

**American Recovery and Reinvestment Act:  
TAX INITIATIVES**

Once again, the United States federal government has endeavored to resuscitate the U.S. economy and vicariously the world economy through fiscal and monetary policy initiatives. As recently as February 17, 2009, it enacted the American Recovery and Reinvestment Act (hereinafter “Act”) of 2009. This article will highlight the major tax initiatives (which are substantial) contained therein, as follows:

1. Net Operating Loss Carryback – As most Taxpayers should know, our income tax system is calculated and paid on an annual basis (in most cases on a calendar year basis). This system can create anomalies for a Taxpayer who earns substantial business income in one year and a loss in another. To mitigate this, Internal Revenue Code Section 172 provides for a Net Operating Loss (“NOL”) to be carried back and, to the extent not fully utilized, forward. Prior to the Act, the law was back for two years and forward for twenty.

For “eligible entities” during 2008, the Act enlarges the carryback period to five years. An eligible entity is a sole proprietorship (which files a Schedule C as part of his/her IRS Form 1040) and corporations whose annual gross receipts do not average more than \$15 million (including gross receipts of certain “related entities”). The average is determined by receipts for 2006-2008, or a shorter period where applicable.

Fiscal-year businesses can apply these rules either to NOLs generated in tax years ending in 2008, or to NOLs generated in tax years beginning in 2008. If a small business has already waived an NOL carryback for the applicable 2008 tax year, the election can be revoked in order to obtain NOL carryback relief under the Act; however, the prior election must be revoked and the new election made within 60 days of the Legislation’s enactment.

This provision is significant because it enlarges the carryback period which in turn allows the Taxpayer more years in which he/she can recoup tax money previously paid. This recoupment or refund could help the Taxpayer with a cash injection to help with current cash flow issues during this severe economic downturn. Please note that special rules and limitations apply to partnerships and S corporations.

2. Cancellation of Debt Income – Unknown to most Taxpayers is that pursuant to Internal Revenue Code Section 61, income includes debt cancellation. Simply put, if a Taxpayer owes a debt (almost any debt) which, for whatever reason (i.e. litigation and/or negotiation) is forgiven or reduced, the reduction amount is income. The theory is that the Taxpayer has an “accession to wealth,” which is taxable.

However, Internal Revenue Code Section 108 now excludes from gross income certain types of this cancellation of indebtedness income at the cost of reducing tax attributes such as the basis of property or loss carryovers. The Act provides for an election to allocate the income over a five-year period beginning in 2014, thus a potential ten-year deferral.

This provision only applies to specified types of business debt. However, given the environment and the magnitude of debt reduction/restructurings occurring in this economic climate, it could be very significant for the Taxpayer.

3. Subchapter C Corporation Double Tax – Prior to the Tax Reform Act of 1986 there was generally no double taxation for a C corporation which liquidated in a qualified manner. After 1986, this is no longer the case. This change also affected previous C corporations which elected to be S corporations. The mechanism to enforce this change is Internal Revenue Code Section 1374. In the case of a C corporation electing S status, any “built in gain” at the time of election remains subject to corporate (double) taxation to the extent such built in gain is realized by the corporation within ten years after the election. For tax years 2009 and 2010, the Act reduces the ten-year period from ten years to seven years. As a result, the Section 1374 corporate tax will not apply if the corporation elected S status more than seven years ago, as opposed to the previous ten years.

4. Small Business Capital Gains – Internal Revenue Code Section 1202 provides that in the case of a Taxpayer other than a corporation, gross income does not include 50% of any gain from the sale or exchange of “qualified small business stock” held for more than five years. The Act increases the exclusion to 75% for small business stock acquired after February 17, 2009 through 2010. As in the past, the exclusion applies only to individual taxpayers and is limited to 10 times a Taxpayer’s basis in the stock or a maximum of \$10 million.

This provision is designed to provide additional incentive to spur investment. With the expected increases in tax rates and potential elimination/reduction in the prefunctional capital gain rates this provision should not go unlooked.

5. First-Time Home Buyer Credit Revision – Internal Revenue Code Section 36, instituted in 2008, provided a credit for first time home buyers who purchased their home before July 1, 2009 equal to 10% of the cost of the home, with a limit of \$7,500. The credit, however, was a disguise for an interest-free loan because it had to be repaid. The Act increases the \$7,500 to \$8,000 and eliminates the repayment obligation for Taxpayers whose qualifying purchase occurs after December 31, 2008, unless the home is sold or ceases to be the Taxpayer’s principal residence within three years of the date of purchase. The credit is subject to a phase-out for single Taxpayers with a modified adjusted gross income of \$75,000 (\$150,000 if married filing jointly) and is fully phased out at \$85,000 (\$170,000 if married filing jointly).

The first-time home buyer credit combined with historically low mortgage interest rates should spur the housing market, at least that is the expectation.

6. Capital Expenditures and Expensing Election – Internal Revenue Code Section 179 provides that a Taxpayer may elect to treat the cost of any acquired tangible property as a current expense not chargeable to a capital account and therefore a deduction in that year. The Act extends the limitation through 2009 at the \$250,000 amount. After 2009, the amount of the Section 179 expense will revert to the previous limit of \$125,000.

7. Reduction of Estimated Tax Payments – Taxpayers are required to make estimated tax payments through withholding and/or quarterly estimates. Under the Act, a qualified taxpayer is now required to make an annual estimated payment of at least 90% of the tax shown on the return or 90% of the tax shown on the return from the preceding year. A person is a qualified individual if his/her adjusted gross income is less than \$500,000 (\$250,000 for married filing separately) and the Taxpayer certifies that a minimum of 50% of the income shown on the return for the prior year was from a small trade or business (generally a business with fewer than 500 employees). Pre-Act law required 110% of the tax shown on the prior year return, or 90% of the current tax shown on the return if adjusted gross income exceeded \$150,000.

8. New Jersey Tax Amnesty – New Jersey once again has enacted a Tax Amnesty program. Because thus far few details have emerged, the following is an excerpt provided by the New Jersey Division of Taxation:

Governor Jon S. Corzine recently signed a bill into law that requires the Director of the Division of Taxation to establish a tax amnesty period, not to exceed 45 days in duration, which shall end no later than June 15, 2009. As a result, the Division of Taxation has announced the Tax Amnesty program will begin on May 4, 2009, and end on June 15, 2009. In accordance with the law, amnesty "...shall apply to February 1, 2009 and shall not extend to any taxpayer who at the time of payment is under criminal investigation or charge for any State tax matter, as certified by a county prosecutor or the Attorney General to the director."

In accordance with the provisions of the law, the program will offer a waiver of all penalties, referral cost fees, and one-half of the balance of the interest that remains due as of May 1, 2009, provided payment of all tax owed and one-half of the balance of the interest that remains due is paid in full during the amnesty period. In addition, all filing requirements must be satisfied for delinquent returns.

More information will be posted on a special Web site that is being planned and developed. In addition, a public awareness campaign is planned and is expected to be implemented on or about mid-April.

The Division of Taxation plans an outreach mailing to all taxpayers who are known to have amnesty-eligible deficient and/or delinquent accounts. In addition, a phone number will be established for the public to reach a special Call Center where representatives will be trained to answer specific inquiries. The Call Center is expected to be established on or about the week of April 27.

For more information about some of the topics discussed in this article visit the following Web sites: [www.irs.gov](http://www.irs.gov), [www.state.nj.us](http://www.state.nj.us) and <http://www.state.nj.us/treasury/taxation/amnesty2009.shtml>. Schenck, Price, Smith and King, LLP (1) does not accept any responsibility for the foregoing links to external Web sites, and (2) the links do not constitute in any way an endorsement of the external Web sites by Schenck, Price, Smith & King, LLP. The foregoing links are provided as helpful aids to our readers and web users. Please contact us if a problem is noted.

**This article is only intended to summarize some of the more salient features of the new law. There may be other issues which are not mentioned above and require a more detailed and intensive examination. This article is not to be construed as legal advice. If you have any questions about anything you read in this article or any other tax related issues, please contact:**

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