

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

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Dear Clients and Friends,

Less than 30 days after taking office, President Barack Obama signed into law the largest spending bill in history, with the hope and intent being that it will pull our economy out of its current slump, prevent more homeowners from losing their homes, and create or preserve millions of jobs. After I sent out a lengthy e-mail describing the tax provisions in the new legislation, my mother forwarded to me what she found to be a better and easier to understand explanation of the stimulus legislation, which I will paraphrase for you here.

After economics class, a student approached the professor and said "I don't understand this stimulus bill. Can you explain it to me?" The professor responded that he did not have time to do so at the moment, but that if the student would come to his home on Saturday to help him with a weekend project he would do so then. When the student showed up at the professor's home, the professor took him to his backyard pool, filled a bucket with water from the deep end of the pool, walked to the shallow end of the pool, and then dumped the bucket of water into the shallow end of the pool. He handed the student a bucket and instructed him to begin doing the same. After several trips of carrying water from the deep end to the shallow end, the confused student asked, "Excuse me, but why are we doing this?" The professor stated matter-of-factly that he was trying

to make the shallow end much deeper. The student became frustrated and said "All we're doing is wasting valuable time and effort on unproductive pursuits. Even worse, when this process is all over, everything will be back at the same level it was before, so all you'll really have accomplished is the destruction of what could have been truly productive action!" The professor put down his bucket and replied with a smile, "Congratulations. You now understand the economic stimulus bill."

The above simplistic explanation notwithstanding, we will endeavor in this issue to provide you with a summary of the tax provisions included in the recent legislation, and we will hope, for the sake of our nation and the global economy, that the economic stimulus legislation will accomplish more than moving water from one end of the pool to the other.

Sincerely,

Kent Bridges



Kent Bridges,
Managing Partner

The American Recovery and Reinvestment Act of 2009

On February 17, 2009, President Obama signed into law *The American Recovery and Reinvestment Act of 2009*. Highlights of the tax provisions in the legislation include:

Longer NOL carryback period – Under present law, net operating losses (NOLs) can only be carried back 2 years or forward 20 years. Under the new rules, NOLs incurred in 2008 by "small businesses" (those with average annual revenue of less than \$15 million) can be carried back up to 5 years to recover tax paid in years 2003 – 2007.

Bonus first-year depreciation – For most new depreciable assets (other than buildings) placed in service during 2008, The Economic Stimulus Act (which was passed in early 2008) permitted 50% of the cost to be expensed immediately, with the balance recovered under the regular depreciation rules. This special first-year deduction applied both for regular tax and

alternative minimum tax. For autos and light trucks, for which first-year depreciation would otherwise have been limited under the so-called "luxury automobile rules", bonus depreciation of \$8,000 could be taken (bringing the total deduction for such to approximately \$11,000). These bonus depreciation rules were to have applied only for 2008. However, the new legislation extends the rules through 2009.

Extension of increased section 179 expense amount – The Economic Stimulus Act (enacted earlier this year) increased the amount of furniture and equipment purchases that businesses could elect to immediately expense to \$250,000 for purchases made during 2008, and also increased the level of purchases at which this benefit would begin to be phased out to \$800,000. The new legislation extends these amounts for another year.

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Kyle K. Bartleson, CPA

Member in the Spotlight – Kyle Bartleson

Kyle Bartleson's broad range of work experience includes, in addition to 13 years in public accounting, 4 years in the U.S. Army as an Intelligence Analyst, and 5 years with the Internal Revenue Service. From an educational standpoint, he holds an undergraduate degree from Western Kentucky University and a Masters in Taxation from Georgia State University.

Kyle and his wife, Carole, are now empty nesters,

with three young adult children, two of whom have followed in dad's footsteps and are serving in the U.S. military. Kyle and Carole are active in Bethesda United Methodist Church, and he enjoys playing both classical and electric guitar.

Bridges & Dunn-Rankin is proud to have Kyle Bartleson as a member of our firm.

The American Recovery and Reinvestment Act of 2009 – continued

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Expansion of the Work Opportunity Tax Credit – The list of individuals qualifying employers for the Work Opportunity Tax Credit (WOTC) is expanded to include “unemployed veterans” (generally defined to include those who have been discharged from active duty within the past 5 years who have been receiving unemployment compensation for at least 4 weeks) and “disconnected youth” (generally defined as those between the ages of 16 and 25 who have not been in school or employed for the previous 6 months and who lack the basic skills to be employable). Employers hiring these individuals during 2009 or 2010 may be eligible for a tax credit of \$2,400 per such person hired.

Extension of election by corporations to accelerate AMT & research credits instead of bonus depreciation – The ability of corporations otherwise eligible for bonus depreciation to instead elect to claim additional alternative minimum tax (AMT) credits or research tax credits is extended through 2009.

Deferral of income from cancellation of business indebtedness – Businesses which satisfy their debt at a discount, which would otherwise under current law have been cancellation of indebtedness income, can elect to defer the taxable income from such and recognize it over a 5 year period beginning in 2014.

Shortening of the “built-in gains tax” period for S-corps – C-corporations which make a Subchapter S election and then sell their assets within 10 years of electing S status are subject to a corporate level tax (the “built-in gains tax”) on any unrealized gains that existed at the effective date of the S election. For asset sales which occur during 2009 or 2010, the new legislation shortens this period to 7 years.

Increase in exclusion for gain on sale of Qualified Small Business Stock – Under current law, non-corporate taxpayers may exclude from taxable income 50% of the gain from the sale of “qualified small business stock” which has been held at least 5 years. While at first blush this exclusion sounds great, due to the fact that the remaining gain is subject to a 28% rate (and the fact that a portion of the excluded gain has to be added back for purposes of the alternative minimum tax), this provision has not been very beneficial. The new legislation increases the amount of the exclusion to 75%. The increased exclusion amount should

mean an effective Federal regular tax rate on such gain of 7%, and an effective alternative minimum tax rate on such gain of 12.88% (rather than the 15% Federal rate which would otherwise apply to an individual's long-term capital gain).

Reduced quarterly estimated tax payments for small business owners and employees – Under present law, in order to avoid a penalty for underpayment of estimated tax you must pay in quarterly at least 90% of your tax liability for the current year or 100% of your tax liability for the immediately preceding year (110% for those whose prior year income was more than \$150,000). The new legislation provides that, for individuals whose prior year income was less than \$500,000 and for whom at least 50% of their income came from a business with 500 employees or less, the prior-year-tax-liability safe harbor will be reduced to 90% of the prior year tax amount.

Subsidized COBRA coverage – Employees who are involuntarily separated from employment between September 1, 2008 and January 1, 2010 may elect to pay 35% of their COBRA coverage premiums and have the Federal government subsidize the balance via payroll tax credits to the employer for a 9-month period.

Loss limitations on banks reinstated – Tax rules discourage “trafficking” in net operating losses (NOLs) or other “built-in losses” by placing potentially severe limitations on the use of a company's tax losses and tax credits following a change in ownership. Generally, if there is a more than 50-percentage point change in ownership during any 3-year period, the amount of the loss carryforwards or built-in losses which existed at the time of the ownership change which can be used in any future period is limited to the value of the company on the date of the ownership change multiplied by a fluctuating rate which is generally around 4%. In October 2008, the IRS shocked many of us in the tax professionals community by issuing a notice which effectively exempted banks from these rules. Many of us in the tax professionals community (and many in Congress as well) believed the IRS had likely overstepped its bounds. The new legislation repeals this IRS notice for changes in ownership occurring after January 16, 2009.

NOL limitations not to apply where EESA bail-out requires ownership restructuring – As noted above, the new legislation
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The American Recovery and Reinvestment Act of 2009 – continued

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repeals the late 2008 IRS notice which effectively exempted banks from the limitations which apply to net operating losses and built-in losses after an ownership change. However, the same legislation exempts from the loss limitation rules any ownership change which occurs under a restructuring plan required under a loan agreement or a commitment for a line of credit entered into with the Treasury Department under the Emergency Economic Stabilization Act of 2008.

Increase in alternative minimum tax exemption – The alternative minimum tax (“AMT”) is a separate but parallel system to the regular income tax. You must compute your tax under both systems, and pay the greater of the two. If the AMT is higher than the regular tax then this excess shows up on your return as an additional tax. For 2008, married individuals filing jointly were permitted a maximum exemption in computing the AMT of \$69,950 and singles were permitted a maximum exemption of \$46,200. For 2009, these maximum exemption amounts (which are subject to phase-out for higher income taxpayers), were scheduled to be reduced to \$45,000 and \$33,750, respectively. This would have meant millions more taxpayers being subject to the AMT for 2009. To prevent this, Congress has increased the exemptions for 2009 to \$70,950 and \$46,700, respectively. This represents a tax savings of up to \$6,747 for those directly affected.

Exclusion of private-activity bond interest from AMT – Under current law, interest on “private-activity bonds” (state and local bonds issued to provide financing for private purposes) is an add-back in computing alternative minimum tax (AMT). Under the new legislation, interest on private-activity bonds issued in 2009 or 2010 will not have to be added back in computing the AMT.

First-time homebuyer credit – Legislation enacted in 2008 provided for a first-time homebuyer tax credit of up to \$7,500, which has to be repaid over a 15-year period. The new legislation increases the maximum credit to \$8,000, and provides that it does not have to be repaid, provided that the taxpayer lives in the home for at least 3 years.

Making Work Pay credit - For 2009 and 2010, singles will be permitted a tax credit of up to \$400 and married couples a tax credit of up to \$800, computed based on 6.2% of earned income

(not to exceed \$6,452 in earnings for singles or \$12,904 for married couples). The credit is phased out for singles with income over \$75,000 or married couples with income over \$150,000.

\$250 Economic Recovery Payment – The new legislation provides for a onetime payment of \$250 to individuals who are eligible for social security benefits, railroad retirement benefits, veterans compensation, supplement security income, or government retirement benefits.

New deduction for sales tax paid on purchase of new vehicle – A new deduction (which can be taken either as part of the standard deduction or as an additional itemized deduction) is provided for the sales tax paid on the purchase of a new vehicle. The deduction cannot exceed the portion of the tax attributable to the first \$49,500 of the purchase price, and the deduction is phased out for singles with income over \$125,000 or married couples with income over \$250,000.

Hope education credit enhanced and renamed – The “Hope” education credit is renamed the “American Opportunity Tax Credit”, the maximum amount of such is increased from \$1,800 to \$2,500 per year, it may apply for the first 4 years of post-secondary education (versus 2 years under current law), it may be claimed against alternative minimum tax, and 40% of the credit is “refundable” (meaning that it can exceed your tax liability). The credit is phased out for singles with income over \$80,000 and married couples with income over \$160,000.

Section 529 plan distributions for computer expenses – For 2009 and 2010, tax-free distributions from section 529 plans may be used to pay for computers, computer technology, and internet access.

Unemployment compensation – Up to \$2,400 of unemployment compensation benefits received in 2009 will be excluded from the recipient’s taxable income.

Increase in credit for nonbusiness energy efficiency improvements – The amount of the tax credit provided to individuals for qualified energy efficiency improvements and residential energy property expenditures incurred in 2009 and 2010 is increased to 30% of the amount expended, with the tax credit for such not to exceed \$1,500.

Client in the Spotlight – Xpanxion, LLC

Following the successful sale of his first company, Compris Technologies, Inc., to NCR in 1997, entrepreneur Paul Eurek founded Xpanxion, LLC, a software engineering services company with offices in Alpharetta, Georgia, Pune, India, and Kearney, Nebraska.

From software maintenance and platform migration to large scale application development and life cycle management, Xpanxion provides a comprehensive suite of services, including product planning, project management, user interface design, database modeling, software architecture and design, software programming and quality assurance. Xpanxion’s clients range

from Fortune 100 companies to small to mid-sized organizations looking to increase their capacity and leverage the benefits of a global delivery approach. Xpanxion helps its clients operate more efficiently, bring products to market quickly, and rapidly achieve their business objectives.

Bridges & Dunn-Rankin is proud to be associated with Xpanxion, LLC.



IRS Scrutinizing Use of Qualified Retirement Plan Money to Fund New Business Startup

In late 2008, the IRS issued an internal memorandum to its employees providing guidelines for examination of potentially abusive retirement plan arrangements called Rollovers as Business Startups (“ROBS”). Apparently it has come to the attention of the IRS that a number of promoters are marketing these arrangements as a means for individuals to convert their existing retirement accounts into seed money for funding a new business venture, without first paying taxes (and potentially early distribution penalties) on the money. Under a ROBS plan, a new business owner first creates a shell C corporation with created, but not issued, stock. Next, the newly created company adopts a retirement plan with a provision permitting

100% of the plan assets from rollovers to be invested in employer stock. Then the business owner rolls over to the new plan money from an existing qualified plan, and has the newly created corporation issue all of its stock to the ROBS plan in exchange for the money in the plan.

The IRS has examined a number of these plans and found significant disqualifying operational defects in most. The IRS believes that these plans likely violate the discrimination rules and/or the prohibited transaction rules.

Required Minimum Distribution Rules Waived for 2009

Under the “required minimum distribution” rules, you are generally required to begin taking certain minimum annual distribution amounts from your qualified retirement plan accounts and IRAs once you reach age 70 1/2, or else face stiff penalties for failure to do so. In light of the recent substantial decline in the stock market (and some investors’ hesitation to

pull money out of the market at these lower values), legislation was enacted in late 2008 waiving the required minimum distribution rules for 2009.

A Few of Our Favorite Quotes Describing the Current Economic and Tax Situation

“Government’s view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.” Ronald Reagan (1986)

“The ultimate result of shielding men from the effects of folly is to fill the world with fools.” Herbert Spencer, English Philosopher (1820 – 1903)

“A government big enough to give you everything you want, is strong enough to take everything you have.” Thomas Jefferson

“I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.” Winston Churchill

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Increase in Defined Contribution Plan Amounts

Effective for 2009, the amount of compensation which may be taken into account in determining the amount of qualified retirement plan contributions is increased to \$245,000, and the maximum amount which may be contributed to a defined contribution plan is increased to \$49,000.

Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth individuals.

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