2009 What the economic stimulus law means to you! - 2/26/2009
by Sandy Botkin, CPA, Esq.

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"Where there is an income tax, the just man will pay more and the unjust less on the same amount of income." — Plato

As in Plato's day, most people know that the government stimulus law (which is known as the American Recovery and Reinvestment Act of 2009) is a giant bailout for some folks: namely large businesses. When I say "giant", I wasn't kidding. The Act consists of thousands of pages. In fact, the entire text of the bill, and that of the previous economic stimulus act, is so huge that they might barely fit in a Winnebago! Congress must have purchased them, plus the vehicle to deliver such huge legislations, at either Wal-Mart or Costco.

Unknown to many people, however, is that there are a number of provisions that apply to both individuals and small businesses. I will try to summarize some of these provisions so that you can see how this new law can apply to you.

Small Business Provisions:

1. **Automobile depreciation increased:** In 2009, the maximum depreciation that you can take this year for a new passenger automobile was going to be $2,960. This number was increased by $8,000 to $10,960 for the first year alone for new cars.

2. **50% Bonus Depreciation:** In addition to any depreciation taken on equipment, you can get an additional 50% bonus depreciation. This applies to any tangible equipment used in business and not to buildings. This is especially good for SUVs where business taxpayers can elect to write off only $25,000 of the business use of the SUV in the first year alone. Example: Sam buys a Cadillac Escalade for $54,000 and uses it about 92% for business. Thus, the business use is $50,000. Sam may elect to deduct the first $25,000 of the business use PLUS he would get 50% bonus depreciation of the remaining $25,000, which would be an additional $12,500 of depreciation. Moreover, he would get regular depreciation of the remaining $12,500 which would be taken over the forthcoming six years. The result is that you would be effectively deducting about 80% of the business use of a qualified SUV!

3. **$250,000 special expense rule:** You know the old golden rule, "he who has the gold, makes the rules." Since the government has the gold…or at least prints enough money to buy all of Fort Knox multiple times, they have limited depreciation of equipment. Usually equipment gets depreciated over 5-7 years depending on the equipment. However, now a small business can elect to deduct up to $250,000 worth of equipment in the year of purchase. Unfortunately, Congress has set some limitations. In order to take this deduction, the equipment must be new to you and purchased this year. Secondly, the equipment must be used over 50% for business. Finally, the total purchase of all equipment must be less than $800,000 or the $250,000 will be phased out.

4. **Transit pass exclusion increased to $230:** In 2009, you can provide transit passes to your employees of up to $230 per month tax free. This matches the amount that you can provide for free parking. Sadly, the person must be an employee and not a self- employed individual.

5. **75% exclusion for qualified small business stock:** If you own stock in a small business for five years or more, you may be able to avoid up to 75% of any gain. The remaining gain is taxed at your normal income tax rates up to 28%. Of course, how many of us have gains on our small business stock these days? Just for

the record, your corporation is deemed to be a small business if you have had annual gross receipts of <u>under</u> fifty million dollars.

6. **Companies that reacquire debt:** Companies that reacquire their debt normally recognize income in the year of reacquisition. Thus, if the debt was originally $1,000,000 and you buy it back for $500,000, you would have taxable income on the $500,000 of debt relief. Now comes helpful Uncle Sam; if your company reacquires its debt at a discount, it would still pay tax on the discount but over a five year period.

7. **Lower estimated taxes:** The normal rule is that if you want to avoid penalties for failing to file estimated taxes, you have to guess at your taxes for the year and pay in 90% of that amount pro-rata during the year. As an alternative, you can pay in 100% of last year's taxes as a safe harbor if you make under $150,000 of adjusted gross income. Those that make over $150,000 of AGI, pay in 110% of last year's taxes. The new law seems to be a benefit, but simply adds an additional wrinkle. If you make less than $500,000 of adjusted gross income, you only have to pay in 90% of last year's taxes as a safe harbor. Those that earn in excess of $500,000 may be subject to the 110% rule.

8. **Carry back of business losses:** In 2008, if your small business generates a loss as a sole proprietor, you may elect to carry back business losses by as much as five years! You can actually get a refund check by both the federal government and many state governments by carrying back losses up to five years. Not too shabby. For 2009 and thereafter, you can only carryback losses for two years.

<u>Provisions that affect individuals:</u>

1. **Making work pay credit:** I like to call this the pulse credit because if you have a pulse and some earned income, you can get an additional credit of up to $400 per person. Married folks can get up to $800 if each meets the rules. The credit is 6.2% of your earned income up to $400. So much for tax simplification! What Congress gives, they take back, which is a spinoff of the golden rule. The credit phases out for single people who earn over $75,000 of modified adjusted gross income (which is adjusted gross income with some minor modifications). If you are single and earn over $75,000 the credit continues to phase out up to $95,000, where it is completely eliminated. For married filing joint returns, the phase out limits are $150,000-$190,000, which is double the limits for single folks.

2. **Hope Scholarship Credit:** Do you have kids in college or are you in college? You will like this. Taxpayers in college can get 100% of tuition and qualified expenses up to $2,000 and 25% of any tuition and qualified expenses as a yummy tax credit each year for each student! This applies for the first four years of college. A tax credit is a dollar for dollar reduction in your taxes. Thus, it is much better than simply getting a deduction. However, what Congress gives, they take back. This wonderful credit phases out ratably for single taxpayers who earn between $80,000 and $90,000 of modified adjusted gross income (MAGI). As with the prior credit noted above, married taxpayers who file joint returns get double the phase out limits. This is a great credit, but if you think that this will substantially benefit the economy or create jobs, I have a bridge for sale in San Francisco.

3. **One Time $250 tax credit:** If you are eligible for receiving social security or VA pension or certain railroad retirement pensions, you are eligible for a one-time $250 tax credit. There doesn't seem to be any phase out based on income.

4. **First time home buyer credit:** If you are a first time homebuyer in 2009 (which is misleading since you don't need to be a first time homebuyer), you can get a tax credit of 10% of the purchase price of your home up to $8,000. Moreover, you never have to pay this credit back if you meet certain holding period rules! To qualify as a "first time homebuyer," you cannot have owned your principal residence within the last 36 months of the purchase of your new residence. Also, as noted above, you won't have to pay back

the credit as long as you keep your home and use it as your principal residence for three years after you first buy your principal residence.

Sandy's observation: Because only prior ownership in a principal residence is considered, it's possible for a taxpayer who already owns a vacation home to claim the new credit, if he /she otherwise qualifies. For example, a taxpayer whose principal residence for at least three years has been a rental apartment in the city, and who owns a seaside home, could claim the credit for the purchase of a new principal residence if his modified AGI doesn't exceed the phase-out levels discussed below.

5. **State and local taxes:** State and local taxes (such as sales taxes) are deductible as itemized deductions on vehicles up to $49,500 in cost. Again, what Congress gives, they take back. The credit phases out for single people who earn over $125,000 and completely phases out at $135,000. For married people filing joint returns, the phase out limit is almost double this: $250,000-$260,000.

   Sandy's Observation: First, no credit is taxable to you. It is all tax free. Secondly, I find it bizarre that there are difference phase out amounts for the sale and local tax deductions vs. those for hope tax credits vs. those for the "making work pay" credit. I don't know what Congress was thinking, but so much for practicality or tax simplification.

6. **Unemployment compensation:** Normally, unemployment compensation is fully taxable. Starting in 2009, the first $2,400 of unemployment compensation is tax free. Frankly, I have always felt that unemployment should have been tax-free. Kicking someone who is already down seemed to have been the government's motto.

7. **Section 529 plan changes:** If you have been saving money in a section 529 plan for college education costs, as I have been advocating, I have good news for you. Section 529 plan funds could have been previously used solely for qualified tuition, required fees, and books. Now, you can even receive tax free a computer and fees for internet access if the student is in college.

8. **Increase in earned income credit:** If you have three or more kids and don't make much money, the new law will greatly benefit you. Now families or single parents with three or more kids will get an increased earned income credit of 45%, which is up from the original 40%. Moreover, the credit is increased on larger amount of earned income, which means you will get more money subject to an income phase-out.

   The following table illustrates this:

Qualifying children	Credit percentage	Earned income amount	Maximum credit
None	7.65%	$ 5,970	$ 457
One	34%	$ 8,950	$3,043
Two	40%	$12,570	$5,028
Three or more	45%	$12,570	$5,656.50

9. **Non business energy credit:** Thinking of buying a more efficient furnace or some new storm windows or fans? This might be the year to do it. Starting in 2009, if you buy "qualified energy equipment" such as a new hot water heater, new ceiling fans, new windows, oil furnace or a new heat pump, you will get a yummy 30% tax credit on these items. However, in order for the government to avoid going broke, they have limited the overall amount of this credit to $1,500 for the year.

In short, I think the government should go shopping at Sears for future tax bills. Moreover, I think I will rush out and get a great SUV for fast write offs. I can stock it with all the new upcoming, porky laws that seem to be forthcoming.

I wonder if Wal-Mart sells SUV's too.

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