

Numerous new business income tax provisions have been passed, all intended to stimulate the economy. Time will tell if the new rules will have the desired effect. However, small businesses can benefit currently with these new rules, detailed below. If you have any questions on these items, please contact one of the members of our tax team.

The American Recovery and Reinvestment Act of 2009 (the Recovery Act), which was signed into law on Feb. 17, 2009, makes a number of beneficial changes for business. Here is a review of the more widely applicable provisions that could have an impact on small businesses.

Liberal expensing limits continued for another year. The Recovery Act gave a one-year extension to enhanced expensing rules, which allow qualifying businesses the option to currently deduct the cost of business machinery and equipment, instead of recovering its cost via depreciation over a number of years. For tax years beginning in 2009, the **maximum amount that a business may expense is \$250,000**, and the expensing election begins to phase out when a business buys more than \$800,000 of expensing-eligible assets. These dollar limits are the same as those that were in effect for 2008. [Had the Recovery Act not been passed and signed into law, the dollar limits would have dropped this year to \$133,000 and \$530,000 respectively.]

Bonus first year depreciation extended for another year, too. Bonus depreciation was supposed to go off the books for most assets placed in service after 2008. Fortunately, the Recovery Act extends for another year the ability for businesses to take an extra “bonus” depreciation deduction for the first year new assets are placed in service. The **bonus first-year depreciation deduction generally equals 50% of the cost of qualified property** acquired and placed in service during 2009. In addition, the otherwise allowable first-year depreciation deduction for business autos first placed in service in 2009 is hiked by \$8,000 thanks to the Recovery Act. Note that Illinois and other states may not allow the bonus depreciation in the current year, necessitating annual adjustments to the state taxable income.

Small businesses may elect longer NOL carryback period. In general, net operating losses (NOLs) may be carried back two years and forward 20 years. For NOLs arising in a tax year beginning or ending in 2008, the Recovery Act permits small businesses to **elect to increase the NOL carryback period from two years to three, four, or five years**. A small business for this purpose is a trade or business (including one conducted in or through a corporation, partnership, or sole proprietorship) whose average annual gross receipts are \$15 million or less for the three-tax-year period (or shorter period of existence) ending with the tax year before the year in which the loss arose. The longer NOL carryback period gives small businesses that experienced losses the ability to get refunds of income taxes paid in earlier years. The refunds can be used to fund capital investment or other expenses. Note that the election for the carryback period must be made on the income tax return for the year of the NOL.

Deferred tax on debt forgiveness income when debt is repurchased. A business generally will wind up with debt discharge income if it repurchases its debt for less than the outstanding amount of the debt. For debt that is repurchased in 2009 or 2010, the Recovery

Act permits the tax that is owed on such debt discharge income to be paid over five years, beginning with 2014.

S corporation built-in gain holding period shortened temporarily. An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who pay tax on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate (currently 35%) on all gains that were "built-in" at the time of the election if the gains are recognized during a special holding period. This holding period is the first ten S corporation years. (Similar rules apply if an S corporation receives property from a C corporation in certain nontaxable transfers.) Thanks to the Recovery Act, for tax years beginning in 2009 and 2010, the special holding period is shortened to seven years.

Bigger exclusion for sale of qualified small business stock. Before the Recovery Act, individuals could exclude 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, a QSBS must meet a number of conditions (e.g., its gross assets cannot exceed \$50 million and it must meet active business requirements). Under the Recovery Act, the percentage exclusion for QSBS sold by an individual increases to 75% for stock acquired after Feb. 17, 2009 and before Jan. 1, 2011.

Reduced estimated taxes in 2009 for individuals with small businesses. To the extent that tax is not collected through withholding, taxpayers generally must make quarterly estimated payments of the "required annual payment." The required annual payment is the lesser of: (1) 90% of the tax shown on the return or (2) 100% of the tax shown on the preceding year's return (110% if adjusted gross income (AGI) for the preceding year exceeded \$150,000). The Recovery Act provides that for a tax year beginning in 2009, the required annual payment for individuals with small businesses is the lesser of (1) 90% of the tax shown on the return for the tax year, or (2) 90% of the tax shown for the preceding tax year. An individual qualifies for this relaxed estimated tax payment rule only if: AGI on preceding year's return is less than \$500,000 (\$250,000 if married filing separately); and at least 50% of the gross income shown on the previous year's return was from a small trade or business (one that employed no more than 500 people, on average, during the calendar year ending in or with the preceding tax year).

More workers eligible for work opportunity tax credit (WOTC). Employers that hire workers from one or more targeted groups (e.g., long term family assistance recipients) can claim a tax credit that varies with the type of person hired. For individuals beginning work for the employer after Dec. 31, 2008, the Recovery Act creates a new targeted group for the WOTC, consisting of unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010.

There are various other business rules that take effect in 2009 or later. If you have questions or opportunities for implementation of any of the foregoing, please allow us to assist you.