

TAXOLUTIONS



►► *ideas on taxes*

STIMULUS PACKAGE PROVIDES NEARLY \$300 BILLION IN TAX RELIEF

A sweeping \$787 billion stimulus package was signed into law by President Barack Obama on February 17. The American Recovery and Reinvestment Act of 2009 includes nearly \$300 billion in tax cuts intended to promote additional spending by individuals and businesses, make higher education more affordable, and encourage investment in clean-energy technologies.

These are some of the most significant tax provisions for individuals:

AMT Patch. To help shield middle-income taxpayers from the alternative minimum tax (AMT), the law increases AMT exemption amounts for 2009 to \$70,950 (up from \$69,950 in 2008) for joint filers and to \$46,700 (up from \$46,200 in 2008) for single filers. Without the enactment of a patch, the exemptions for 2009 would have reverted back to \$45,000 for joint filers and \$33,750 for single filers.

Making Work Pay credit. Under this provision, wage earners and the self-employed are permitted to claim a credit equal to the lesser of 6.2% of earned income, or up to \$400 a year for single filers or \$800 a year for joint filers in 2009 and 2010. However, the credit begins phasing out at an adjusted gross income (AGI) of \$75,000 for single filers and \$150,000 for joint filers. Rather

than sending out these rebates in the form of checks, employers will adjust the amount withheld from each paycheck, resulting in an increase in workers' take-home pay. Those who do not have taxes withheld by an employer during the year may claim the credit on their tax return. Self-employed taxpayers will be permitted to lower their estimated tax payments in 2009 and 2010.

One-time \$250 payment for individuals on fixed incomes. The package includes a one-time payment of \$250 to certain groups of people who are not wage earners, including retirees receiving Social Security, veterans receiving pension and disability benefits from the Veterans Administration, and individuals with disabilities receiving Supplemental

Security Income payments. Retired government workers will also receive a one-time payment of \$250.

Enhanced credits for families with children. The new law increases the amount of the Earned Income Tax Credit (EITC) for 2009 and 2010 to 45% of the first \$12,750 of earned income for taxpayers with three or more children. For 2009, the phase-out range for the EITC starts at \$21,420, or \$1,880 higher than in 2008, allowing more married couples with children to qualify.

In addition, the new law expands the Child Tax Credit to cover more families with low incomes in 2009 and 2010. The credit is refundable to the extent

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SMALL BUSINESSES BENEFIT FROM TAX BREAKS IN NEW LEGISLATION

In addition to providing tax breaks for individuals, the American Recovery and Reinvestment Act of 2009 (ARRA) contains a number of provisions that affect small businesses and employees, including additional tax relief for the unemployed, subsidies for COBRA benefits, transit benefit parity for employees, and an expansion of a tax credit for employers who hire disadvantaged workers. In addition, ARRA extends and enhances tax breaks for small businesses that invest in qualifying equipment and green energy production.

Here are some of the tax breaks aimed at small businesses and workers:

Bonus depreciation. For qualifying property bought and placed in service in 2009, small businesses have the option of depreciating 50% of the adjusted basis of the property, in addition to the usual depreciation that may be claimed for year one. This is an extension of the 50% bonus depreciation provision of the Economic Stimulus Act of 2008, which expired at the end of last year.

Credits in lieu of bonus depreciation. Companies that do not claim bonus depreciation are permitted under the new law to accelerate a portion of their AMT and research and development (R&D) credit carryovers for qualifying property placed in service in 2009. The amount of credit that may be accelerated is capped at the lesser of \$30 million or a company's historic accumulated AMT and R&D credits.

Extension of enhanced Section 179 expensing rules. In another extension of the 2008 stimulus legislation, the new law permits small businesses to expense up to \$250,000 of Section 179 property in 2009, equal to the amount permitted in 2008 and up from \$125,000 in 2007. Also as in 2008, the amount that may be expensed is reduced when the cost of the Section 179 property placed in service during 2009 exceeds \$800,000. If purchases exceed \$1,050,000, Section 179 expensing is not permitted.

Relief for the unemployed. Generally, unemployment benefits are considered taxable income. For 2009 only, the new law allows recipients to exclude from taxable income the first \$2,400 in unemployment benefits. ARRA also extends the Emergency Unemployment Compensation program, which had been due to expire at the end of March, until December 31, 2009. The program provides up to 33 weeks of benefits to unemployed workers. Under the legislation, weekly benefit payments will rise by \$25 per week.

ARRA also subsidizes the cost of health care coverage provided under the Consolidated Omnibus Budget Reconciliation Act of 1986 (COBRA), which allows individuals to remain enrolled in their company health plan for a period of time after leaving a job. Previously, terminated employees covered the full cost of the health plan premiums themselves. Under the new law, workers who are involuntarily separated from employment between September 1, 2008 and January 1, 2010 are given the option of paying just 35% of the cost of COBRA coverage for up to nine months. The former employer will be required to pay the remaining 65%, but will be reimbursed by the government through a payroll tax credit.

The COBRA premium assistance under ARRA applies to all group health plans currently subject to COBRA and to all forms of health care continuation coverage required by states. Individuals with higher incomes (starting at \$125,000 for the taxable year) will be required to repay all or a portion of the premium subsidies.

Mass transit benefits. Starting in March 2009, the new law increases the amount that may be excluded from taxable income of employees used to pay for qualified mass transit and van pools to \$230 per month, up from \$120 previously. This sum of \$230 is equal to the tax-free benefit for parking that employers may provide per employee, per month, through a qualified transportation plan.

Expansion of the Work Opportunity Tax Credit (WOTC). The WOTC, which provides businesses that hire members of certain "targeted groups" with a credit of up to \$2,400 per employee, is broadened under the provisions of ARRA to include unemployed veterans and "disconnected youth," or young people between the ages of 16 and 25 who have not been regularly employed or in school over the previous six months. The new categories apply to individuals who are hired and begin work in 2009 or 2010.

Net operating loss carrybacks of up to five years. Businesses are generally permitted to "carry back" net operating losses to the previous two tax years, which may generate a tax refund for a preceding year. Small businesses, defined as those that averaged less than \$15 million in gross receipts over the past three years, will be permitted under the new law to carry back 2008 losses for up to five years, instead of two. The normal carryback period of two years will apply to losses incurred in 2009.

Discharge of indebtedness. Under the new law, certain companies that buy back their debt at a discount in 2009 and 2010 only will be allowed to defer taxes until 2014 and then recognize the deferred debt in income ratably over the next five years.

Enhanced breaks on sales of small business stock. Under the new law, investors will be permitted to exclude 75% of the gain from the sale of certain small business stock that has been held for more than five years, up from 50% previously. To qualify, the stock must be purchased after the date of enactment and before January 1, 2011. For the purposes of this provision, a small business is defined as a company with assets of less than \$50 million that conducts an active trade or business.

S corporation built-in gains tax relief. For tax years beginning in 2009 and 2010, ARRA shortens, from ten to seven years,

THE EXPANDING REACH OF THE ALTERNATIVE MINIMUM TAX

Every year, millions of taxpayers maximize their deductions to cash in on tax savings. Instead, they find themselves paying more than they ever expected. Welcome to the parallel universe of the alternative minimum tax (AMT). According to the Urban-Brookings Tax Policy Center (2009), 4.1 million taxpayers were subject to the AMT in 2007, and the average AMT liability in 2007 was \$6,577.

The AMT was enacted in 1969 to make it more difficult for the wealthy to avoid paying income tax by taking advantage of write-offs and tax shelters. Today, however, the AMT is more likely to hit middle to upper-middle income taxpayers than the wealthy. Unlike the regular tax brackets, the AMT exemption amounts are not adjusted for inflation annually by the IRS. As a result, deductions that were introduced to cut the tax bills of people of more modest means have caused some families who claim these deductions to be subject to AMT rules.

Generally, the AMT applies to individuals and small businesses that make substantial use of exemptions and deductions. Claiming exemptions for dependents or deductions for state and property taxes can trigger the AMT. This means that large families and those living in high-tax states are more likely than other Americans to pay the AMT. Events such as the exercise of incentive stock options or the sale of property can also result in large AMT bills.

Under the AMT, individuals are taxed at rates of 26% and 28% on the amount of taxable income above the exemption amounts. Under a provision of the American Recovery and Reinvestment Act of 2009 (ARRA), the AMT exemption amounts for 2009 have been raised to \$46,700 for single filers and \$70,950 for joint filers. Without further reform, the exemptions will drop to \$33,750 for single filers and \$45,000 for married couples filing jointly in 2010.



Taxable income is calculated differently under AMT rules than under the regular tax code. The AMT system does not allow personal exemptions for individuals or dependents, deductions for state and property taxes, deductions for interest on a second mortgage, or a number of other common write-offs, such as out-of-pocket business expenses. Depending on the situation, the loss of these deductions can result in a substantially higher

tax bill. Let's review some tips for minimizing your AMT liability.

1. Accelerate income and defer deductions. If you can arrange it, have your salary and bonus paid in advance, and take the bulk of your deductions in a year when you are less likely to be subject to the AMT. The more income you have relative to your deductions, the less you will pay in AMT.
2. Be aware that large capital gains may do more than push you into the AMT zone: If large enough, they can also wipe out all or part of your AMT exemption.
3. Consider carefully the tax implications before exercising incentive stock options (ISOs). You may be presented with a large AMT bill on the spread between the stock option exercise price and the fair market value (FMV) of the shares if you fail to dispose of them in the same year.
4. Avoid state and local municipal bonds that are used to finance "private activities," such as the construction of sports stadiums or hospitals, as the interest from these bonds is not tax free under AMT rules.

Until Congress permanently reforms the AMT, the best defense is to be aware of the implications and prepare accordingly to minimize your AMT liability. For specific guidance, consult one of our qualified tax professionals. ■

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the amount of time that an S corporation that has converted from a C corporation must hold on to its assets to avoid taxes on any built-in gains at the time of the conversion.

Extension of green energy credits.

The legislation extends through 2013 existing renewable energy production tax credits for solar, biomass, geothermal,

and certain other alternative energy forms. The credit for producing electricity from wind is extended through 2012. The law also creates a new tax credit of 30% for certain renewable energy investments, up to \$2,000 for solar or geothermal installations, \$4,000 for wind, and \$500 for each one-half kilowatt of fuel cell capacity. The investment tax credit, currently available for 2009 and

2010 only, must be claimed in lieu of the production credit.

With the passage of the American Recovery and Reinvestment Act of 2009, Congress has provided more ways for small businesses to reduce their tax bill. Since many of these provisions are temporary, early planning is key. Contact one of our qualified tax professionals for more information. ■

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of 15% of an individual's earned income in excess of \$3,000, down significantly from \$8,500 in 2008.

Incentives for new car purchases.

Under the new law, buyers of new cars, light trucks, SUVs, motorcycles, or motor homes will be permitted to deduct the state sales or excise tax paid on the first \$49,500 of the vehicle's price, provided the purchase is made after February 17 and before the end of 2009. This is an above-the-line deduction, and therefore, it may be claimed by taxpayers who do not itemize their deductions. This deduction starts to phase out for single filers with AGIs over \$125,000 and for joint filers with AGIs over \$250,000.

Incentives for first-time home buyers.

The current \$7,500 credit for taxpayers buying their first home is increased to \$8,000 for primary residences purchased

between January 1, 2009 and November 30, 2009. Under the new legislation, the previous requirement that the credit be repaid is waived provided the home is not sold within 36 months. The credit starts to phase out for taxpayers with AGIs above \$75,000 for single filers and \$150,000 for joint filers.

Enhanced higher education tax

breaks. The new legislation renames the HOPE credit for higher education costs as the American Opportunity Tax Credit. The maximum credit amount is increased to \$2,500 for 2009 and 2010, up from \$1,800 previously. This covers 100% of the first \$2,000 of qualifying tuition and related expenses per year and 25% of the next \$2,000 of qualifying expenses. Under the new law, the credit is made available for all four years of college and may also be used to cover the cost of course materials. Income

phase-out levels for the credit are also raised to \$80,000 of AGI for single filers and \$160,000 of AGI for joint filers. In addition, 40% of the credit becomes refundable.

The new law also allows beneficiaries of Section 529 savings plans to use tax-free distributions to cover the cost of computer equipment and Internet access.

Incentives for energy-saving home

improvements. Under the provisions of the stimulus package, the existing 10% tax credit for energy-saving home improvements is raised to 30% and extended through 2010. The lifetime cap has been replaced with a single aggregate amount of \$1,500 for improvements on all qualifying properties for 2009 and 2010.

For more information, contact one of our qualified tax professionals. ■

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