

# Keeping up with...

## tax issues

February 3, 2009

### Legislative Update: House Passes Economic Stimulus Bill

On January 28, the U.S. House of Representatives voted 244 to 188 to pass its version of an economic stimulus package that contains tax relief provisions entitled the “American Recovery and Reinvestment Tax Act of 2009” (the “House Bill.”) The House Bill renews certain expired provisions and adds a few measures that target businesses. The following is a short summary of the House Bill incentives as they relate to business.

#### **Bonus Depreciation**

Businesses would be entitled to an initial year “bonus” depreciation of 50 percent of their cost for qualifying assets purchased and placed in service in 2009 or 2010. Bonus depreciation is allowed for both regular tax and alternative minimum tax (“AMT”) purposes. Bonus depreciation was adopted during the first term of the Bush administration as a stimulus measure that was renewed in 2008 for one year.

Under bonus depreciation, both the bonus amount and regular depreciation are reported in the first year of service. The tax basis of the purchased property is first adjusted downward to reflect the bonus depreciation amount. Then, the remaining basis is eligible for regular depreciation starting with the first year. Bonus depreciation is not prorated by either the length of time the property is placed in service or a short tax year, i.e. less than 12 months such as the case of the first year of a new company. A taxpayer may elect out of bonus depreciation, but its use does not require a special election.

Property that qualifies for bonus depreciation generally is depreciable property with a recovery period of 20 years or less for tax purposes, certain computer software, qualified leasehold improvement property and water utility property. In the case of certain aircraft or certain depreciable property with a recovery

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period of at least 10 years for tax purposes, bonus depreciation would also apply to property purchased and placed in service in 2010.

### **Section 179 Expensing**

The House Bill would extend through 2009 the expensing of up to \$250,000 of the cost of depreciable personal property used in an active trade or business. However, this expense deduction is reduced dollar-for-dollar by the extent that the purchase price exceeds \$800,000. The amount expensed may not exceed taxable income that is derived from the active conduct of a trade or business; in other words, the expense cannot by itself generate a net operating loss (an "NOL").

### **Increased NOL Carryback Period**

The House Bill makes two changes to the NOL carryback rules with regard to NOLs realized in 2008 and 2009 that could benefit companies that were profitable in the preceding 5 tax years. Under present law, NOLs may be carried back 2 taxable years and carried forward 20 taxable years. Moreover, for AMT purposes, NOLs can only be used to offset up to 90 percent of the taxpayer's alternative minimum taxable income.

The House Bill eases these limitations in two ways for NOLs generated in any taxable year ending during 2008 or 2009. The House Bill first would enlarge the carryback period to 5 taxable years, permitting a 2008 or 2009 NOL to be carried as far back as 2003 and 2004, respectively. The House Bill, however, requires that the amount of the NOL be reduced by 10 percent. The House Bill would also exempt the NOL from the 90 percent limitation for AMT purposes. The extended carryback period would enable businesses incurring NOLs to amend prior year returns seeking a tax refund(s) for taxes paid in tax years as early as 2003. Taxpayers can elect to either forgo the five year carryback or elect to use a carryback period of either three or four years.

The NOL carryback provision would not apply to any financial institution receiving funding from the Treasury under the Troubled Relief Program (TARP).

Lastly, the House Bill would repeal with prospective effect IRS Notice 2008-83, which was issued just prior to TARP's enactment, regarding the treatment of bank loan built-in losses realized after an ownership change. The IRS Notice exempts banks from the restriction on use of an NOL with regard to a built-in loan loss on the ownership change date. This exemption received much negative publicity with news that TARP-financed acquisitions of banks were also tax-advantaged. The exemption was also criticized as outside Congress' delegation to Treasury of regulatory authority that did not authorize rules benefitting particular industries or classes of taxpayers.

### **Corporate Tax Rates**

The House Bill would make no change to present corporate income tax rates under which the highest marginal rate is 35 percent.

### **Business Tax Credits for Hiring**

The House Bill would add two new categories of employees to the targeted groups eligible for the work opportunity credit: (i) “unemployed veterans” (veterans discharged or released from military service between 2008 and 2010 who have received more than four weeks of unemployment compensation in the year hired), and (ii) “disconnected youths” (youths between the ages of 16 and 25 who have not been regularly employed or attended school in the 6 months preceding their hiring date and who are not “readily employable by reason of lacking a sufficient number of basic skills”). If an unemployed veteran or disconnected youth is hired during 2009 or 2010, the business would receive an income tax credit equal to 40 percent of the individual’s qualified first-year wages, however, the amount of qualified first-year wages eligible for credit for any single individual cannot exceed \$6,000 per year (\$12,000 in the case of certain disabled veterans).

### **New Categories of Tax-Exempt Financings**

The House Bill would enact an array of measures designed to enhance the marketability of State and local government bonds, as well as reduce the financing costs of such bonds. The House Bill would allocate more financing and other tax benefits to areas with significant poverty, unemployment, home foreclosures or general economic distress, and enact a new bond-financing program for school construction and repair.

### **Renewable Energy Incentives**

The House Bill would provide \$20 billion for a wide range of tax incentives related to energy, including an enhanced 20 percent research and development credit in tax years beginning in 2009 and 2010 for expenditures on fuel cells, battery technology, renewable energy, energy conservation technology, efficient transmission and distribution of electricity, and carbon capture and sequestration.

## **Future Prospects – Break for Foreign Subsidiary Repatriations of Earnings**

The House Bill has been forwarded to the Senate Committee on Finance for its consideration, and the Senate plans to have a bill in front of President Obama by mid-February. It remains to be seen which House Bill business tax incentives will survive the legislative process and in what form, as any final legislation remains unclear both as to content and timing.

One important measure gaining momentum in the Senate is a reduced dividend tax rate for U.S. corporations that receive earnings repatriations from controlled foreign subsidiaries. This would offer U.S. corporations the ability to obtain cash from profitable foreign subsidiaries at a low tax cost. It is expected that the proposal will be quite similar to the version provided by the American Jobs Creation Act of 2004, which reduced the effective corporate tax rate from 35 percent to 5.25 percent provided the dividend was invested in the U.S. under a qualifying “domestic reinvestment plan.” The current version is being led by Senators John Ensign (R-Nev.) and Barbara Boxer (D-Calif.) and has received support from a coalition of technology and pharmaceutical companies. Another proposal outside the pending bill, supported by the private equity lobby, would eliminate cancellation of indebtedness income from certain debt restructurings.

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