



"STIMULUS BILL" BUSINESS TAX IMPACT

On February 13, the House of Representatives, by a vote of 246-183, and the Senate, by a vote of 60-38, passed H.R. 1, the American Recovery and Reinvestment Act of 2009 (the Recovery Act). The Recovery Act contains \$787 billion in spending, investment and tax cuts; approximately 60% is allocated to spending and investment provisions, with the remaining 40% allocated to tax cuts. President Obama is expected to sign the Recovery Act on Tuesday, February 17th, which will impact closely-held businesses as follows:

Increased Expensing Provisions

The Recovery Act extends the current bonus depreciation provision to cover assets placed in service during 2009. This provision allows a business to immediately deduct 50% of the cost of assets acquired and placed in service in 2009 with depreciable lives of 20 years or less.

The Recovery Act also extends, for property placed in service during 2009, the provision allowing a business to monetize its AMT credits and research and development ("R&D") credits in lieu of the aforementioned bonus depreciation. This provision is geared to businesses with AMT exposure, or, who have current year losses and cannot benefit from bonus depreciation. The provision allows such businesses to elect to receive 20% of the value of unused AMT or R&D credits to the extent they invest in assets that would qualify for bonus depreciation. The amount is capped at the lesser of 6% of the outstanding unused AMT credits and R&D credits, or \$30 million.

Additionally, the Recovery Act would allow businesses to immediately expense acquired capital assets. An existing provision in the Internal Revenue Code permits businesses to expense up to \$125,000 (subject to a phase-out) of applicable capital acquisitions through 2010; however, in 2008, Congress temporarily increased the deductible amount to \$250,000 only for 2008. This \$250,000 deduction amount is now extended through 2009 (with retroactive effect to January 1, 2009). This expensing amount will be reduced to \$25,000 beginning in 2010.

The Closely Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

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Increased Net Operating Loss Carryback Provision

The Recovery Act extends the carryback period for net operating losses (“NOLs”) generated in 2008 (years beginning or ending in 2008) to the previous five years, but only for businesses with annual gross receipts of not more than \$15 million per year. This “gross receipts test” would be met if the average annual gross receipts for the previous three years are \$15 million or less. Under pre-Act law, a corporation could carryback a current year NOL to generate a refund of income taxes only where the corporation had income in the prior two years. The five-year carryback period will allow the recovery of tax payments made in prior years, which could be applied by corporate taxpayers to operate businesses struggling in the current economic climate.

Cancellation of Indebtedness

The Recovery Act will encourage business restructurings by allowing the delayed recognition of cancellation of debt income (“CODI”). Businesses would be allowed to recognize CODI over ten years (defer tax on CODI for the first four or five years and recognize this income ratably over the following five tax years) for specified types of business debt repurchased by the business in 2009 or 2010.

Qualified small business stock

“Qualified small business stock” is any stock in a qualified small business issued to a taxpayer after August 10, 1993, in exchange for money or other property (not including stock), or as compensation for services. A “qualified small business” is a domestic C Corporation with aggregate gross assets not in excess of \$50,000,000.

Under pre-Act law, a taxpayer (other than a corporation) that recognized gain from the sale or exchange of “qualified small business stock” held for more than five years could exclude 50% of such gain from gross income for regular income tax purposes. The new law increases the exclusion from 50% to 75% for stock issued after the enactment date and prior to 2011, which effectively reduces the tax on gains from such stock to 7%.

S Corporation Holding Period

An “S” corporation allows certain corporations to be taxed as a conduit so that income, gains, and losses pass through to the shareholder’s tax return without tax consequences to the corporation. In the absence of restrictions, an S corporation election would provide substantial tax avoidance opportunities for a C corporation holding appreciated assets that would yield taxable gains if sold.

For example, a corporation holding assets worth \$500,000 in market value and having total adjusted bases of \$150,000 has \$350,000 of “built-in gain” on its balance sheet. Prior to making an S election, the disposal of these assets would generate a \$350,000 gain that would be taxed to the C corporation. When the after-tax proceeds from this sale are distributed, they are subject to tax again at the shareholder level. If the corporation delays disposition of the assets until an S election is made, the typical tax treatment under Subchapter S would be to pass through \$350,000 of income to the shareholders and thus avoid double taxation on gain which had actually accrued during the C corporation years. The Internal Revenue Code enacted a law in 1986 to close this loophole by assessing a tax on any “built-in gains” from C corporation years when they are realized within the first ten years of the S election.

The Recovery Act temporarily shortens the holding period of assets subject to the built-in gains tax from ten years to seven years for sales occurring in 2009 and 2010.

If you have questions whether your business qualifies for any of these corporate tax benefits, or how you can structure your business affairs to maximize these benefits, please contact our closely held business members Randall L. Duncan or Jonathan D. Mishkin at (503) 242-0000, and we will be glad to assist you.



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