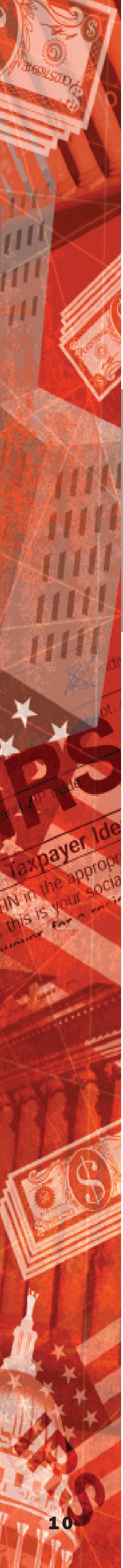

Anthony P. Curatola, Editor
By Timothy B. Biggart and J. William Harden, CPA, ChFC

ARRA and Business Tax Provisions

The American Recovery and Reinvestment Act contains provisions that affect asset expensing and accelerated depreciation, S corporation conversions, net operating losses for small businesses, cancellation of debt income, and more.

In response to the continuing decline in the U.S. economy, Congress and President Obama have enacted the American Recovery and Reinvestment Act of 2009 (ARRA) (P.L. 111-5). As with the Stimulus Act of 2008, ARRA provides incentives for businesses to acquire certain business assets, along with numerous provisions affecting individual taxpayers. In addition, it contains provisions that will affect business entities. This column briefly reviews the extended incentives for acquiring assets (IRC §179 expensing and IRC §168(k) bonus depreciation) and then describes other key business provisions.

Asset Expensing and Accelerated Depreciation

ARRA extended the IRC §179 expense amount and the asset acquisition limit amount in effect for tax years beginning in 2008 to tax years beginning in 2009. This means that the maximum IRC §179 expense amount that a small business taxpayer can claim for 2009 is $250,000, and the asset acquisition limit that begins the phase-out of the $250,000 amount is $800,000. This affects taxpayers with tax years beginning in 2009. Absent this extension, Revenue Procedure 2008-56 had announced the maximum expense amount would have been an inflation-adjusted $125,000 (or $133,000 in 2009).

Likewise, the 50% bonus depreciation has been extended for qualifying assets placed in service during calendar year 2009. Assets that qualify as longer production period assets continue to have an additional year. (Both of these provisions were described in the November 2008 Taxes column.) Since the mechanics of the provisions remain intact, they aren't described here in detail.

S Corporation Built-in Gains

Corporations that have been operated as regular "C" corporations and convert into S corporations are subject to three provisions that can result in a tax at the corporate level: built-in gains, excess passive income, and LIFO recapture. Normally the built-in gains tax provision of IRC §1374 imposes a corporate-level tax, subject to certain limits, on the appreciation that was inherent in assets held by the corporation at the time of conversion to S status and that are sold within 10 years of this conversion. ARRA has adjusted the time window from 10 years to seven years, but only for 2009 and 2010. This provision provides a window for those corporations whose seventh year preceded the tax years beginning in 2009 and 2010. The gain will still be recognized by the shareholders, but it won't be taxed at the corporate level. There's an exception to this shortening of the period for certain bad debt reserves (of thrifts).

Small Business Net Operating Losses

ARRA also provides for an extended net operating loss (NOL) carryback period for qualifying small businesses. Such qualifying businesses may elect up to a five-year carryback instead of the two-year carryback. The change is flexible and allows the taxpayer to elect to use an NOL generated in tax year 2008 in the fifth, fourth, or third year prior instead of the normal two-year period. As the law currently reads, any losses generated in tax years beginning in 2009 and thereafter will return to the normal two-year carryback period. In order to qualify, the business must have had average gross receipts that don't exceed $15 million for the prior three years. The election is irrevocable and must be made by the extended due date of the return for the loss year. Readers should note that, although the original proposal for a five-year carryback was to apply to all businesses, the rule as enacted applies only to small businesses.

Certain Cancellation of Debt

Generally, taxpayers must recognize income from the discharge of indebtedness. ARRA provides that certain types of cancellation of debt (COD) income will be allowed to be spread over five years beginning in tax year 2014. This elective provision is available for the reacquisition of certain types of debt during calendar years 2009 and 2010. The law contains a broad definition of applicable debt instruments, including bonds, debentures, notes, certificates, or any other instrument and certain debt contracts. These can be issued by either a C corporation or any other person related to the conduct of a business.

Section 1202 Stock

One change that may assist small corporations that are attempting to raise capital is an increase in the exclusion of gain on qualifying stock acquired after February 17, 2009, and before January 1, 2011, from 50% to 75%. Even though the remaining 25% is taxed at a rate of 28%, the exclusion of 75% reduces the effective tax rate to 7%, which is below the current long-term capital gains rate of 15%.

Other Provisions

ARRA also includes a number of additional provisions that may impact businesses and are likely to be discussed in other tax columns or in *Strategic Finance* articles. Some of the other provisions that are included in ARRA are: (1) the two new targeted groups under the work opportunity tax credit, (2) the extension of the ability to take additional refundable alternative minimum tax and research & development credits in place of bonus depreciation, (3) a subsidy of 65% of the cost of COBRA coverage for the employer, and (4) a number of energy credits, among others. But everyone must be aware that most of ARRA's provisions affect either 2009 or 2009 and 2010. Few have any long-term power. In some situations, the provision is retroactive, such as the five-year NOL carryback rule, which is applicable only for 2008. It's unclear whether Congress will enact further tax legislation this year. Readers should examine the specifics of any provision they desire to employ to ensure that it's applicable to their situation and time period. **SF**

Timothy B. Biggart, Ph.D., is an associate professor of accounting at the Campbell School of Business at Berry College, Mount Berry, Ga., and a member of IMA's Atlanta Chapter. You can reach him at (706) 238-7943 or tbiggart@berry.edu.

J. William Harden, Ph.D., CPA, ChFC, is an associate professor of accounting at the Bryan School of Business and Economics at the University of North Carolina at Greensboro. You can contact him at (336) 334-5647 or jwharden@uncg.edu.

Anthony P. Curatola is the Joseph F. Ford Professor of Accounting at Drexel University in Philadelphia, Pa., and a member of the Greater Philadelphia Chapter. You can reach Tony at (215) 895-1453 or curatola@drexel.edu.