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Business Tax Relief Included in The American Recovery and Reinvestment Act of 2009

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President Obama recently signed the American Recovery and Reinvestment Act of 2009 ("ARRA"), which, as the Act makes clear is intended to promote recovery for the current recession. This legislation not only extended previously enacted tax laws designed to assist domestic businesses but introduced new legislation as well. The following is an overview of many of the changes designed to alleviate the tax burden on domestic businesses.

I. Cancellation of Indebtedness Income

Generally, a discharge of indebtedness, including discharges through settlement, modification, repurchase of the debt instrument for less than its issue price, forgiveness, or issuance of equity instruments results in income to the debtor. The amount of income generally equals the difference between the amount of the outstanding debt and any amount paid to satisfy the debt. Pre-ARRA, debt discharge realized income had to be recognized in the year of discharge. Under ARRA, however, a taxpayer can elect to include debt discharge income realized in connection with the reacquisition of a debt instrument in gross income ratably over five tax years beginning in 2014. For example:

> In 2009, C reacquires for $200,000 notes that it issued with an adjusted issue price of $400,000 and elects to include the income over a five-year period. Taxpayer realizes $200,000 of debt discharge income, but does not recognize that income in 2009. Instead, it recognizes $40,000 of debt discharge income ($200,000 ÷ 5) in each of the five tax years from 2014-2018.

II. S Corporations – Relief from Built-in Gains

In general, an S Corporation is a pass through entity. It is the shareholders who pay tax on their pro rata shares of the S Corporation's income. When a C Corporation elects to become an S Corporation, however, the S Corporation is taxed at the highest corporate rate on all built-in gains recognized during the "recognition period." The ARRA reduces the "recognition period" from ten years to seven years. For example:

> In 2002, E a C Corporation elected to become an S Corporation. After the expiration of the recognition period no tax will be imposed on E's net unrecognized built-in gain. Pre-ARRA the recognition period would continue until 2012. ARRA reduced the recognition period to seven years. Beginning in 2009, therefore, no tax will be imposed on E's net unrecognized built in gain.

III. Extension of First Year Expensing Limit

In general, taxpayers can elect to take a one time deduction for "qualified section 179 property" placed in service during the tax year. Section 179 property, includes most depreciable property. Prior to 2008, the deduction limit was set at $125,000 and was further reduced to the extent the value of the qualified property exceeded $500,000 ("phase-out amount"). These limitations, were later adjusted for qualified property placed in service in 2008. The ARRA extends the 2008 deduction limit for 2009. The deduction limit, therefore, remains set at $250,000, and the phase-out amount set at $800,000. For example:

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A, a calendar year taxpayer, places into service qualified section 179 property with a cost of $850,000 during 2009. A can elect to expense $200,000: $250,000 [maximum deduction in 2009] - $50,000 [amount 179 property exceeds the 2009 phase-out amount, $800,000].

IV. Bonus Depreciation

Taxpayers are allowed a 50% depreciation deduction (bonus depreciation) on qualified property in the year that the property is placed in service. Qualified property, refers to tangible depreciable property with a recovery period no longer than 20 years, water utility property, computer software or "qualified leasehold improvement property." Bonus depreciation was set to expire on December 31, 2008. The ARRA, however, extends bonus depreciation to qualified property placed in service before January 1, 2010. Certain aircraft and long production period property must be placed in service before January 1, 2011.

A. Passenger Automobiles

The ARRA also increased the depreciation deduction limits that can be claimed with respect to "passenger automobiles" used in a business. Generally, the deduction limit is adjusted annually to reflect changes in the automobile component of the Consumer Price Index. Specifically, for vehicles placed in service in 2007 the first year depreciation deduction limit was $2,960 ($3,160 for passenger cars built on a truck chassis). In 2008, the applicable first year depreciation limit was increased by $8,000. The ARRA extends this increase making the depreciation limit $10,960 for vehicles place in service before January 1, 2010. For example:

B, a calendar year taxpayer, places a new passenger vehicle into service in his business. Assume the vehicle is "qualified property" (and an election to decline bonus depreciation and AMT depreciation relief doesn't apply to the vehicle). B uses the passenger vehicle 80% for business and 20% for personal activities. The auto depreciation limits will be proportionally reduced to the extent that a vehicle isn't exclusively used in business. So, B is allowed a first year depreciation for 2009 of no more than $8,768 (80% (% of business use) x $10,960 (depreciation limit).

V. Net Operating Loss Extended Carryback Period

The ARRA allows eligible small businesses to carry back net operating losses (NOLs) arising in 2008 for three, four, or five taxable years rather than the previous limit of two taxable years. Eligible small businesses are businesses with average annual gross receipts of less than $15 million (including gross receipts of certain related taxpayers). For example:

In 2008, D an eligible small business incurred a NOL of $500,000. D elects a five year carry back period. The $500,000 NOL arising in 2008 can be carried back to 2003.

VI. Additional Business Related Provisions

The ARRA also addresses the extension of the optional refund of unused alternative minimum tax ("AMT") and research and development ("R&D") credits. Click here to view Tax Alerts addressing the Energy, IDB and NMTC provisions of the ARRA.

Taxpayers with questions regarding the ARRA may contact Katherine Murphy at (734) 214-7671 or kcmurphy@dykema.com, or Tony Ilardi at (248) 203-0863 or ailardi@dykema.com, or Wayne Roberts at (616) 776-7514 or wroberts@dykema.com.

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