

A quarterly newsletter examining recent tax developments for the business professional.

RECOVERY ACT PROVIDES IMPORTANT NEW TAX BENEFITS FOR SMALL BUSINESSES

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (commonly referred to as the "Recovery Act") into law. While the impact of the Recovery Act on individuals has been widely publicized, the Recovery Act also enacted a number of beneficial tax provisions for businesses. These provisions are highlighted below.

1. **Election for longer NOL carryback period.** In general, net operating losses ("NOLs") may be carried back two years and forward twenty years. However, for NOLs arising in a tax year beginning or ending in 2008, the Recovery Act permits small businesses to elect to increase the NOL carryback period from two years to three, four, or five years. A small business for this purpose is one whose average annual gross receipts are \$15 million or less for the three-year period ending with the tax year in which the loss arose. The longer NOL carryback period means that small businesses that experienced losses can seek immediate refunds of income taxes paid in earlier years.

2. **Expensing limits continued for another year.** The Recovery Act extended the liberal expensing rules for purchases of business machinery and equipment. The expensing rules allow businesses to take a current deduction for the cost of business machinery and equipment, rather than recovering those costs through depreciation. For tax years beginning in 2009, qualifying businesses have the option to currently deduct up to \$250,000. However, the \$250,000 deduction is decreased, dollar-for-dollar, for purchases in excess of \$800,000.

3. **Bonus first year depreciation extended for another year.** The Recovery Act provides a one-year extension of the ability for businesses to take an extra "bonus" depreciation deduction for the first year new assets are placed in service. The bonus first-year depreciation deduction generally equals 50% of the cost of qualified property acquired and placed in service in 2009.

4. **S corporation built-in gain holding period shortened temporarily.** A business originally formed as a C corporation, which later elects to be taxed as an S corporation, may be subject to a built-in gain tax on gains that were "built-in" at the time of the corporation's S

election, if the gains are recognized during the ten-year period following the election. The built-in gain is then taxed at the highest marginal corporate rate. Thanks to the Recovery Act, the built-in gain tax will not be imposed on any recognized built-in gain, if the seventh year in the recognition period expired prior to 2009 or 2010.

5. **Subsidy for COBRA continuation coverage.** The Recovery Act provides a 65% subsidy for COBRA continuation premiums for up to nine months for workers who have been involuntarily terminated. Companies who have plans subject to the federal COBRA continuation coverage requirements, or similar requirements under state law, and receive a 35% payment from someone eligible for the subsidy must make the remaining 65% premium payment. However, the company is "paid back" by either offsetting payroll tax deposits or claiming the subsidy as an overpayment at the end of the payroll quarter.

6. **Deferred tax on debt forgiveness income.** The Recovery Act allows certain businesses to elect to defer any income from the cancellation of business debt arising from the reacquisition of certain types of business debt repurchased in 2009 or 2010. The tax owed on the debt discharge income must be paid over five years, beginning in 2014.

7. **Improved energy tax breaks.** The Recovery Act includes a number of provisions designed to promote the creation and use of alternative forms of energy. For tax years beginning after 2008, the Recovery Act allows a 30% tax credit for qualified solar water heating property, small wind energy property, and geothermal heat pumps. The Recovery Act also creates a new 10% tax credit, up to \$4,000, for the cost of converting any motor vehicle into a qualified plug-in electric drive motor vehicle. The vehicle must be placed in service after February 17, 2009, and converted before January 1, 2012.

RECENT HIGHLIGHTS & HOT TOPICS

Recent Highlights & Hot Topics provides a brief summary of the latest breaking tax developments and happenings on a taxpayer-by-taxpayer basis.

INDIVIDUAL INCOME TAX: The IRS recently posted a series of questions and answers (“Q&As”) on its web-site with respect to the first-time homebuyer credit. The original homebuyer credit allows certain eligible first-time homebuyers to claim a refundable tax credit equal to the lesser of 10% of the home’s purchase price or \$7,500 for single or married-filing joint taxpayers or \$3,750 for married filing separately taxpayers on either their 2008 or 2009 federal income tax returns. The Recovery Act modified the credit for homes purchased in 2009, increasing the credit amount to \$8,000 and eliminating the repayment requirement. The IRS Q&As can found on the IRS website at <http://www.irs.gov/newsroom/article>.

PARTNERSHIP TAX: After a wait of nearly 25 years, on April 13, 2009, the IRS finally issued proposed regulations under IRC § 706 providing methods for determining a partner’s distributive share of partnership items in any year in which there is a change in a partner’s interest in the partnership. The proposed regulations contain a number of rules, including a requirement that, if a partner’s interest changes during the partnership’s tax year, the partnership must use the interim closing of the books method to determine the partner’s distributive share, unless the partnership agreement permits the use of the proration method.

REAL ESTATE TAX: In Private Letter Ruling (“PLR”) 200901020, the IRS recently ruled that residential density development rights are “like-kind” to other interests in real property for purposes of IRC § 1031. The taxpayer at issue in PLR 200901020 owned certain residential density development rights that it contracted to sell to a third-party buyer. Pursuant to the contract, the taxpayer had a put option, entitling it to transfer additional residential density development rights to the buyer. In the event the

put was exercised, the taxpayer was required to record a perpetual restrictive covenant confirming the number of residential units that could be constructed by virtue of the development rights. The taxpayer requested the PLR to determine whether the residential density development rights were like-kind to real property. The IRS ruled that, because the development rights were real property interests under state law, would be granted in perpetuity, and were directly related to the interest, use, and enjoyment of the underlying real property, the development rights were like-kind to a fee interest in real estate, thus permitting a tax-free exchange.

EMPLOYMENT TAX: On August 8, 2008, the IRS Office of Chief Counsel issued a memorandum indicating that, with respect to employment tax liabilities accruing after December 31, 2008, the IRS may look to the assets of a single-member, disregarded LLC to satisfy unpaid employment tax liabilities. The memorandum provides that, pursuant to Treas. Reg. § 301.7701-2(c)(iv), single-member LLCs treated as disregarded entities for tax purposes will be treated as corporations with respect to employment tax liabilities accruing after December 31, 2008, such that the IRS can reach the LLC’s assets to satisfy any unpaid employment taxes that accrue during the 2009 taxable year and beyond.

CORPORATE TAX: In Kerzner v. Comm’r, T.C. Memo 2009-76, the Tax Court recently held that S corporation shareholders did not acquire sufficient debt basis under IRC § 1366(d)(1) to absorb the S corporation’s losses by making yearly loans to the corporation of amounts borrowed from their wholly owned partnership. The court reached this decision because the loans merely resulted in a circular flow of cash between the S corporation and the wholly owned partnership.

Please be advised that this newsletter only provides brief descriptions of tax information of general interest and that any tax information contained herein was not intended and cannot be used for the purpose of: (1) avoiding penalties that may be imposed by the Internal Revenue Service; or (2) supporting, promoting, or marketing any transaction(s) or matter(s) addressed herein.

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