has been reinstated for eligible property placed in service after December 31, 2008, and before January 1, 2011. The 2009 Act also:

- eliminates the lifetime limitation for the CNEP (previously \$500);
- increases the credit from 10 percent to 30 percent of qualified expenses; and
- increases the maximum CNEP amount for 2009 and 2010 installations to \$1,500.

The REEP credit is allowed for qualified expenditures that produce energy for home use, such as for solar energy and fuel cell energy property. The REEP was previously extended through the 2016 tax year, and applies not only to your principal residence, but also to your vacation home. Although the maximum credit for qualified fuel cell property remains unchanged (\$500 for each half kilowatt of capacity), the 2009 Act removes the maximum credit amounts for the following qualified property expenditures for tax years beginning after December 31, 2008:

- solar electric (previously capped at \$2,000);
- small wind energy (previously capped at \$500 for each half kilowatt of capacity of wind turbines (not to exceed \$4,000)); and
- geothermal heat pump (previously capped at \$2,000).

Extension of Bonus Depreciation and Code Sec. 179 Expense Deduction

These provisions extend prior law increases in the limitation on expense deductions for depreciable assets and allowable 50% bonus depreciation on new equipment for the year it is placed in service. More specifically, the 2009 Act extends the available expense deduction limitation under Code Sec. 179 of \$250,000, and the phase-out amount of \$800,000, through tax years beginning in 2009. Bonus depreciation is also extended through 2009 (through 2010 for certain longer-lived and transportation property).

Because these extensions are temporary and generally apply only to tax years beginning in 2009, new purchases should be made and placed in service accordingly. The increased expense deduction will revert back to \$125,000 (as indexed for inflation) for qualifying assets after 2009. Further, the \$125,000 deduction (as adjusted for inflation) is scheduled to revert back to \$25,000 for tax years beginning after 2011. Similarly, in 2010, the phase-out amount, which begins with every dollar spent over \$800,000, reverts back to \$500,000, as adjusted for inflation, and is scheduled to revert to \$200,000 after 2011.

Enhanced First-time Homebuyer Credit

You may remember that last year's Housing Act included a tax credit giving first-time homebuyers up to a \$7,500 (actually, 10% of the purchase price or \$7,500, whichever is less) credit for buying a home between April 8, 2008, and July 1, 2009, with single taxpayers with incomes up to \$75,000 and married couples with incomes up to \$150,000 qualifying for the full tax credit. However, despite high hopes that the credit would be effective in getting people to buy homes and thereby reduce the excessive inventory on the market, the credit is widely acknowledged to have failed in its objective. The problem, according to realtors and industry officials, was that buyers were turned off by the odd way the credit worked. While the credit functioned initially like other tax credits, reducing a person's tax liability on a dollar-for-dollar basis, it was unusual in that, unlike other federal tax credits (for example, the child credit), the credit for first-time homebuyers had to be paid back to the government ratably over a period of 15

cont. pg 4

years (or earlier if the house is sold). So, as a practical matter, the credit was the equivalent of an interest-free loan from the government. It was the payback requirement that many in the industry felt kept potential buyers on the sidelines. Now, Congress has beefed up the credit in renewed optimism of enticing more first-time homebuyers to take the plunge. First and foremost, the new legislation scuttles the repayment requirement for homes purchased on or after January 1, 2009. The new law also extends the credit through the end of November 2009, and bumps up the maximum credit amount from \$7,500 to \$8,000. However, the new law retains the recapture provisions if the house is sold within three years of purchase.

Additional Stimulus Changes

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

Cancellation of indebtedness. Eligible businesses will be able to recognize cancellation of certain indebtedness over five years, beginning in 2014, under the new law. This treatment applies to specified types of business debt repurchased or forgiven by the business after December 31, 2008 and before January 1, 2011.

Energy incentives. The new law extends and enhances many energy tax incentives for developers and producers of alternative and renewable energy. Examples are wind, biomass and solar power. The incentives are temporary and are intended to boost production of energy from renewable sources.

S corporations. A built-in gains tax applies to corporations that make an S corporation election. The tax is computed by applying the highest corporate tax rate to the net recognized built-in gain of the S corporation for the tax year. The new law reduces the recognition period for assets subject to the built-in gains tax from 10 to seven years.

Small business stock. Generally, an investor other than an entity doing business as a C corporation, may exclude 50 percent of the gain from the sale or exchange of "qualified small business stock." The new law raises the 50 percent exclusion

to 75 percent. However, the increase is temporary and applies to stock acquired after the date of enactment and before January 1, 2011. Holding period rules also apply.

Executive compensation. The economic slowdown cast a spotlight on the executive compensation practices of Wall Street firms and many lawmakers are unhappy with what they see as "excessive" compensation. The new law reflects the changing mood in Congress. Lawmakers especially singled-out expenditures for luxury items by companies receiving financial assistance from the government's Troubled Asset Relief Program (TARP) for more regulation. Congress also directed the Treasury Secretary to review bonuses, awards and other incentives paid to senior executives at these firms and determine if the payments were contrary to public interest. Separately, the Treasury Administration has recently heightened its oversight of these firms and placed additional limits on executive compensation.

COBRA. Individuals who are involuntarily separated from employment between September 1, 2008 and January 1, 2010 can elect to pay 35 percent of their premiums for COBRA coverage and will be treated under the new law 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 new law is extremely technical application, especially with notice requirements and timeframes for eligibility for coverage.

AMT patch. Every year, bills are introduced in Congress to abolish the alternative minimum tax (AMT). This year is no different but because the federal budget deficit, Congress cannot eliminate the AMT without finding an equivalent source of revenue. However, there is some good news. The new law increases the AMT exemption amounts and allows taxpayers to take most personal credits to reduce AMT liability for 2009.

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

Transit benefits. Individuals who take public transportation to work or van pool

may benefit from enhanced transit incentives in the new law. Congress increased the income exclusion amount for transit passes and van pooling from \$120 per month to \$230 per month for 2009 (starting in March 2009) and through 2010 with an inflation adjustment. However, these benefits must be offered by your employer to take advantage of them.

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 new law enhances the EITC for taxpayers with three or more qualifying children and helps eliminate an existing "marriage penalty" across the board.

Tax Impacts of California Budget

Following are the tax impacts of the latest California budget. The next edition of Briefly Stated will have more details.

- A temporary 0.125% to 0.25% increase in the personal income tax rate.
- A temporary 1% increase in the state sales and use tax rate effective from April 1, 2009 through June 30, 2011.
- A temporary increase in the vehicle license fee from 0.65% to 1.15%.
- A temporary reduction in the personal income tax dependent credit.
- A new jobs tax credit against personal income and corporate income taxes for small employers.
- A new motion picture production tax credit against corporate income and personal income taxes.
- A new homebuyer's credit against personal income tax.
- Modification of the apportionment formula for multi-state businesses.

This newsletter's content are not intended to provide tax advice directed at the particular facts and circumstances of any person. If you are interested in the subject of this document we encourage you to contact us or an independent tax advisor to discuss the potential application to your particular situation. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this document may be considered to contain written tax advice, any written advice contained in, forwarded with, or attached to this document is not intended by Miller Kaplan to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.