

HIGHLIGHTS OF 2009 TAX LEGISLATION

American Recovery and Reinvestment Act of 2009



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ISBN 978-0-8080-2147-6

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Printed in the United States of America

CONTENTS

Introduction	5
Individuals	6
Economic Recovery Payments.....	6
\$250 Payments to Recipients of Federal Program Benefits.....	6
Tax Credits	8
\$250 Credit for Certain Government Retirees	8
Making Work Pay Credit	9
Earned Income Tax Credit.....	10
Refundable Child Tax Credit Increased.....	12
Credit for First-Time Homebuyers Extended and Expanded	13
American Opportunity Tax Credit	14
Income and Deductions.....	17
Tax on Purchase of New Vehicle.....	17
Qualified Tuition Programs (Section 529 Accounts).....	19
Parity for Qualified Transportation Fringe Benefits.....	20
Exclusion of Gain From the Sale of Qualified Small Business Stock.....	21
Unemployment Compensation	22
AMT Relief.....	22
Increased Exemption Amounts.....	22
Nonrefundable Credits.....	23
AMT Limitations on Tax-Exempt Bonds	24
Businesses.....	24
Depreciation and Expensing.....	24
Increased Section 179 Deduction	24
Bonus Depreciation	25
Election to Accelerate AMT and Research Credits in Lieu of Bonus Depreciation	26
Gains and Losses.....	27
Maximum Five-Year Carryback of Net Operating Losses of Small Businesses	27
S Corporations: Built -in Gains Tax.....	30

Other Business Provisions	31
Incentives to Hire Unemployed Veterans and Disconnected Youth	31
Estimated Tax for Individuals with Income From Small Businesses	32
Deferral of Cancellation-of-Indebtedness Income on Repurchase of Debt	33
Withholding Tax on Government Contractors	35
Energy	36
Individual Energy Provisions	36
Credit for Residential Energy Property Extended and Modified	36
Credit for Residential Energy Efficient Property Increased	38
Alternative Vehicle Refueling Station Credit Increased	39
Plug-in Electric Drive Motor Vehicles	40
Alternative Motor Vehicle Credit as Nonrefundable Personal Credit Against AMT	44
Business Energy Provisions	45
Energy Portion of Investment Credit	45
Renewable Electricity Production Credit	46
Investors	46
Mutual Funds Not Required to Pass Tax Credit Bond Credits Through to Investors	46
Health	47
COBRA Premium Assistance	47
Health Coverage Tax Credit	48

INTRODUCTION

On February 17, 2009, President Obama signed into law the much-anticipated American Recovery and Reinvestment Act of 2009 (P.L. 111-5). The massive \$787 billion total cost of this economic stimulus package includes nearly \$300 billion in tax relief.

The tax title of the Act — the American Recovery and Reinvestment Tax Act of 2009 — includes a new Making Work Pay Credit, enhancements to the child tax credit and first-time homebuyer credit, an enhanced Hope scholarship credit for 2009 and 2010 (called the American Opportunity tax credit), an alternative minimum tax (AMT) patch for 2009, and energy incentives. In addition, the legislation provides extensions for 2008 bonus depreciation and increased Code Sec. 179 expensing, a limited five-year net operating loss (NOL) carryback for small businesses, and incentives to hire unemployed veterans and disconnected youth. The package also contains:

- a one-time stimulus payment of \$250 to retirees, disabled individuals, social security recipients, and disabled veterans;
- a temporary increase of the earned income credit for working families with three or more children;
- a deduction for state and local taxes paid on the purchase of a new automobile during 2009; and
- a suspension of federal income tax on the first \$2,400 of unemployment benefits per recipient for 2009.

INDIVIDUALS

Economic Recovery Payments

\$250 Payments to Recipients of Federal Program Benefits

Under one of the Act's flagship provisions for individuals, eligible recipients of federal benefits will receive a one-time economic recovery payment of \$250 in 2009 or 2010. These economic recovery payments are not considered gross income for income tax purposes.



Comment

This is not a rebate or otherwise related to taxes — just an outright payment. The Secretary of the Treasury is required to begin making these payments as soon as possible, but no later than 120 days after February 17, 2009, the date of enactment. No economic recovery payments can be made after December 31, 2010.

To receive an economic recovery payment, you must meet both of the following eligibility requirements:

- (1) During November 2008, December 2008, or January 2009, you must have been entitled to a benefit payment under a qualifying program — generally, Social Security benefits, Railroad Retirement Act benefits, veterans compensation or pension benefits, or supplemental security income (SSI) benefits.



Comment

Although the provision is generally aimed at adult benefit recipients, the veterans benefits and SSI benefits categories may include individuals under age 18.

- (2) Your current address of record under the qualifying program must be in one of the 50 states, the District of Columbia, Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa, or the Northern Mariana Islands.



Comment

Individuals who receive certain government pensions or annuities can qualify for similar economic assistance through a tax credit, discussed on page 8.

If you are eligible for benefits under more than one of the qualifying programs, you will receive only one economic recovery payment.

An individual who might otherwise meet the eligibility requirements nevertheless will not receive an economic recovery payment if, for the most recent month in which the individual is entitled to a qualifying benefit during the three-month qualification period (November 2008 through January 2009), the individual's federal program benefits have been suspended because the individual was in prison, a fugitive, a probation or parole violator; committed fraud; or is no longer lawfully present in the United States. In addition, no payment will be made in the case of an individual who dies before the date the individual is certified by the relevant

federal agency as being entitled to receive an economic recovery payment.

If you are also eligible for the new Making Work Pay Credit, the amount of that credit is reduced by the amount of your economic recovery payment.

These payments are not taken into account as income or regarded as resources for the month of receipt (and the following nine months) in determining your eligibility for, or the amount or extent of, benefits or assistance under any federal program or any state or local program financed in whole or in part with federal funds.

Tax Credits

\$250 Credit for Certain Government Retirees

Certain government retirees can claim a refundable \$250 tax credit for their first tax year beginning in 2009. The credit is \$500 on a joint return if both spouses are eligible.

To be eligible for the credit, you must meet all the following tests:

- (1) During your first tax year beginning in 2009, you must receive some amount as a pension or annuity for service performed in the employ of the United States, any state, or any instrumentality thereof, that is not considered employment for Federal Insurance Contributions Act (social security tax) purposes.
- (2) You must not receive an economic recovery payment during the tax year.
- (3) Your tax return must include your social security number. A joint return must include the social security number of at least one of the spouses.

Making Work Pay Credit

In both 2009 and 2010, many individuals are eligible for a refundable credit equal to either (1) \$400 (\$800 for married taxpayers filing jointly) or (2) 6.2 percent of earned income, whichever is less. The credit may seem like free money — and it is, as far as the tax code goes: It is not included in taxable income.

The credit is not available to everyone, however. It is not available to nonresident aliens, individuals that can be claimed as dependents by any other taxpayer, or estates or trusts. In addition, it is phased out at a rate of 2 percent of modified adjusted gross income (MAGI) above \$75,000 (\$150,000 in the case of joint filers), and is therefore totally eliminated if you have a MAGI of \$95,000 or greater (\$190,000 in the case of joint filers). Finally, you cannot claim the credit if you do not include on your return your social security number and, in the case of a joint return, the social security number of at least one of the spouses. A taxpayer identification number (TIN) issued by the IRS does not qualify as a social security number.



Comment

If you receive the \$250 economic recovery payment available to veterans, recipients of social security, and certain other individuals, or the \$250 special credit to government retirees, that payment or credit reduces the Making Work Pay Credit.



Taxpayer Tip

You will not have to wait until you file your taxes in 2010 to take advantage of this credit. Instead, less tax will be withheld from your paychecks for the remainder of 2009, putting the money immediately into your pocket. The bad news is that many lower-income workers have little or nothing withheld from their taxes, and will have to wait until they file their taxes next year to claim the credit.

If you live in Puerto Rico, the U.S. Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, or American Samoa, you are also eligible for the credit.

Earned income is defined as it is for purposes of the earned income credit, with two modifications:

- (1) It includes combat pay excluded from income, even for taxpayers that do not elect to include it in income for the earned income tax credit.
- (2) It does not include net earnings from self-employment that are not taken into account in computing taxable income, such as parsonage allowances.



Comment

If you're wondering where the "6.2 percent" number comes from, that's the percentage of your wages that is taken out of your paycheck to pay social security taxes (but not on your wages above \$106,800 for 2009). Thus, the credit effectively eliminates your share of social security tax on about the first \$6,450 of a single worker's wages

Earned Income Tax Credit

Low and moderate-income taxpayers may be eligible for the earned income tax credit (EITC), depending

on their income, filing status, and immigration and work status. If you are eligible, the amount you receive depends on the number of children in your family, how much income you earn, and the amount of your adjusted gross income.

If you are eligible for the EITC, you may be entitled to a larger credit for tax years 2009 and 2010. For taxpayers with three or more eligible children, the credit percentage used to calculate the EITC is increased to 45 percent (instead of 40 percent). For married taxpayers, the phase-out amount is increased to \$5,000 more than the amount used for other taxpayers (instead of \$3,000 more), adjusted for inflation for 2010. Thus, for tax years beginning in 2009, the following amounts are used in determining a taxpayer's earned income tax credit:

Single, Surviving Spouse, or Head of Household

Number of Qualifying Children	Earned Income Amount	Credit Percentage	Maximum Credit Amount	AGI Phaseout Range
One	\$8,950	34%	\$3,043	\$16,420 —\$35,463
Two	\$12,570	40%	\$5,028	\$16,420 —\$40,295
Three or More	\$12,570	45%	\$5,657	\$16,420 —\$43,281
None	\$5,970	7.65%	\$457	\$7,470 —\$13,440

Married Filing Jointly

Number of Qualifying Children	Earned Income Amount	Credit Percentage	Maximum Credit Amount	AGI Phaseout Range
One	\$8,950	34%	\$3,043	\$21,420 —\$40,463
Two	\$12,570	40%	\$5,028	\$21,420 —\$45,295
Three or More	\$12,570	45%	\$5,657	\$21,420 —\$48,281
None	\$5,970	7.65%	\$457	\$12,470 —\$18,440

Refundable Child Tax Credit Increased

If you have children younger than 17, you may be eligible for a larger child tax credit for 2009 and 2010. As under current law, you can claim \$1,000 for each child, but this amount is decreased if you make more than \$110,000 and file a joint return, \$75,000 and are single, or \$55,000 and are married but file separately. The good news is that the new law increases the amount of the credit that is refundable to you if the credit exceeds your tax liability. For 2009 and 2010, the credit is refundable to the extent of 15 percent of your earned income in excess of \$3,000 (instead of \$8,500 for 2008, or \$12,550 for 2009 under prior law).



Example

In 2009, Jane Allen has two children and earned income of \$10,000. She has no other income and no alternative minimum tax liability. Jane is not entitled to any nonrefundable personal credits other than the child tax credit. She files as a head of household and, therefore, is entitled to a standard deduction of \$8,350. She is also entitled to a personal exemption of \$3,650 for each family member, for a total of \$10,950. Jane has no taxable income and no tax liability.

Her nonrefundable child tax credit would be equal to \$2,000 (\$1,000 per child); however, the nonrefundable credit is limited to the amount of tax liability, or zero in Jane's case. The refundable credit is equal to the lesser of either the unclaimed portion of the nonrefundable credit amount (\$2,000) or 15 percent of Jane's earned income that exceeds \$3,000 — \$1,050 ($(\$10,000 - 3,000) \times 15\%$). Jane's total refundable credit is \$1,050. Jane receives \$950 (\$2,000 - 1,050) less than the full \$2,000 child tax credit; if the threshold amount had not been reduced for 2009, Jane would have received no child tax credit.



Comment

The effect of reducing the earned income threshold for computing the refundable child tax credit is an increase in the amount of the refundable child tax credit for more taxpayers. Fifteen percent of the difference between \$12,550 and \$3,000 (\$9,550) is \$1,432.50, and therefore the maximum refundable child tax credit increase in 2009 and 2010 will not exceed \$1,432.50 for any taxpayer.



Comment

Unless Congress changes the law, the refundable portion of the child tax credit is set to disappear after 2010, and the amount you can claim per child is set to decrease to \$500.



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Credit for First-Time Homebuyers Extended and Expanded

If you buy a house in 2009 before December 1, you may be eligible for the newly expanded First-Time Homebuyers Credit. This credit, which was to expire June 30, 2009, has been extended through November 30, 2009 — and has been made significantly more attractive.

You can now claim \$8,000 (up from \$7,500) or 10 percent of the purchase price, whichever is lower. If you are married and file a separate return, however, the most you can claim is \$4,000 (up from \$3,750). As under prior law, the credit is phased out for taxpayers with adjusted gross income over \$75,000 (\$150,000 for married taxpayers filing jointly).

Perhaps more significant is the fact that the credit is no longer treated as a zero-interest loan that must be paid back over 15 years. Instead, the credit needs to be paid back only if, within 36 months of purchasing the home, you either sell it or you (and your spouse) stop using it as your principal residence.



Comment

Even though the credit is available for houses purchased in 2009, you can claim the credit on your return for 2008 by electing to treat the purchase as occurring in 2008. This election will not affect the application of the 15-year repayment provision — it will not apply to purchases in 2009 even if they are treated as occurring in 2008 for purposes of claiming the credit in 2008.

The credit can now be claimed for the purchase of a residence financed by the proceeds of a mortgage revenue bond.

For residents of Washington, D.C., this credit is now the default credit, instead of the \$5,000 credit solely for D.C. first-time homebuyers. Under the prior law, D.C. homebuyers were entitled to the D.C. credit, not the first-time homebuyer credit. However, no first-time homebuyer credit is available to any taxpayer who claimed the D.C. homebuyer credit in any prior year.

American Opportunity Tax Credit

The new law provides a temporarily enhanced Hope scholarship credit for 2009 and 2010, called the American Opportunity tax credit.

The enhanced credit is available for a higher amount of tuition, is available for up to the first four years of post-secondary education and for additional expenses, and is available to taxpayers who may not have been able to claim it for prior years because of the adjusted-gross-income limitation.



Comment

The enhanced credit is only available for tuition and related expenses paid in 2009 or 2010 for education furnished to the student in an academic period beginning in 2009 or 2010. Many institutions require payment for a spring semester before the end of December in the prior year. For example, the tuition for a spring semester beginning in January 2009 may be due in December 2008. Under these circumstances, the tuition paid in December 2008 is not eligible for the enhanced credit because it was not paid in 2009.

Amount of the credit. The enhanced credit is allowed for the first 100 percent of qualified tuition and related expenses up to \$2,000, and 25 percent of the qualified tuition and related expenses for the next \$2,000, for a total of \$2,500 a year. In contrast, under prior law, the Hope credit was equal to 100 percent of the first \$1,000 of qualified tuition and related expenses and 50 percent of the next \$1,000 of such expenses, both adjusted for inflation to \$1,200 for 2009, so that the maximum credit per student for 2009 was \$1,800.



Comment

In 2009, you can claim a larger Hope scholarship credit of up to \$3,600 with respect to students attending educational institutions in the Midwestern disaster area. You can elect to waive the American Opportunity credit and claim the larger credit.

Additional expenses. In general, the Hope scholarship credit is available for qualified tuition and related expenses, which include the tuition and fees required to be enrolled at or attend a particular institution. The IRS has stated that expenses for room and board are not included in qualified tuition and related expenses, and books and classroom supplies and equipment are not considered qualified tuition and related expenses unless payment for such expenses must be made directly to the educational institution for the student to enroll and attend classes at the institution.

The enhanced credit is specifically made available for books and other required course materials.

Available for four years of post-secondary education. The Hope scholarship credit is available for up to two years for any student, and only for expenses paid for the first two years of post-secondary education. The enhanced credit applies to the first four years of a student's post-secondary education for 2009 and 2010.

Income phase-out. You may be able to claim the American Opportunity tax credit even if you have been unable to claim the Hope scholarship credit because of the adjusted gross income (AGI) phaseout. The American Opportunity tax credit is phased out for

taxpayers with AGIs between \$80,000 and \$90,000 (\$160,000 and \$180,000 in the case of a joint return). In comparison, the Hope scholarship is phased out starting at \$50,000 (\$100,000 for joint returns).

Alternative minimum tax. The American Opportunity tax credit can offset the alternative minimum tax even in years in which most personal credits cannot.



Comment

Another provision of the new law provides that all personal credits offset the AMT in 2009. Thus, this rule applies only in 2010.

Credit is refundable. In addition, 40 percent of the credit is refundable — in other words, a taxpayer claiming the credit can receive a refund greater than the amount of tax liability. However, this does not apply in the case of a child whose income is subject to tax at his parent's income tax rate — generally, any child under age 18 or any child under age 24 who is a student providing less than one-half of his or her own support, who has at least one living parent, and who does not file a joint return.

Income and Deductions

Tax on Purchase of New Vehicle

Starting on February 17, 2009, both itemizers and non-itemizers are allowed a deduction for sales and excise taxes incurred on the purchase of a new motor vehicle, motorcycle, or motor home during 2009.



Comment

Motor vehicles include passenger vehicles, light trucks, and SUVs.

If you are an itemizer, the new law expands the definition of deductible taxes to include qualified motor vehicle taxes, which are state or local sales or excise taxes imposed on the purchase of a qualified motor vehicle. Until now, you generally could deduct these taxes only if you elected to deduct state and local sales taxes in lieu of state and local income taxes — and even then, only certain sales taxes were deductible.

If you are a non-itemizer, the new law adds a new motor vehicle sales tax deduction to the standard deduction.



Comment

For both itemizers and non-itemizers, the deduction can be claimed in computing both regular tax and alternative minimum tax liability.

The deduction is not without limitations. First, the amount of tax you can deduct is limited to the tax on the first \$49,500 of the purchase price. In the case of a car, truck, SUV, or motorcycle, the gross vehicle weight rating must not exceed 8,500 pounds. In addition, the deduction is phased out for taxpayers with modified adjusted gross income between \$125,000 and \$135,000 (\$250,000 and \$260,000 in the case of a joint return). Finally, the increased standard deduction is not available if you make the election to deduct sales tax rather than income taxes for the year.



Comment

A proposed deduction for car loan interest was not included in the final version of the Act.

Qualified Tuition Programs (Section 529 Accounts)

Distributions for qualified tuition programs (Section 529 accounts) are tax-free if they are used to pay a beneficiary's qualified educational expenses. Other distributions are included in the beneficiary's income and are subject to a penalty.

In general, qualified educational expenses are tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution, certain expenses of special-needs beneficiaries, and room and board expenses for students enrolled at least half time. However, for 2009 and 2010, the new law expands the definition of qualified educational expenses to include the purchase of computer technology or equipment, as well as Internet access and related services, if they are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is enrolled at an eligible educational institution. These expenses may include expenses for computer software, computer or peripheral equipment, and fiber optic cable related to computer use. However, the expansion does not apply to expenses for software designed for sports, games, or hobbies unless it is primarily educational in nature.

Parity for Qualified Transportation Fringe Benefits

The Act provides some good news for employees who commute to work by mass transit or vanpool: It temporarily boosts the monthly exclusion for employer-provided transit and vanpool benefits to the same level as the exclusion for employer-provided parking.

Employer-provided qualified transportation fringe benefits are excluded from an employee's gross income for income tax purposes and from the employee's wages for payroll tax purposes. Qualified transportation fringe benefits include qualified parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. The exclusions for parking, transit passes, and vanpool benefits are subject to monthly dollar limits that are indexed for inflation each year. For 2009, up to \$230 a month of employer-provided parking is excludable from income — but under the rules in effect prior to the Act, the exclusion for employer-provided transit and vanpool benefits for 2009 was limited to \$120 a month.

The new law temporarily increases the monthly exclusion for employer-provided transit and vanpool benefits to the same amount as the exclusion for employer-provided parking, effective for months beginning after February 17, 2009 and before January 1, 2011. Thus, in cases where excludable qualified transportation fringe benefits are calculated on a calendar-month basis, the aggregate monthly excludable amount for March 2009 through December 2009 for employer-provided transit and vanpool benefits is \$230 a month. For months in 2010, the monthly excludable amount will be equal to the 2010 inflation-adjusted monthly limit on excludable qualified parking.



Comment

Under regulations, in calculating excludable qualified transportation fringe benefits, a month is a calendar month or a "substantially equivalent period applied consistently."

Exclusion of Gain From the Sale of Qualified Small Business Stock

Individuals may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years. The taxable portion of the gain is taxed at a maximum rate of 28 percent, and 7 percent of the excluded gain is an alternative minimum tax preference. The portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of 28 percent under the AMT. Thus, gain from the sale of qualified small business stock is taxed at effective rates of 14 percent under the regular tax and 14.98 percent, 17.92 percent, or 19.98 percent under the alternative minimum tax depending on the dates of acquisition and disposition. The amount of gain eligible for the exclusion by an individual with respect to any corporation is limited to the greater of (1) 10 times the taxpayer's basis in the stock, or (2) \$10 million.

Under the Act, the percentage exclusion for qualified small business stock sold by an individual is increased to 75 percent for stock issued after February 17, 2009 and before January 1, 2011. As a result, gain from the sale of this qualified small business stock is taxed at effective rates of 7 percent under

regular tax and 12.88 percent under the alternative minimum tax.

Unemployment Compensation

In general, unemployment compensation is included in gross income for federal tax purposes. However, under the new law, you can exclude up to \$2,400 in unemployment compensation you receive during 2009. Amounts in excess of that amount remain fully taxable.

AMT Relief

Increased Exemption Amounts

If you're one of the many taxpayers who is subject to the alternative minimum tax (AMT), you will be pleased to know that the new law increases the exemption amounts for tax years beginning in 2009. The increased exemption amounts for 2009 are:

- \$70,950 for married individuals filing a joint return and surviving spouses;
- \$46,700 for unmarried individuals; and
- \$35,475 for married individuals filing a separate return.



Comment

The \$40,000 exemption amount for corporations and the \$22,500 exemption amount for estates and trusts remain unchanged for tax years beginning in 2009.



Comment

The new law gives the growing number of individuals otherwise subject to AMT only a one-year reprieve. Unless the increased exemption amount is further extended, the AMT exemption amounts for individuals are scheduled to revert, for tax years beginning after 2009, to the amounts that applied before the 2001 tax year. Thus, the exemption amounts would go back to: (1) \$45,000 for married individuals filing a joint return and surviving spouses, (2) \$33,750 for unmarried individuals, and (3) \$22,500 for married individuals filing a separate return.

Nonrefundable Credits

For 2009, you may continue to claim all non-refundable personal tax credits in full for purposes of the AMT, as well as for purposes of the regular income tax. If Congress does not extend this provision, after 2009, only a handful of these credits will be allowed against the AMT. However, the Act expands the credits allowed after 2009 to include:

- the American opportunity tax credit,
- the credit for certain plug-in electric vehicles, and
- the alternative motor vehicle credit.



Comment

Before the Act, only the adoption, child, saver's, residential energy efficient property, and qualified plug-in electric drive motor vehicles credits could be claimed for purposes of the AMT after 2009.

AMT Limitations on Tax-Exempt Bonds

In general, interest on tax-exempt bonds known as private activity bonds is exempt from federal income tax, but is included in income as a preference item for alternative minimum tax (AMT) purposes. The new law removes this interest as a tax preference for bonds issued in 2009 and 2010. Similarly, for corporations, the interest earned on these bonds is not included in the AMT adjustment based on current earnings.



Comment

Private activity bonds are municipal bonds used to finance residential mortgages, redevelopment in blighted areas, manufacturing facilities, student loans, or various facilities owned or used by private entities, including mass transit, water treatment, sewage disposal, and solid waste disposal facilities.



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Depreciation and Expensing

Increased Section 179 Deduction

In lieu of depreciation, a taxpayer with a relatively small capital budget can elect to write off the cost of a limited amount of property for the year it is placed in service, rather than treating it as a capital expense. In general, the amount for which this election is available is limited to \$125,000, phased out to the extent the total amount of property placed in service exceeds \$500,000. However, for 2008, these amounts were increased to \$250,000 and \$800,000, respectively.

The new law extends these higher amounts for 2009. Thus, for tax years beginning in 2009, a taxpayer may expense up to \$250,000 of qualifying property. This amount is reduced, but not below zero, by the amount by which the cost of the qualifying property placed in service during the tax year exceeds \$800,000.

Section 179 property is depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in tax years beginning before 2010 is also treated as Section 179 property.

Bonus Depreciation

The 50 percent first-year bonus depreciation deduction for qualified property placed in service in 2008 (2009 for certain property with longer production periods and certain noncommercial aircraft) is extended to property placed in service in 2009 (2010 for certain property with longer production periods and certain noncommercial aircraft). The bonus depreciation allowance is available for property whose original use begins with the taxpayer and (1) is depreciable under MACRS and has a recovery period of 20 years or less, (2) is MACRS water utility property, (3) is off-the-shelf computer software depreciable over three years, or (4) is qualified leasehold improvement property.



Caution

Property that must be depreciated using the alternative depreciation system (ADS) does not qualify. In addition, listed property (e.g., a passenger automobile) that is used 50 percent or less for business and intangible property does not qualify.

Qualified property must also meet time requirements with respect to use and acquisition to be eligible. The original use of the property must commence with the taxpayer after December 31, 2007, and before January 1, 2010. The property must be acquired by the taxpayer after December 31, 2007, and before January 1, 2010, but only if no written binding contract for its acquisition was in effect before January 1, 2008, or acquired by the taxpayer as the result of a written binding contract entered into after December 31, 2007, and before January 1, 2010.



Comment

Taxpayers may elect not to take the allowance.

Election to Accelerate AMT and Research Credits in Lieu of Bonus Depreciation

Corporations otherwise eligible for the 50 percent first-year bonus depreciation could elect to accelerate the AMT or research credits for eligible qualified property placed in service after March 31, 2008, and before January 1, 2009. Corporations may now make this election with respect to property placed in service in 2009 that qualifies for the 50 percent first-year bonus depreciation allowance (extension property). A corporation had to make the acceleration election for its first tax year ending after March 31, 2008, to apply for that year and each subsequent year, even if it did not place in service any eligible qualified property in its first tax year ending after March 31, 2008. Taxpayers that did not make the previous acceleration election may make the election with

respect to extension property placed in service in its first tax year ending after December 31, 2008, and each subsequent year.



Comment

S corporations and their shareholders may also make this election.

The increases in the allowable credits are treated as refundable for purposes of this provision. The research or minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of the bonus depreciation for certain eligible qualified property that could be claimed absent an election under this provision.

Gains and Losses

Maximum Five-Year Carryback of Net Operating Losses of Small Businesses

In general, NOLs may be carried back two years. However, corporations, partnerships, and sole proprietorships can elect to carry NOLs for any tax year beginning or ending in 2008 back three, four, or five years. This applies only to businesses that meet a \$15-million-or-less gross-receipts test. There are also several helpful transition rules:

- Taxpayers may revoke any prior election made to waive the carryback of NOLs by 60 days after the date of enactment of the new law.
- Any election to increase the carryback period under this provision is treated as timely if made before the date that is 60 days after the new law is enacted.

- Any application for a tentative carryback adjustment with respect to the loss is treated as timely if filed before the date that is 60 days after the new law is enacted.



Comment

The carryforward period for 2008 NOLs remains 20 years.

The \$15 million gross-receipts test is met for any prior tax year if the average annual gross receipts for the business for the three-tax-year period ending with the tax year does not exceed \$15 million. If the business was not in existence for the entire three-year period, then the test is applied for the period during which the business was in existence. Gross receipts for a short tax year of less than 12 months are annualized by multiplying the gross receipts for the short period by 12 and dividing the result by the number of months in the short period. Gross receipts of predecessor entities are taken into account. In determining whether a partnership meets the gross-receipts test, the gross receipts of corporate partners are not taken into consideration.

Gross receipts include total sales, amounts received for services, income from investments, and any income from incidental or outside sources. Gross receipts are reduced by returns and allowances made during the year, but not by the cost of goods or certain capital assets sold. However, the basis of capital assets or property used in the trade or business and disposed of during the year reduces the amount of gross receipts. Taxes for which the taxpayer is the withholding

agent also reduce the amount of gross receipts, but taxes for which the business is directly liable do not. Finally, gross receipts do not include repayment of a loan or similar instrument.



Compliance Tip

Only one election can be made: either to extend the carryback period for a tax year ending in 2008 or to extend the carryback period for a tax year beginning in 2008.



Example

Badger Manufacturing Co., an eligible small business, has a fiscal year that ends on September 30. It has suffered losses for the past 18 months, and the losses are expected to continue for at least another year. Badger's 2008 NOL eligible for the extended carryback is its NOL for the tax year that began October 1, 2007, and ended September 30, 2008. However, it may also elect an extended carryback of its NOL for the tax year that begins October 1, 2008, and ends September 30, 2009.

The election must be made by the due date, including extensions, for filing the taxpayer's return for the tax year of the NOL. The election is irrevocable. The IRS will provide additional procedures for making the election.

The IRS is authorized to issue anti-abuse rules that may include anti-stuffing rules, anti-churning rules, and rules similar to the wash sales rules to prevent misuse of the extended NOL carryback election.

S Corporations: Built-in Gains Tax

S corporations are subject to the built-in gains (BIG) tax during the 10-year recognition period following the S election. The BIG tax applies to S corporation gain that arose prior to the conversion of the C corporation, and with respect to net recognized built-in gain attributable to property received by an S corporation from a C corporation in a carryover basis transaction. The Act provides relief from the BIG tax by providing that in the case of any tax year beginning in 2009 or 2010, no BIG tax is imposed if the seventh tax year in the recognition period preceded the tax year.



Comment

The reduction in the recognition period applies separately with respect to any asset acquired in a carryover basis transaction. Thus, for a tax year beginning in 2009 or 2010, in the case of gain that arose before the conversion of a C corporation to an S corporation, no built-in gain tax will be imposed on the corporation after the seventh tax year that the S corporation election is in effect. With respect to built-in gain attributable to an asset received by an S corporation from a C corporation in a carryover basis transaction, no tax will be imposed on the corporation if the gain is recognized after the date that is seven years following the date on which the asset was acquired. Shareholders will continue to take into account all items of gain and loss.

Other Business Provisions

Incentives to Hire Unemployed Veterans and Disconnected Youth

The work opportunity tax credit is available on an elective basis for employers hiring individuals who are members of one or more targeted groups. In general, the credit is equal to 40 percent of the first \$6,000 of qualified wages paid to an individual during the first year of employment. However, the credit is reduced to 25 percent of the qualified first-year wages for an employee who works 400 hours or less during the first year of employment. The credit may not be claimed for qualified wages paid to an employee who works less than 120 hours in the first year of employment.

Under the new law, the targeted groups are expanded to include unemployed veterans and disconnected youths who are hired during 2009 or 2010.

An unemployed veteran must have been discharged or released from active duty in the Armed Forces at any time during the five-year period ending on the hiring date and in receipt of unemployment compensation for at least four weeks during the one-year period ending on the hiring date.

A disconnected youth is an individual who is (1) between 16 and 25 years old on the hiring date; (2) not regularly attending secondary, technical, or post-secondary school and not regularly employed during the six-month period preceding the hiring date; and (3) not readily employable by reason of lacking a sufficient number of basic skills.

An employer cannot treat an individual as a member of a targeted group unless:

- (1) the employer has received certification from a designated local agency (e.g., a state employment agency) on or before the date the individual begins work that the individual is a member of a targeted group; or
- (2) a pre-screening notice for the individual has been completed by the employer on or before the date the individual is offered employment, and the employer submits that notice to the designated local agency as part of a certification request by the 28th day after the individual begins work.

Estimated Tax for Individuals with Income From Small Businesses

To the extent income tax is not collected through withholding, taxpayers must make quarterly estimated payments of tax based on their required annual payment. The required annual payment generally is the lesser of 90 percent shown on the return, or 100 percent of the tax shown on the return for the preceding tax year (110 percent if the adjusted gross income for the preceding year exceeded \$150,000).

For tax years beginning in 2009, the new law decreases the required estimated tax payments for qualified individuals with income from small businesses. For these individuals, the required annual estimated tax payment for tax years beginning in 2009 is not greater than 90 percent of the tax liability shown on the return for the preceding tax year.

A qualified individual is any individual with adjusted gross income of less than \$500,000 (\$250,000 if married filing separately) for the preceding tax year. The individual must certify that more than 50 percent of the gross income on the preceding year's

return is income from a small trade or business (a business that employs no more than 500 persons, on average, during the calendar year ending in or with the preceding tax year).



Comment

The IRS will prescribe regulations that govern the form, manner, and time of certification.

Deferral of Cancellation-of-Indebtedness Income on Repurchase of Debt

In general, taxpayers must recognize income immediately when their debt is cancelled or satisfied at less than its full amount.



Comment

Cancellation-of-indebtedness income is particularly burdensome because transactions that cause such income do not normally provide cash to pay the tax.

To address this issue, the new law permits certain business taxpayers that reacquire their own debt at less than face value in 2009 or 2010 to elect to defer the resulting income and recognize it over a five-year period beginning in 2014.

This provision is available to C corporations and any other person that issued debt in the course of a trade or business. Debt for this purpose includes bonds, debentures, notes, certificates, or any other instrument or contractual arrangement constituting indebtedness. Debt is considered reacquired if it is

repurchased, completely forgiven, contributed to capital, or exchanged for new debt or for stock or an interest in an entity, including in an exchange resulting from a modification.

The election to defer COD income is to be made on an instrument-by-instrument basis. Once made, the election is irrevocable. A taxpayer makes an election with respect to a debt instrument by including with its return for the tax year in which the reacquisition of the debt instrument occurs a statement that clearly identifies the debt instrument, and includes the amount of deferred income under this provision, plus any other information the IRS may prescribe. The IRS is authorized to require reporting of the election (and other information with respect to the reacquisition) for years subsequent to the year of the reacquisition.



Comment

In the case of a pass-through entity, such as a partnership or S corporation, the election is made at the entity level.

If a taxpayer elects to defer discharge-of-indebtedness income, the exclusions for discharge under a Chapter 11 bankruptcy, when the taxpayer is insolvent, qualified farm indebtedness, and qualified real property business indebtedness do not apply to the income from the discharge of indebtedness for the tax year of the election or any subsequent tax year. Thus, for example, an insolvent taxpayer may elect to defer income from the discharge of indebtedness rather than excluding the income and reducing tax attributes by a corresponding amount.

Any amount that has not yet been included in income will be included in the year in which a taxpayer dies, liquidates, or sells all its assets, including in Chapter 11 bankruptcy, ceases to do business, or is in similar circumstances.



Comment

The new law also modifies the rules on original issue discount on certain high-yield obligations.

Withholding Tax on Government Contractors

The Act delays for one year the implementation of a 3 percent withholding requirement on certain payments made by governmental entities to government contractors. The withholding requirement, originally scheduled to apply to payments made after December 31, 2010, is now scheduled to apply to payments made after December 31, 2011.

Once it takes effect, the withholding requirement will apply to certain payments made by the U.S Government, every state, every political subdivision thereof, and every instrumentality of the foregoing (including multi-state agencies), to persons providing property or services. The withholding requirement applies regardless of whether the governmental entity making the payment is the recipient of the property or services.

Payments subject to the withholding requirement include any payment made in connection with a government voucher or certificate program that functions as a payment for property or services. For example, payments to a commodity producer under a government commodity support program are subject to the

withholding requirement. Present law also imposes information reporting requirements on the payments that are subject to withholding requirement.

The 3 percent withholding requirement does not apply to:

- any payments made through a federal, state, or local government public assistance or public welfare program for which eligibility is determined by a needs or income test;
- payments of wages or to any other payment with respect to which mandatory or voluntary withholding applies under present law; and
- payments from which amounts are actually being withheld under backup withholding rules.

Political subdivisions of states (or any instrumentality thereof) with less than \$100 million of annual expenditures for property or services that would otherwise be subject to withholding are exempt from the withholding requirement.

ENERGY

Individual Energy Provisions

Credit for Residential Energy Property Extended and Modified

As an incentive to make your home more energy efficient, the new law extends the residential energy property credit through 2010 and also makes the credit more attractive. Under the old law, the credit was limited to 10 percent of certain costs and to a fixed amount of other costs. Now, however, you can claim a credit for 30 percent of the cost of installing energy efficient improvements and energy efficient property,

such as certain insulating materials, windows, exterior doors, metal roofs, circulating fans, boilers, heat pumps, air conditioners, and heaters. The amount of the credit that can be claimed by any taxpayer is limited to a total of \$1,500 for 2009 and 2010.

The new law also modifies the energy efficiency standards for many types of property effective as of the date of enactment of the new law. The new law requires that: heat pumps, central air conditioners, and insulation meet certain energy standards in effect for 2009; water heaters have an energy factor of at least 0.82 or a thermal efficiency of at least 90 percent; the 0.75 thermal rating of wood stoves be measured using a lower heating value; natural gas furnaces and propane furnaces have an annual fuel utilization efficiency rate of not less than 95; and gas hot water boilers, propane hot water boilers, oil furnaces, and oil hot water boilers have an annual fuel utilization rate of not less than 90. Also, the new law creates stricter requirements for exterior windows and doors by requiring that they have a U-factor at or below 0.30 and a seasonal heat gain coefficient (SHGC) at or below 0.30.



Comment

If you hit the previous \$500 lifetime maximum in 2006 and/or 2007, you can now incur additional qualifying property costs in 2009 and/or 2010 and be eligible for a credit of up \$1,500 over both years. The credit was not available in 2008.

Credit for Residential Energy Efficient Property Increased

From 2006 through 2016, you can claim a credit for 30 percent of the cost of installing solar electric property or a fuel cell power plant to generate electricity for your home, or for installing solar water heating property to heat water in your home. Also, from 2008 through 2016, you can claim the credit for 30 percent of the cost of installing a small wind turbine to generate electricity for your home or for installing a geothermal heat pump system to heat or cool your home. The amount you can claim had been capped depending on the type of property you are installing, but the new law largely removes these caps, effective for 2009. The only cap remaining in place is for fuel cells, which remains limited to \$500 with respect to each 0.5 kilowatt of capacity (\$1,667 with respect to each 0.5 kilowatt in the case of a house that is jointly occupied and used by multiple people).



Example

Jim bought a qualified heat pump for his family home in January of 2009 at a cost of \$10,000. In May of 2009, he spent \$21,000 on an 8 kilowatt fuel cell power plant for his home. In 2009, Jim is entitled to a credit of \$11,000 ($(\$10,000 \times .30 = \$3,000) + (\$500 \times 16 = \$8,000)$).



Comment

The caps were \$2,000 per year with respect to solar water heating property or geothermal heat pump property (\$6,667 in the case of a house that is jointly occupied and used by multiple people); and \$500 per year with respect to each 0.5 kilowatt of capacity of wind turbines (\$1,667 with respect to each 0.5 kilowatt of capacity in the case of a house that is jointly occupied and used by multiple people). For wind turbines, the credit could not to exceed \$4,000 a year.

Alternative Vehicle Refueling Station Credit Increased

The new law expands the alternative vehicle refueling station credit for 2009 and 2010. For 2009 and 2010, the credit is now allowed for 50 percent of the cost (increased from 30 percent) of installing property that refuels vehicles that run on electricity, ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or any mixture of biodiesel and diesel fuel, up to a maximum credit amount of \$50,000. For hydrogen-related property, the credit remains 30 percent of the cost, but the cap has been increased to \$200,000. For nonbusiness taxpayers that want to install refueling property for their own use, the maximum credit has been increased to \$2,000 (up from \$1,000) for non-hydrogen-related property.



Comment

The credit is set to end after 2010 except for property that refuels hydrogen vehicles, for which the credit is available through 2014.

Plug-in Electric Drive Motor Vehicles

Starting in 2009, you can claim a credit for the purchase of new plug-in electric drive motor vehicles. The new law significantly modifies and expands credits related to these vehicles. It modifies the existing credit for such vehicles, starting in 2010. It also adds a new credit for two-wheeled, three-wheeled, and low-speed plug-in electric vehicles. Finally, it adds a credit for conversion kits.

Modified credit for new qualified plug-in electric drive motor vehicles. The Act modifies the existing credit for qualified plug-in electric drive motor vehicles, effective for vehicles acquired after December 31, 2009, repeals the scheduled expiration of the credit, and replaces the phase-out provision based on total number sold with a phase-out provision based on the number sold by individual manufacturers.

The modified credit is available for new motor vehicles you purchase for use or lease, not for resale. To qualify, the vehicle must have a gross vehicle weight rating of less than 14,000 pounds and be propelled to a significant extent by an electric motor drawing electricity from a battery with a capacity of at least 4 kilowatt hours that can be recharged from an external source of electricity. In addition, it must be in compliance with the applicable provisions of the Clean Air Act.



Comment

A motor vehicle for this credit is any vehicle manufactured primarily for use on public streets, roads, and highways that has at least four wheels. Other types of vehicles may qualify for the new "credit for certain plug-in electric vehicles," discussed below.

The base amount of the credit is \$2,500, which applies if the vehicle's battery has a capacity of 4 kilowatt hours. To that base amount is added (1) \$417 for a vehicle drawing propulsion energy from a battery with at least five kilowatt hours of capacity, plus (2) \$417 for each additional kilowatt hour of capacity in excess of five kilowatt hours, up to a total of \$5,000. Thus, the maximum allowable credit for any new qualified plug-in electric drive motor vehicle is \$7,500 (\$2,500 base amount, plus up to \$5,000 additional credit based on battery capacity).

The credit is phased out for vehicles sold by any manufacturer that has sold at least 200,000 qualified vehicles for use in the United States after 2009. The phase-out period for a particular vehicle begins with the second calendar quarter following the quarter that includes the first date on which the number of new qualified vehicles manufactured by the manufacturer of that particular vehicle and sold for use in the United States after December 31, 2009, is at least 200,000. The credit is reduced to 50 percent of the otherwise allowable credit amount for the first two quarters of the phaseout period and 25 percent for the third and fourth quarters of the phaseout period. Thereafter, there is no credit allowed.

The credit is treated as part of the general business credit to the extent the vehicle is eligible for depreciation. The nonbusiness portion of the credit will be treated as a nonrefundable personal credit. This means that, to the extent permitted at the time, you can use it to offset regular tax liability and alternative minimum tax liability. The amount of any deduction or other credit allowable for a new qualified plug-in electric drive motor vehicle must be reduced by the

amount of the new qualified plug-in electric drive motor vehicle credit allowed under these rules.



Comment

The original version of the qualified plug-in electric drive motor vehicle credit, as enacted in the Emergency Economic Stabilization Act of 2008, continues to apply for qualified plug-in electric drive motor vehicles placed in service in 2009. For 2009, the base amount of the credit is \$2,500 and the maximum credit is between \$7,500 and \$15,000, depending on gross vehicle weight and the kilowatt hour battery capacity in excess of 4 kilowatt hours. This original credit was scheduled to terminate after 2014.

New credit for certain plug-in electric vehicles. The Act adds a new credit equal to 10 percent of the cost of acquiring certain electrically powered two-wheeled vehicles, three-wheeled vehicles, and low-speed vehicles, up to a maximum of \$2,500 after February 17, 2009 and before 2012. However, it is not available for a vehicle purchased in 2009 if the vehicle qualifies for the “qualified plug-in electric drive motor vehicle” credit (discussed above) as in effect in 2009.

To qualify for this new credit, the vehicle must be a “qualified plug-in electric vehicle,” which means:

- The vehicle must have two or three wheels, or be a “low speed vehicle,” which is one that has four wheels, a maximum speed attainable in one mile of no more than 25 miles an hour on a paved level surface, and a gross weight of less than 3,000 pounds.
- The vehicle must be made by a manufacturer.

- The vehicle must be acquired for use or lease by the taxpayer, and not for resale.
- The original use must begin with the taxpayer.
- The vehicle must be manufactured primarily for use on public streets, roads, and highways.
- The vehicle must have a gross vehicle weight rating of less than 14,000 pounds.
- The vehicle must be propelled to a “significant extent” by an electric motor drawing power from a battery that can be recharged from an external source with a “battery capacity” (defined below) of not less than (1) four kilowatt hours in the case of low speed vehicles, or (2) two and one-half kilowatt hours in the case of a two- or three-wheeled vehicle.

The credit is treated as part of the general business credit to the extent the vehicle is eligible for depreciation. The nonbusiness portion of the credit will be treated as a nonrefundable personal credit. This means that, to the extent permitted at the time, you can use it to offset regular tax liability and alternative minimum tax liability. The amount of this credit claimed for a specific vehicle reduces the amount of any other credit or deduction the taxpayer may take on the same vehicle.

New credit for plug-in electric drive motor vehicle conversion. A new credit is available for the cost of converting any motor vehicle into a qualified plug-in electric drive motor vehicle. The conversion credit is equal to 10 percent of the cost of converting the vehicle, up to \$40,000, for a maximum credit of \$4,000. The credit is available for property placed in service after February 17, 2009, but will not apply to conversions made after December 31, 2011.



Comment

The vehicle for which the conversion credit is claimed generally must satisfy the qualified plug-in electric drive motor vehicle requirements that are in effect during the tax year the credit is being claimed.

However, the requirements that the original use of the vehicle must begin with the taxpayer and that the vehicle must be made by a manufacturer do not apply to the plug-in conversion credit.

The conversion credit is treated as part of the alternative motor vehicle credit and may be claimed even if another alternative motor vehicle credit was claimed for the same motor vehicle in any preceding tax year.

Alternative Motor Vehicle Credit as Nonrefundable Personal Credit Against AMT

For tax years beginning after December 31, 2008, the alternative motor vehicle tax credit is treated as a nonrefundable personal tax credit. This means that, to the extent permitted at the time, you can use it to offset regular tax liability and alternative minimum tax liability.

The alternative motor vehicle credit is available for each new qualified fuel cell vehicle, hybrid vehicle, advanced lean burn technology vehicle, and alternative fuel vehicle placed in service by the taxpayer during the tax year. In general, the credit amount varies depending on the type of technology used, the weight class of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, for some vehicles, the estimated lifetime fuel savings. The credit generally is available for vehicles purchased

after 2005. The credit terminates after 2009, 2010, or 2014, depending on the type of vehicle, and is subject to phaseout based on the number of vehicles sold by the manufacturer.

Business Energy Provisions

Several Act provisions modify credits for energy providers.

Energy Portion of Investment Credit

The investment credit is comprised of several credits including the energy credit. The Act provides taxpayers with a new election, and makes two other changes to the energy credit.

Energy credit election. Taxpayers may now make an irrevocable election to have certain qualified facilities placed in service in 2009 through 2013 (through 2012 for wind facilities) be treated as energy property eligible for a 30 percent investment credit. Qualified facilities are facilities otherwise eligible for the renewable electricity production credit (other than refined coal, Indian coal, and solar facilities), but for which no credit was allowed. Property eligible for the credit is tangible personal or other tangible property (not including a building or its structural components) and with respect to which depreciation or amortization is allowable, but only if the property is used as an integral part of the qualified facility.

Energy cap for small wind energy property. The \$4,000 credit cap applicable to qualified small wind energy property is eliminated for any qualified property if the construction, reconstruction, or erection is completed by the taxpayer after 2008, or is placed in service by the taxpayer after 2008.

Basis reduction for subsidized financing. No basis reduction is required for periods after December 31, 2008, if the property is financed in whole or in part by subsidized energy financing or with proceeds from private activity bonds.

Renewable Electricity Production Credit

In general, the placed-in-service date for qualified facilities that produce electricity from renewable resources is extended to 2013 (2012 for a qualified wind facility).

INVESTORS

Mutual Funds Not Required to Pass Tax Credit Bond Credits Through to Investors

Under the new law, a regulated investment company (RIC), commonly known as a mutual fund, can elect to pass through to its shareholders credits attributable to tax credit bonds it holds. This provision replaces one under which the credits were required to be passed through, under rules to be provided by the IRS.

If the election is made, the RIC is not allowed any credits attributable to the tax credit bonds and includes in gross income, as interest, the amount of income the RIC would have included if the election did not apply, increasing the amount of the dividends paid deduction by the same amount. The shareholders include in income their proportionate share of the interest income attributable to the credits and are simultaneously allowed the proportionate share of credits.



Comment

The seemingly complicated process of including the interest in income and then allowing a dividends-paid deduction for an equal amount is meant to assist a RIC in satisfying its qualification requirements. Without this process, a RIC would have to satisfy requirements through other holdings that bear sufficient interest or other similarly passive income. Ultimately, this allows a RIC to be formed that consists entirely of investments in tax credit bonds.

The prior law requiring the credits to be passed through continues to apply to real estate investment trusts (REITs).

HEALTH

COBRA Premium Assistance

The Act enhances COBRA continuation coverage by offering a premium subsidy for eligible individuals who are involuntarily terminated from their employment. An eligible individual is treated as having paid the premium required for coverage if the individual pays 35 percent of the premium. In effect, the individual is provided with a 65-percent reduction in premiums for the first nine months for which COBRA coverage is required. The employer is reimbursed for the premium not paid in the form of a credit against payroll taxes.

Generally, the premium-reduction amount is excluded from the eligible individual's gross income.

If a premium subsidy is provided to an individual during a tax year in which the individual's modified adjusted gross income exceeds \$125,000 (\$250,000 in the case of a joint return), the individual must repay all or a portion of the subsidy provided in that year. The mechanism for repaying the subsidy is an increase in the individual's tax liability for the year equal to the amount of the subsidy. The amount of the subsidy that must be repaid is phased in for individuals whose modified AGI does not exceed \$145,000 (\$290,000 in the case of a joint return).

Health Coverage Tax Credit

As part of an overhaul of the Trade Adjustment Assistance programs, which provide workers, firms, and farmers who are negatively affected by trade with government funded adjustment assistance, the Act makes a number of changes to the health coverage tax credit to make the credit more favorable for eligible individuals and their qualifying family members, including an increase in the amount of the credit.