

# \$MALL BUSINESS\$ BREAK\$

## Recovery Act provides new tax benefits for small businesses

In response to an economic downturn the likes of which has not been seen since the Great Depression, President Barack Obama signed the American Recovery and Reinvestment Act of 2009 (commonly referred to as the Recovery Act) into law on Feb. 17. Intended to serve as a stimulus for the U.S. economy, the measures set forth in the Recovery Act are nominally worth approximately \$787 billion.

Of those measures, roughly \$288 billion are devoted to federal tax relief, with \$51 billion aimed at providing tax benefits for small businesses. While the impact of the Recovery Act on individual taxpayers has been widely publicized, the beneficial tax provisions for small businesses and their owners have been overlooked. However, many of the Recovery Act's new tax provisions offer significant tax savings opportunities for small businesses. Some of these provisions are highlighted below.

### Election for longer net operating loss (NOL) carryback period

Currently, corporate taxpayers are allowed to use a NOL from one tax year to reduce taxable income in past or future tax years. Prior to the Recovery Act, NOLs could be carried back for two tax years and carried forward for 20 tax years. The Recovery Act now permits certain qualified small businesses to elect to increase the NOL carryback period from two years to three, four or five years for NOLs arising in a tax year beginning or ending in 2008.

Because many small businesses were profitable in tax years leading up to the current economic crisis, the extended carryback period provides small businesses with an opportunity to offset prior years' taxable income with losses incurred in 2008. For purposes of the extended carryback period, qualifying small businesses are

corporations whose average annual gross receipts are \$15 million or less for the three-year period ending in 2008. As a result of the longer NOL carryback period, small businesses that experienced losses in 2008 likely can seek an immediate refund of income taxes paid in earlier years.

### Expensing limits continued for another year

Before the enactment of the Recovery Act, the Internal Revenue Code's expensing rules allowed businesses to deduct up to \$133,000 of costs incurred in purchasing certain business machinery and equipment, instead of recovering those costs through depreciation deductions over a number of years. The Recovery Act increased that amount and now provides that, for tax years beginning in 2009, certain qualifying businesses have the option to deduct up to \$250,000 of such costs. Although the increased expensing limits are subject to some limitations (for example, the \$250,000 deduction is decreased dollar-for-dollar for purchases in excess of \$800,000), any amounts that cannot be deducted because of these limitations can be carried forward to later years.

The more liberal expensing rules provided under the Recovery Act provide small businesses with the ability to take increased, current-year deductions for costs associated with acquiring business machinery and equipment, which should help to offset the often substantial economic outlays such purchases require.

### Bonus first-year depreciation extended for another year

The Recovery Act also provides a one-year extension on the ability of businesses to take a "bonus" depreciation deduction for the first year new assets are placed in service. The bonus first-year depreciation deduction generally is equal to 50 percent of the cost of qualified property acquired and placed in service in 2009. Qualified property includes most types of tangible personal ▶



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property, certain improvements to leased real property and most software. As with the increased expensing limits discussed above, the extension of the ability to claim a first-year bonus depreciation deduction may materially reduce the costs associated with acquiring new business property and equipment.

#### **S corporation built-in gain holding period shortened temporarily**

Typically, a Subchapter S corporation is not subject to an entity-level tax on its income. Rather, the S corporation's income flows through to its shareholders, who then pay tax on their pro-rata share of the S corporation's income. However, a business originally formed as a Subchapter C corporation, which later elects to be taxed as an S corporation, is subject to a built-in gain tax at the highest marginal corporate tax rate (currently 35 percent) on certain gains that are built-in at the time of the corporation's S election.

These types of S corporations generally are subject to the built-in gain tax on the disposition of appreciated assets acquired during their C corporation period for the first 10 years after their S election. In other words, if the S corporation disposes of appreciated assets from its C corporation period during the 10 years following its S election, the corporation is subject to tax on the gain at the highest marginal corporate tax 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 10-year recognition period ended before 2009 or 2010. This provision will enable S corporations subject to the built-in gain tax to dispose of appreciated assets earlier in the recognition period without triggering the built-in gain tax on the transfer.

#### **Deferred tax on debt forgiveness income**

When debt is discharged or canceled, taxpayers generally must include the amount discharged in taxable, ordinary income. In order to reduce the economic hardships often associated with the recognition of this cancellation of indebtedness (COD) income, the Recovery Act now allows taxpayers to elect to defer the recognition of certain COD income that would otherwise be recognized in 2009 and 2010, until 2014, and then recognize the COD income ratably over five years. The type of COD income that may be deferred under the Recovery Act is income that results from the reacquisition or modification of certain business debt instruments during 2009 or 2010. This provision enables certain businesses that might otherwise have taxable income as a result of a debt modification to defer the recognition of that income into future, and hopefully better, tax years. **AB**

Kelly C. Mooney and Heather A. McKee are associates in the taxation department at Gallagher & Kennedy, [www.gknet.com](http://www.gknet.com).