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Money in Your Pocket

Advice From Your Trusted Advisor on Making the Most of Stimulus Tax Breaks

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American Recovery and Reinvestment Act of 2009

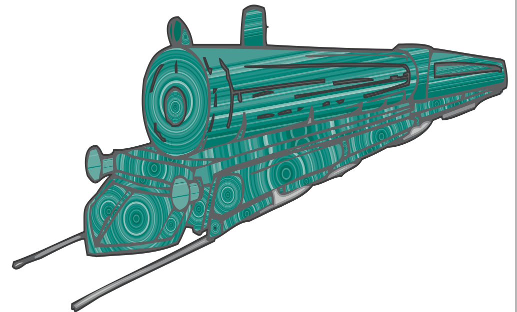
Faster, Slimmer Stimulus Payments

In the **Economic Stimulus Act of 2008** (Stimulus Act), most taxpayers were given stimulus payments of $600 each to spur a sputtering economy. Generally, they received another $300 for each child under age 17. Some low-income retirees received $300. In 2009, with the U.S. economy still struggling, the **American Recovery and Reinvestment Act of 2009** (Recovery Act) provides another round of stimulus payments. There are some key differences in this year's law.

Making work pay

The new law provides two years of stimulus payments for most workers and their spouses. In 2009 and 2010, working individuals get a refundable tax credit of up to $400, while married couples filing jointly get a refundable tax credit up to $800. (There are no tax credits for children.)

Technically, this tax credit is calculated at a rate of 6.2% of earned income: 6.2% is the amount of tax withheld from workers' paychecks for Social Security. Thus, this tax credit effectively offsets a worker's contributions to Social Security. The tax credit generally will be distributed to workers via reduced paycheck withholding on the first $6,452 of earnings ($12,904 for married couples filing joint tax returns). You probably have seen this increase in your paychecks already because the federal government wanted the economic stimulus to take effect as soon as possible. With $800 in annual savings, a married couple will have about $65 per month in extra take-home pay. (New withholding tables for employers are available at *www.irs.gov/pub/irs-pdf/n1036.pdf*.)



Self-employed individuals and other workers who do not receive paychecks will not get these stimulus payments via withholding. Instead, they can claim the tax credits on their 2009 and 2010 tax returns. If you pay quarterly estimated income tax, contact our office for help in adjusting your payments to account for this tax savings.

The Stimulus Act's payments were not extended to high-income taxpayers, and this year's law has similar constraints. The new tax credits phase out for taxpayers with modified adjusted gross income (MAGI) in excess of $75,000 ($150,000 for married couples filing jointly). If your MAGI is over $95,000 ($190,000 on joint returns), you will get no tax credit. Also, nonresident aliens, estates, trusts, and people who are claimed as dependents on someone else's tax return will not get these making work pay tax credits.

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Payout to pensioners

Recipients collecting Social Security, Supplemental Security Income, Railroad Retirement benefits, and Veterans' Disability Compensation benefits will get a one-time payment of $250 ($500 to married couples if both spouses qualify) in 2009. Similarly, federal and state pensioners who are not eligible for Social Security retirement benefits will receive a one-time refundable tax credit of $250 in 2009. These $250 payments won't be withheld from paychecks, so they'll be distributed in the same manner (generally, direct deposit) as the 2008 stimulus payments.

The payout will be limited to $250 per person, even for those who receive more than one of the benefits listed in the preceding paragraph. What's more, people who get this one-time $250 benefit will get a $250 reduction of any making work pay tax credit to which they would be entitled.

Raising Tax Relief for Higher Education

The American opportunity tax credit is in effect for 2009 and 2010. For those years, most taxpayers who pay tuition and related expenses for post-high school education can claim a tax credit of up to $2,500. The tax credit will be equal to 100% of the first $2,000 of higher education expenses and 25% of the next $2,000 of those expenses. Outlays for course materials such as books are included among the costs eligible for the credit.

The American opportunity tax credit is actually an enhanced 2009–2010 substitute for the Hope education tax credit, which has been in effect for many years. While the Hope tax credit has a maximum of $1,800 per year and is limited to the first two years of college, the two-year temporary American opportunity tax credit has a $2,500 annual maximum for expenses incurred in up to four years of college. Also, the Hope tax credit doesn't cover expenses for course materials.

Taxpayers who don't owe enough tax to take the full credit can get a refund of up to 40% of the credit for which they qualify.

Example: Laura Lancaster qualifies for a $2,500 American opportunity tax credit in 2009. However, Laura's federal income tax liability is only $1,500 this year. Thus, the American opportunity tax credit completely offsets her tax liability, with $1,000 left over. Laura will receive a $1,000 refund (40% of her $2,500 tax credit) from the IRS.

The American opportunity tax credit is subject to a phaseout for taxpayers with modified adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly).

If you're paying higher education bills in 2009, 2010, or both, you probably can choose among the American opportunity credit, the lifetime learning credit, and an above-the-line tuition deduction. You'll typically enjoy the greatest tax benefit by selecting the American opportunity credit; our office can help you with that decision.

Laptop largesse

Another two-year tax break (2009 and 2010) applies to computers bought for higher education. This year and next, you can take tax-free withdrawals from 529 college savings plans for the purchase of computers and related equipment, as well as for Internet access for students and their families. In prior years (and in years after this provision expires), such outlays qualify for tax-free 529 plan withdrawals only if they're required by the college as a condition of enrollment or attendance.

Even before this new law was passed, the federal government had been trying to make 529 plans more user friendly. For example, the IRS issued Notice 2009-01, which permits investors in 529 plans to switch the investment options on their existing contributions twice each year. This notice applies only to 2009; otherwise, 529 account owners may switch investment options only once per year. In 2009, at least, 529 plan investors have more flexibility to help them cope with difficult market conditions.

First Time Homebuyers Get a Real Tax Credit

In last year's **Housing and Economic Recovery Act of 2008**, Congress provided certain home purchasers with a "tax credit" of 10% of the home's price, up to $7,500. Homebuyers who had not owned and occupied a house as a principal residence in the three years before the purchase were eligible.

In reality, this tax break was not a true tax credit. Instead, qualified homebuyers received an interest-free loan from the federal government. That is, they received up to $7,500 upfront in tax savings, an IRS refund check, or both. However, taxpayers receiving that $7,500 were scheduled to repay that amount in higher taxes—$500 per year for 15 years. If those taxpayers sold the house within 15 years, repayment would be accelerated.

Raising the cap, forgiving repayment

The Recovery Act modifies the homebuyers tax credit. The cap is now $8,000 on qualified home purchases over $80,000. (For less expensive homes, the tax credit is 10% of the price.) In addition, qualified homebuyers will not have to repay the $8,000 tax credit as long as they stay in the house as owners for at least 36 months. This credit amounts to an $8,000 discount on the home's price, courtesy of the federal government.

Example: Mark and Claire Collins buy their first home for $100,000 and qualify for an $8,000 tax credit. Without this tax credit, they would have owed $1,000 when they filed their federal income tax return. The $8,000 tax credit completely offsets their $1,000 tax obligation, so they'll owe no income tax with their return. In addition, they'll get a $7,000 refund from the IRS for a total tax savings of $8,000.

Sooner or later

Now that two laws have included a tax credit for homebuyers who have not owned and occupied a principal residence in the previous three years, there are two sets of tax benefits:

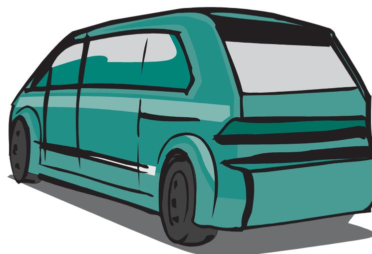
- *For qualified home purchases that closed from April 9, 2008–December 31, 2008*. Taxpayers in this category can get a credit up to $7,500. They must repay the amount received under this provision over 15 years, or sooner if they sell their home.
- *For qualified home purchases that closed or will close from January 1, 2009–November 30, 2009.* Taxpayers in this category can get a credit up to $8,000. They will have no repayment obligation after they have owned and occupied the home for 36 months. (If they sell or move out within 36 months, they must repay the amount received under this provision.)

Taxpayers in either of these two categories face the same income limits. To get the full credit, a single taxpayer can have modified adjusted gross income (MAGI) no higher than $75,000; married couples filing joint tax returns can have MAGI up to $150,000. With MAGI up to $95,000 ($170,000 on joint returns), qualified homebuyers can get partial credits.

All qualified taxpayers may claim the appropriate credit on their 2008 tax return. If you have already filed your 2008 return and have not claimed the credit, our office can help you file an amended return. Alternatively, you can wait until you file your 2009 return to claim this tax credit.

Auto Buyers Get a Break, Too

Congress not only enhanced the tax benefit offered to first time homebuyers in the Recovery Act, it also added a tax incentive for most purchasers of new vehicles. If you pay state or local sales and excise taxes, you may get a federal income tax deduction for the amount you pay. You can take such a deduction "above the line," meaning that it goes on the front page of your tax return. Such deductions reduce your adjusted gross income, which may help you claim more credits and deductions elsewhere on your tax return. You can take above-the-line deductions even if you don't itemize deductions on Schedule A of your 1040. The above-the-line sales tax deduction for a vehicle purchase



can reduce your alternative minimum tax (see related article on page 10), as well as your regular income tax.

The above-the-line deduction for vehicle sales tax applies to tax paid on the purchase of new cars, light trucks, and motorcycles weighing no more than 8,500 pounds; this deduction also applies to new motor homes. You must purchase or have purchased the vehicle from February 17, 2009–December 31, 2009. You won't get an above-the-line sales tax deduction for leasing a vehicle.

Over the limit

You may deduct the sales tax you pay on a purchase price up to $49,500; if you pay more for the vehicle, you'll get a partial deduction.

Example: Jerry Harris pays $60,000 for a sports car plus $2,400 (4%) in sales tax. Jerry can deduct $1,980 (82.5% of $2,400) because $49,500 is 82.5% of $60,000.

This deduction is phased out for taxpayers with modified adjusted gross income (MAGI) over $125,000 ($250,000

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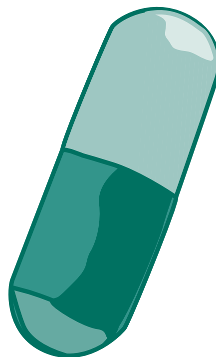
for married couples filing a joint return). If your MAGI is over $135,000 ($260,000 filing jointly), you can't use this above-the-line tax break. If you qualify, you can claim it on your 2009 tax return. However, you won't be able to take the above-the-line deduction if you also claim an itemized deduction for state and local sales taxes.

On the other hand, if you do claim an itemized deduction for state and local sales taxes, you can deduct the sales tax paid for a vehicle on Schedule A, and this deduction won't be subject to the limits previously mentioned. Typically, you'll find the standard sales tax you can deduct, based on your income and place of residence, in an IRS table and then add the sales tax paid on certain big-ticket items to get your total itemized sales tax deduction.

Health Care Help for Former Employees

With the economy in recession, unemployment has increased. For many people, the loss of a job also means losing health insurance. To help people maintain coverage through their employer after being laid off, the Recovery Act provides a 65% subsidy for Consolidated Omnibus Budget Reconciliation Act (COBRA) continuation premiums for up to nine months. This 65% subsidy applies not only to COBRA, a federal law, but also to any similar laws on the state level.

Under COBRA, if you were a participant in your former employer's health insurance plan, you can extend your group health coverage after leaving the company. You have to pay the entire premium, which might be steep, plus administrative costs. COBRA coverage is generally limited to 18 months. The new law will make it easier for workers who lose their jobs to afford nine months of COBRA payments.



Example: William Patterson lost his job in January. He had health insurance for his family through that job. Under COBRA, William is entitled to maintain his health coverage for 18 months if he pays the full price. If the full price of his COBRA is $1,000 per month (approximately the national average), William can purchase his coverage for 35% of the full price ($350 per month) for up to nine months. His former employer will be required to pay the remaining $650 per month (65%) during that period. However, his employer effectively will be reimbursed via federal tax credits against the income tax withholding and payroll taxes it normally remits to the federal government.

To qualify for this subsidy, a worker must be or have been involuntarily terminated from a job between September 1, 2008 and December 31, 2009. Individuals must have modified adjusted gross income (MAGI) of no more than $125,000 ($250,000 for joint filers) in any year they receive this subsidy to get the full amount. With MAGI up to $145,000 ($290,000 on joint returns), a partial subsidy is available. The subsidy will terminate in fewer than nine months if the worker is offered employer-sponsored health care coverage or becomes eligible for Medicare.

Your Retirement

How the Bear Market Affects Your Retirement

For investors, 2008 was one of the worst years since the 1930s. How this market dive affects your retirement plans depends largely on your stage in life.

Young workers

If you are 15 or more years from retirement, recent market turmoil actually may be beneficial. There are several reasons for this counterintuitive result:

1. **Modest losses.** Many young workers have used their earnings to repay student loans, save up to buy a house, and pay the expenses of starting a family. As a result, they may have only small investment portfolios. The less you had invested prior to last year's crash, the less you have lost, in absolute dollars.

2. **More time for recovery.** With 15 or more years to retirement, you probably will have ample time for your investments to recover before you'll tap your portfolio. If markets stay down for some time, you'll have an extended opportunity to invest at low prices. By investing regularly, perhaps through a 401(k) plan, you can build up a low-cost portfolio in anticipation of the next bull market.

3. **Lessons learned.** Investment markets' performance in 2008 illustrates the importance of diversification. You should not load up on shares of your employer because that company stock could fall sharply. Also, you should include not only stocks but also high quality bonds or bond funds in your portfolio because such bonds provided a valuable cushion last year.

Preretirees

The closer you are to retirement, the more you'll feel the impact of a plummeting portfolio. You may have suffered greater losses after many years of investing, and you'll have fewer years to rebuild your retirement fund. As you approach retirement, your planning becomes a numbers game. Will you be able to stop working and still afford your customary lifestyle? One way to approach this calculation is to assume you'll need as much spending money in retirement as you need before retirement. You won't have to save for retirement, however.

Example #1: Kim Grant, age 62, earns $100,000 per year and contributes $20,000 to her 401(k) plan. Once Kim stops working, she won't continue those contributions. Thus, Kim figures she can retire comfortably on $80,000 per year. Kim calculates how much she can expect from Social Security by looking at the estimates of benefits she receives each year from the Social Security Administration. Then Kim eyes other likely sources of retirement income: a pension, earnings from part-time consulting, and so on.

Kim then can estimate the amount she can safely withdraw from her investment portfolio. Many financial advisors tell people retiring in their mid-60s to start with a 4% withdrawal. Then retirees can increase the annual withdrawal amount to keep pace with inflation. Such a strategy probably will keep an investment portfolio intact for 25–30 years.

Example #2: Suppose that Kim Grant estimates she will receive $30,000 per year from Social Security and other nonportfolio sources of income. Her retirement fund is now $500,000. Withdrawing 4% of $500,000 in Year 1 of her retirement would give her $20,000. Altogether, Kim can count on $50,000 of cash flow when she retires. Assuming she wants $80,000 of cash flow to maintain her lifestyle in retirement, Kim might have to keep working for several more years. Extending her career may increase Kim's Social Security benefits and allow her to make substantial contributions to her retirement fund.

Example #3: Assume the same facts as in Example 2, except that Kim has a $1 million portfolio. If she retires now and withdraws $40,000 (4%), Kim will have $70,000 of cash flow in Year 1, close to her $80,000 target. Thus, Kim may be able to retire in a few years if she puts more money into her retirement fund and her investments recover to some extent.

If you are thinking about retiring soon, our office can go over your specific situation and help you decide if you need to keep working in order to build a larger retirement fund.

Retirees

If you already are retired, you may have been tapping your portfolio for spending money. Your previous actions probably will influence what you can do in the future.

Example #4: Larry and Jill Martin retired a few years ago with $1 million in investments. They started with a $40,000 (4%) portfolio withdrawal and have increased that withdrawal each year to match annual inflation rates. After last year's bear market, the Martins' portfolio is down sharply. If they keep up their practice of increasing withdrawals to match inflation, their 2009 withdrawal will be about 5.5% of their portfolio. Although cutting their withdrawals may help in the long run, the Martins can maintain their spending if they'd like. The so-called "4% rule,"based on historic patterns of investment returns, generates a high probability that a portfolio will remain intact for 25–30 years.

On the other hand, suppose that the Martins started with a $70,000 (7%) withdrawal and have made similar withdrawals during their retirement. With their depleted portfolio, keeping up this pace of withdrawals might mean spending over 10% of what's left this year. If they continue to spend at that level, the Martins run a risk of depleting their retirement fund.

Again, our office can help you determine a reasonable level of portfolio withdrawals during your retirement.

Money in Your Pocket

Advice From Your Trusted Advisor on Making the Most of Stimulus Tax Breaks

A Holiday for Required Minimum Distributions

At year-end 2008, the **Worker, Retiree, and Employer Recovery Act of 2008** became law. Among its many provisions, this new law suspends required minimum distributions (RMDs) from traditional IRAs, 401(k)s, and other retirement accounts for 2009.

Relief from the 50% penalty

Individuals older than 70½ generally are required to take at least a certain amount from their retirement plans each year. An IRS table determines the RMD. Any shortfall is subject to a 50% penalty. In 2009, however, there will be no RMD and no 50% penalty.

Example: Beth Williams is a 76-year-old widow. She had $400,000 in her IRA at year-end 2008. At her age, IRS tables require Beth to withdraw at least 1⁄22 of her IRA. Thus, Beth normally would have had to take $18,182 from her IRA in 2009, even if she didn't need the money. If Beth had failed to make any withdrawal, she would have owed a $9,091 (50%) penalty.

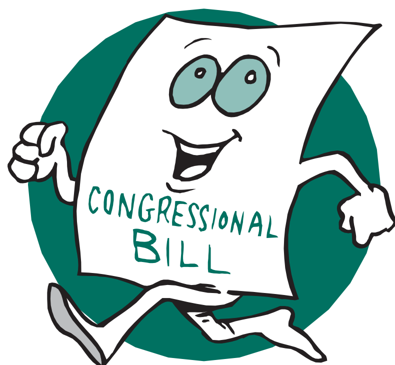
The new law was spurred by Congress's belief that seniors such as Beth might have to sell securities at low prices in order to meet the RMD rules. Therefore, pursuant to the new law, those rules are not in effect this year. Beth can leave her IRA untouched, if she wishes, and hope that the securities inside her account regain some of their lost value.

Still a taxing issue

As you can see, this RMD relief affects seniors who need to take little or nothing from their IRAs. Retirees who need to tap their IRAs for living expenses can do so; they'll owe ordinary income tax on all withdrawals, as before. What's more, Congress has not relaxed the 10% penalty on withdrawals from IRAs and other retirement accounts before age 59½. If you need to tap your retirement funds before that age, ask our office for details on how you may be able to avoid owing the 10% surtax.

Nonspouse beneficiaries get a benefit

A less publicized but perhaps even more important provision of the new law affects nonspouse beneficiaries of employer-sponsored retirement plans. Many of these plans have forced such beneficiaries to withdraw the inherited funds within a relatively short time period, thus limiting ongoing tax deferral.



The Pension Protection Act of 2006 allowed such nonspouse beneficiaries to roll over an account from an employer-sponsored plan to an IRA. Subsequently, these beneficiaries can stretch distributions over their life expectancy for more tax deferral. After the Pension Protection Act was passed, however, the IRS released Notice 2007-7, which indicated that the nonspouse stretchout was discretionary. According to this notice, employers could choose whether to allow such a stretchout or force nonspouse beneficiaries to withdraw the money more rapidly.

Some observers believed that the IRS notice was contrary to Congress's intent. In this new law, Congress has confirmed that all employers must offer a stretchout to nonspouse beneficiaries. However, employers don't have to include the stretchout option until 2010. In 2009, employers may insist upon a faster payout.

Roth IRA rescue

Another provision of the new law affects participants in Roth 401(k) and Roth 403(b) plans. Participants in these plans contribute after-tax dollars. After five years and age 59½, all distributions from a Roth 401(k) or Roth 403(b) are tax free. Often, taxpayers who expect to be in a higher tax bracket in retirement (such as young workers with relatively low salaries) are better off in a Roth 401(k) or Roth 403(b) plan than in a traditional 401(k) or 403(b) plan.

When you leave an employer, you are eligible to roll your Roth account to a Roth IRA or to another employer's Roth retirement plan. Many participants prefer the Roth IRA because they have more control over their investments. Roth IRAs have the same requirements (five years, age 59½) for tax-free withdrawals.

Because of a glitch in the tax law, though, taxpayers with modified adjusted gross income (MAGI) over $100,000 could not roll over a Roth 401(k) or Roth 403(b) to a Roth IRA in 2009. The new law says that such rollovers are permitted for all taxpayers, including those with MAGI over $100,000, in 2009. In addition, the new law confirms that such rollovers won't trigger taxable income.

Your Estate

Employing the Expanded Estate Tax Exemption

If you're reading this, you may have qualified for a tax break worth hundreds of thousands of dollars. No, the previous sentence is not an Internet come-on. It refers to the laws on federal estate taxes, which changed when 2009 began. In 2009, the federal estate tax exemption rose from $2 million to $3.5 million per person. The federal estate tax rate remains at 45%. President Obama has indicated that he would like to keep the exemption and tax rate at current levels. If that proves to be the case, many families will benefit from huge tax savings.

Example #1: Bill Wilson is a widower with a $4 million estate. He has been seriously ill. If Bill had died in late 2008 and left everything to his children, his estate would have been $2 million over the limit. At a 45% rate, his estate would have owed $900,000 in federal estate tax. Suppose, instead, that Bill did not die until January 2009, when he had that same $4 million estate. This year, Bill's estate is only $500,000 over the $3.5 million limit, so it will owe only $225,000 in federal estate tax. Extending his life from one year to the next saved Bill's heirs $675,000 in tax.

Prudent planning

Your estate plan should incorporate the increased exemption.

Example #2: Joanne Adams is a widow with a $3 million estate. Her estate will owe no federal estate tax when she dies. Thus, she can plan the distribution of her assets without considering the impact of federal estate tax.

The estates of single taxpayers worth over $3.5 million may owe federal estate tax. If such people won't need all of those assets during their lifetimes, they might shrink their estates by making gifts. In 2009, the annual gift tax exclusion increased from $12,000 to $13,000 per recipient. Within that $13,000 limit, a gift has no tax consequences as long as the recipient has a present interest in the gift: he or she must have immediate access to the transferred assets.

Example #3: Michael and Dayna Young have an estate that's far in excess of $7 million. Therefore, they have transferred assets between them so that both spouses have more than $3.5 million in assets. Each spouse can leave at least $3.5 million to their children (or to trusts for the children). Therefore, the Youngs can leave $7 million to their children, free of federal estate tax.

Caught in the middle

"Such married couples should look at formula clauses in their wills and trusts," says Steve Siegel, president of The Siegel Group in Morristown, NJ, a consulting firm specializing in tax and estate planning. "A document drafted in the last 10 years may have been intended to create a trust holding $600,000–$2 million at the death of the first spouse. Now this trust might hold $3.5 million."

Couples with estates in this range may want to revise their estate plans. They can decide how much should be left to the surviving spouse and how much might be left to other heirs in order to use the estate tax exemption of the first spouse to die.

Siegel also notes that some states have estate taxes with lower exemptions. "Someone might leave an estate that generates no federal estate tax," he says, "but that estate could owe hundreds of thousands of dollars in state death tax." Therefore, a married couple might construct their estate plan so that the first spouse to die leaves to nonspousal heirs the amount of assets that will be exempt from federal and state estate tax, with the balance going to the surviving spouse.

Why? Assets left to a spouse avoid estate tax, so no estate tax will be due at the first spouse's death. The surviving spouse, who probably will have ample assets for living expenses, can spend down or give away assets to reduce estate tax at the second death, if that is a concern.

Business—Growth and Taxes

Businesses Get Some Breaks

Several business tax breaks expired at the end of 2007 or were scheduled to expire at the end of 2008. The **Emergency Economic Stabilization Act of 2008** extends some of those tax benefits:

- **Research credit.** The new law restores the research credit for 2008 and 2009. This credit generally is 20% of incremental research expenses.

In 2007, there had been two other ways to figure the research credit besides the 20% solution: an alternative incremental research credit and an alternative simplified credit. Under the new law, the alternative incremental research credit has been repealed. Moreover, the alternative simplified credit has been increased to 14% of qualified research expenses that exceed 50% of the average qualified research expenses for the three preceding years. In 2007, the credit percentage had been 12%.

- **Amortization for leasehold and restaurant improvements.** The 15-year amortization period for qualified leasehold and qualified restaurant improvements was extended for 2008 and 2009. Without this special treatment, such expenditures must be depreciated over 39 years. The same 15-year amortization period applies to certain improvements to retail space in 2008 and 2009.
- **New markets credit.** This credit, which is designed to encourage investments and loans to small businesses located in economically distressed areas, has been extended for 2008 and 2009.
- **Deduction for energy-efficient commercial building property.** The deduction for owners of commercial building property had been set to expire at the end of 2008; it has been extended through 2013. The deduction may be as much as $1.80 per square foot for a building that meets certain energy usage standards. There is a modified deduction of 60 cents per square foot for a commercial building that attains some measure of energy efficiency but not enough to warrant the $1.80 per square foot deduction.
- **Credit for manufacturers of certain energy-efficient appliances.** The credit for manufacturing certain appliances, including clothes washers, dishwashers, and refrigerators, has been extended through 2009 or 2010, depending upon the appliance.
- **Renewable energy.** The credit for producing electricity from qualified wind facilities will run through 2009. The credit for producing electricity through biomass and other qualifying renewable sources will run through September 30, 2011. The credit for solar energy, fuel cell, and microturbine property will run through 2016.
- **Domestic production activities deduction.** Starting in 2010, the domestic production activities deduction is set to rise from the current 6% rate to 9%. The new law retains the 6% rate for oil and gas production. This 6% rate applies to qualified production activities income from producing, refining, processing, and transporting or distributing oil or gas, or any primary product of oil and gas.
- **Charitable contributions.** There are four tax extensions relating to charitable contributions by businesses, as follows:

1. **Basis adjustment required for S corporation shareholders for corporate donations of appreciated property.** Pursuant to the S corporation rules made by the Pension Protection Act, for 2006 and 2007, the amount of the shareholder's basis reduction in the stock of an S corporation will be equal to his or her pro rata share of the adjusted basis of the contributed property. The new law extends this treatment for two more years. Please contact us if you would like to discuss how this provision may apply to you.
2. **Donating computers and peripherals to schools and libraries.** This break, which applies only to C corporations, has been extended through 2008 and 2009. A special rule allows donors to increase their deduction by 50% of the difference between the basis and the fair market value of the computers, but not by more than 200% of the basis of the computers.
3. **Contributing food inventory.** This deduction, which is calculated in the same way as the deduction for computer donations by C corporations, can be used by any business entity. The food must be wholesome and meet all labeling standards.
4. **Contributing books to qualifying schools.** Again, this deduction is enhanced the same way as the deduction for computer donations by C corporations—but it is not limited to C corporations. A company seeking this deduction must give books to a public school, grades K–12, for use in an education program.

A Bigger Incentive to Invest in Small Companies

The tax code includes several incentives to invest in small businesses. Section 1202, one of those incentives, has provided individual investors a 50% tax exclusion on gains from selling certain small business stock. The Recovery Act increases the tax exclusion from 50% to 75% on gains from the sale of such stock issued after the date of enactment (February 17, 2009) and before January 1, 2011.

Until the Recovery Act was passed, § 1202 effectively limited the tax rate on qualified sales to 14% (50% of a 28% rate in effect during prior years). Under the new law, with a 75% exclusion, you would owe only 7% in tax on qualified sales: 25% of that former 28% rate. If you'd rather not pay 7%, you can roll over any gains and defer the tax bill.

Example: Cindy Roberts invests $50,000 in a small company and receives stock issued in 2009. She sells that stock in 2016 for $150,000. Section 1202 permits Cindy to exclude 75% of her $100,000 gain: $75,000. The other $25,000 of gain will be taxed at 28% under § 1202, so Cindy owes only $7,000 in tax on her $100,000 gain. Cindy also has the option of reinvesting her $100,000 gain in another small company and deferring all tax on her gain.

To get this tax break, you must meet the following conditions:

- You must invest in a domestic C corporation and receive stock in the company's original issue.
- The gross assets of the company can't exceed $50 million before or right after issuance.
- The company must be in a qualified trade or business. The IRS defines "qualified trade or business" as excluding the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, farming, hotel services, restaurant services, and the production or extraction of minerals, oil, or natural gas.
- You must hold the stock for five years before selling.
- The amount of gain eligible for the § 1202 exclusion is limited to the greater of 10 times the investor's basis in the stock or $10 million.

Going for more gains

If you invest in a company that meets the preceding conditions and you hold this qualified small business stock for more than six months, you can roll over any capital gain on a sale of the stock into another qualified small business within 60 days. The tax can be deferred, and the ultimate sale can qualify for the § 1202 tax exclusion.

The expansion of § 1202 can help small companies attract investors. Therefore, if you start a new business between now and the end of 2010, you should consider choosing C corporation status. You'll give up the tax benefits of an S corporation or a limited liability company, both of which let you avoid corporate income tax and deduct company losses on your personal tax return. With a C corporation, however, you might find it easier to raise needed capital.

Turning Losses Into Gains

In most cases, a company that sustains a net operating loss (NOL) may carry back that loss to the prior two taxable years and use the NOL to offset taxable gains that the company reported. Such a company could recover income tax it had paid for those years. If this company does not fully use up its NOL with a two-year carryback, it can carry forward the remaining NOL to each of the succeeding 20 taxable years to offset future gains.

The Recovery Act changes the treatment of NOLs incurred in 2008, but only for companies with gross receipts of $15 million or less. If your company is in that category, it can carry back a 2008 NOL and recover income tax paid in the previous five years. If your company already has filed its 2008 return showing an NOL, our office can help you start the process to receive a refund of taxes previously paid.

Money in Your Pocket

Advice From Your Trusted Advisor on Making the Most of Stimulus Tax Breaks

Encouraging Equipment Expenditures

The Recovery Act also extends some tax benefits designed to increase the purchase of business equipment and thus stimulate economic activity. One provision involves § 179 of the tax code, which allows small companies to buy business equipment and take an upfront tax deduction rather than recovering those outlays over several years.

In 2008, Congress increased the maximum first year "expensing" election from $128,000, indexed for inflation, to $250,000. This year's Recovery Act retains the $250,000 cap for 2009; the new law also keeps the 2008 phaseout threshold at $800,000 for 2009.

Example #1: ABC Corp. spends $350,000 on business equipment in 2009. It can immediately deduct $250,000.

Example #2: XYZ Corp. spends $1 million on business equipment in 2009. The company's expenditures are $200,000 over the $800,000 phaseout threshold, so its expensing election is reduced by $200,000: from $250,000 to $50,000.

As you can see, if a company spends $1,050,000 or more on equipment this year, no expensing will be permitted.

A bonus for business

In the preceding discussion, ABC Corp. had $100,000 of equipment purchases in 2009 that it could not deduct via § 179, and XYZ Corp. had $950,000 of purchases that it could not deduct. The new law extends another tax benefit—"bonus depreciation"—which covers such outlays. Under this provision, property purchased and first placed in service in 2009 for use in the U.S. may qualify for 50% first year depreciation if it can't be expensed.

Example #3: As illustrated, XYZ Corp. buys $1 million worth of equipment this year. It can expense $50,000 worth. Of the other $950,000, it can take another $475,000 (50%) deduction for bonus depreciation. Of the remaining $475,000, XYZ can deduct $95,000 (20%), assuming the property qualifies for a 20% first year writeoff under prior law. Thus, XYZ Corp. can deduct $50,000 plus $475,000 plus $95,000, for a total of $620,000 out of the $1 million it spends on equipment in 2009. The Recovery Act also retains the limitation imposed on sport utility vehicles, which have a § 179 expensing limit of $25,000.

The new law also retains first year writeoffs of around $11,000 for cars, vans, and light trucks purchased in 2009 and used primarily for business. This is another form of bonus depreciation initiated in 2008.

AMT

Another Patch for the AMT

Virtually every year, Congress raises the amount of income that's exempt from the alternative minimum tax (AMT). The Recovery Act raises the AMT exemption amounts for 2009 to $70,950 for joint filers and $46,700 for single taxpayers. In 2008, those numbers were $69,950 for joint filers and $46,200 for single taxpayers.

Without the annual patch, the AMT exemption amounts would drop to much lower levels. Therefore, lawmakers state that this year's version will keep 26 million taxpayers from paying the AMT.

Tax break for bonds

Some municipal bonds are issued by government agencies to fund private activities such as airports and waste disposal facilities. Investors who hold such private activity municipal bonds must pay tax on the interest if they owe the AMT, even though investors generally receive tax-exempt interest from municipal bonds.

In 2009, Congress excluded the interest paid by private activity housing bonds from the AMT. The new law excludes all other private activity bonds from the AMT as well, if those bonds are issued or (for private activity bonds issued after 2003) refunded during 2009 and 2010. This provision will benefit some investors who own municipal bonds and bond funds while stimulating the issuance of bonds that can fund such private activities.