

To our Clients and Friends of the Firm:

As you know from daily news coverage, Congress has passed the largest spending bill in U.S. history. Clients and Friends of the Firm have been asking many questions about the impact of this bill. The nearly \$800 billion American Recovery and Reinvestment Act is roughly two-thirds spending and one-third tax cuts. The massive infusion of spending and tax incentives is designed to jump start the troubled U.S. economy. Many of the tax incentives are retroactive to January 1, 2009. This letter describes the basic impacts on individual and business taxes.

BUSINESS TAX IMPACTS

Bonus Depreciation - Bonus depreciation is back for 2009. The new law extends the 50 percent bonus depreciation authorized by the Economic Stimulus Act of 2008, which generally expired at the end of 2008. Businesses can take advantage of bonus depreciation throughout 2009 (and longer for certain types of property). Bonus depreciation is an acceleration of the depreciation deduction. It is not additional depreciation. Future deductions are reduced, so planning is essential. To allow vehicles to continue to be depreciated at a higher level, the new law also adds \$8,000 to the "caps" ordinarily placed on such deductions. Especially useful to businesses with accumulated AMT and research tax credits on their tax books, the new law also allows eligible businesses to monetize these credits in lieu of taking bonus depreciation for 2009.

Code Sec. 179 expensing - Increased Code Sec. 179 expensing is extended. The Economic Stimulus Act of 2008 increased Code Sec. 179 expensing for 2008 to \$250,000 and the threshold for reducing the deduction to \$800,000. The new law revives it for calendar year 2009.

State tax note: Bonus Depreciation and enhanced section 179 expensing are the most common items in this package not followed by the states. Check the state rules where your business files as a part of your planning.

Net Operating Losses - The new law expands the carryback period to five years *only* for qualified small businesses (businesses with average gross receipts of \$15 million or less). The treatment is also temporary and only applies to NOLs for any tax year beginning or ending in 2008. Qualified businesses can choose to carry back NOLs three, four or five years. Immediate refunds are available to businesses that qualify.

Cancellation of Indebtedness - Eligible businesses will be able to recognize cancellation of certain indebtedness over five years, beginning in 2014, under the new law. This treatment applies to specified types of business debt repurchased or forgiven by the business after December 31, 2008 and before January 1, 2011.

Work Opportunity Tax Credit - The new law modifies the definitions of eligible veterans and disconnected youth to bring more individuals under the WOTC. This treatment is temporary.

BUSINESS TAX IMPACTS (continued)

S Corporations - A built-in gains tax, at the highest corporate tax rate, applies to C corporations that make an S corporation election and have certain unrecognized gains. The new law reduces the period in which this tax could be triggered from 10 to seven years after the election for tax years that begin in 2009 and 2010.

Small Business Stock - Generally, an investor other than an entity doing business as a C corporation may exclude 50 percent of the gain from the sale or exchange of "qualified small business stock." The new law raises the 50 percent exclusion to 75 percent held more than 5 years. However, the increase is temporary and applies to stock acquired after the date of enactment and before January 1, 2011. Holding period rules also apply.

Executive Compensation - Lawmakers targeted expenditures for luxury items by companies receiving financial assistance from the government's Troubled Asset Relief Program (TARP) for more regulation. Congress also directed the Treasury Secretary to review bonuses, awards and other incentives paid to senior executives at these firms and determine if the payments were contrary to public interest. Separately, the Treasury Administration has recently heightened its oversight of these firms and placed additional limits on executive compensation.

COBRA - Individuals who are involuntarily separated from employment between September 1, 2008 and January 1, 2010 can elect to pay 35 percent of their premiums for COBRA coverage and will be treated under the new law as paying the full amount. The former employer will pay the remaining 65 percent of the premium. In return, the employer will be able to credit its share of this temporary COBRA subsidy against wage withholdings and payroll taxes. The new law is extremely technical application, especially with notice requirements and time-frames for eligibility for coverage.

Energy Incentives - Among the new incentives are an enhanced renewable electricity production tax credit, an expanded energy investment tax credit, an increased alternative fuel pump tax credit, and an investment credit election. The incentives are temporary.

AMT / R&D Credits - The legislation extends the provision allowing companies to take advantage of AMT and R&D credits in lieu of bonus depreciation to include assets purchased in 2009.

Estimated Taxes for Individuals with Small Businesses - Effective Feb. 17, 2009, for tax years beginning in 2009, in computing the amount for the required annual installments of estimated income tax of any qualified individual, "required annual payment" is the lesser of 1) 90% of the tax shown on the return of the tax year, or 2) 90% of the tax shown on the return of the individual for the preceding tax year. A "qualified individual" is one with an AGI of less than \$500k (\$250 if married filing separately), and 50% of the gross income on the preceding-year's tax return was income from a small trade or business (defined as a business that employed no more than 500 persons on average during the preceding tax year).

More Business Incentives - The new law also prospectively revokes a controversial IRS notice affecting NOL limitations on banks and expands the health coverage tax credit for eligible taxpayers. The new law also increases the New Markets Tax Credit program, modifies the low income housing credit, decreases estimated tax payments for certain individuals whose incomes come from small businesses and delays withholding on government contractors. Congress also enhanced many tax-exempt and tax-credit bond rules to help states and local governments generate revenue.

PERSONAL TAX IMPACTS

Homebuyer Tax Credit - The credit gives first-time homebuyers a temporary refundable tax credit equal to 10 percent of the purchase price of a home up to \$8,000 (\$4,000 for married individuals filing separately) The credit begins to phase out for higher-income taxpayers. The credit is effective for homes purchased on or after April 9, 2008, and before November 30, 2009. Moreover, the new law eliminates the repayment requirement for homes purchased after December 31, 2008 and before December 1, 2009.

New Car Deduction - Congress has created an above-the-line deduction for state and local sales taxes or excise taxes paid on qualified purchases of new motor vehicles. Income limits and other restrictions apply. This deduction is temporary and also prospective. It will expire at the end of 2009. Because it is an above-the-line deduction, itemizers and non-itemizers can benefit.

AMT Patch - To help middle income taxpayers avoid the AMT, the new law increases the AMT exemption amounts and allows taxpayers to take most personal credits to reduce AMT liability for 2009.

Education - The new law expands the current Hope education credit (and renames it the American Opportunity Tax Credit). More individuals will be able to take advantage of this credit because of expanded income phase-outs. The new law also raises the maximum credit, extends it over four years of post-secondary school education, and makes 40 percent of the credit refundable. In a related development, the new law also permits beneficiaries of qualified tuition plans (known as "529" plan) to use tax-free distributions to pay for computers and computer technology.

Child Tax Credit - The new law increases the refundable portion of the child tax credit for 2009 and 2010. Taxpayers are eligible for a refundable credit equal to 15 percent of their earned income in excess of \$3,000 subject to certain restrictions and phase-outs.

Energy Incentives - The new law enhances several energy tax incentives that reward taxpayers for installing energy-efficient property and alternative sources of energy in their homes. Some state tax incentives may piggyback on the federal ones.

More Personal Incentives - The new law also increases the health coverage tax credit (HCTC) for, among others, individuals receiving Trade Adjustment Assistance benefits. As mentioned in the business incentives above, the new law also decreases estimated tax payments for certain individuals whose incomes come from a small business in 2009. Dislocated workers who apply for COBRA coverage will benefit from an enhanced but temporary subsidy.

Please contact our office if you have any questions about the tax incentives in the American Recovery and Reinvestment Act. Because many of the tax incentives are temporary, don't delay. We don't want you to miss out on any tax savings.

Sincerely yours,

The Elliott Davis Team