



# From the Desk of Dean Zerbe.



## Stimulus Tax Bill Signals Bigger Problems Ahead for Business

by Dean Zerbe

(February 20, 2009)

Like the child shoveling a mountain of manure in the belief that there must be a pony somewhere, I kept searching in the stimulus bill for good news to tell business. Unfortunately, I've found neither a pony nor much good news to convey. In fact, I believe the tea leaves from this bill: the behind-the-scenes story of the stimulus bill do not portend well for business in terms of tax legislation down the road.

Those who want to be spared the sizzle with the steak can skip my analysis and just go to the meat provided in the outline of the legislation below.

My main concern is that this legislation is the product of the administration turning over the keys to the new car to Congressional leaders. Despite good comments in good speeches, less than 1% of the nearly \$800 billion in this package will be providing tax benefits to small and medium businesses, according to estimates by my former colleagues at the Senate Finance Committee (minority). The Federal Buildings Fund (\$7 billion) and Broadband expansion (\$6.7 billion) got more than the roughly \$6 billion in estimated tax relief for small business. This is not a partisan comment. For business, the bill went even further south in the negotiations with the three Republican Senators. Gone from the Senate bill are the NOL carryback for all businesses (now just limited to small business, but I think of limited utility in practice) and the five-year carryback for general business credits.

In addition, not even getting out of the blocks for consideration by Congress was President Obama's call for a \$3,000 credit for businesses making new hires (maybe not the best thing since sliced bread but still reflecting the understanding that we need to get dollars into the hands of businesses). The new President's proposal for zero capital gains for investments in new small businesses was turned into a mouse: 75% exclusion for 1202 stock. To add insult to injury, the claimed \$326 billion in tax cuts is basically a third less than advertised.

The Joint Committee on Taxation scoring of the stimulus bill (the nonpartisan official scorekeeper of taxes for Congress) makes clear that \$111 billion of the tax cuts are "outlays," Congress-speak for payments made to folks who pay no federal income tax.

**Bottom line:** there is very little in the tax provisions of the stimulus that suggests the imprint of the new administration. My worry - and what should be your clients' worry - is what this will mean down the road, especially for estate/death tax that will have to be dealt with before January 1, 2010 (yes, there will be no taking Grandma to Oregon). I previously thought that the estate tax was on a fairly set glide path to keep in place at least for the next two/three years the 3.5 million unified credit and 45% rates that are in place now, and of which candidate Obama spoke in favor. Now, in a new world where Congress is driving tax policy, I am not nearly as sanguine about that glide path. Yes there are members on both sides of the aisle who support Obama's position on estate tax, but there are many who don't. Without Presidential leadership, it is much more uncertain where Congress will end up on estate/death tax and other tax issues important to business. Things are very fluid in Washington, D.C. right now, so I'm not ready to say the way the stimulus bill went is how the future will go, but color me worried for now.

**One last note:** I continue to be asked by colleagues in Congress (both sides of the aisle) for any ideas or thoughts on tax relief that would help small and medium business. I have forwarded the ones I've received previously and made it clear what I've heard from so many of you that what is really needed is improved access to credit and credit lines. I welcome and appreciate any thoughts you may have because yes, I do think we will see another stimulus bill, and hopefully one that will do more to help employers.

### Business Tax Provisions in the Stimulus Bill

By now, most of you are familiar with the general contours of the stimulus bill as it relates to taxes:

**EXTENSION.** 50% first year depreciation for property acquired and placed in service before Jan. 1, 2010 (with January 1 2011 for certain longer-lived property).

**EXTENSION.** Section 179 expensing for one year (\$250,000 expenditures and phase-out threshold of \$800,000).

**NEW.** Net operating losses (NOLs) carry-back for small businesses extended to five years (from previous law - two years). Good only for small businesses with gross receipts of \$15 million or less for the tax year in which the loss arose. The earlier draft provision of an expanded carryback for all businesses was dropped due in part to cost and also concerns of some in Congress that would provide significant benefit to homebuilders.

**EXPANDED.** WOTC for employers who hire two new targeted groups: 1) unemployed (recent) veterans and 2) disconnected youth who begin work in 2009 or 2010 (disconnected youth defined as an individual certified by the designated local agency as someone: a) at least age 16 but not yet age 25 on the hiring date; b) not regularly attending any school during the six-month period preceding the hiring date; c) not regularly employed during the six-month period preceding the hiring date; and d) not readily employable by reason of lacking a sufficient number of skills.) I highlight these details only for those who were concerned that the days of Congress providing detailed, wear-a-red-dress-and-hop-on-one-foot-before-you-get-a-tax-break days were over.



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**CHANGED.** Estimated taxes for individuals with small businesses. Effective Feb. 17, 2009, For tax years beginning in 2009, in computing the amount for the required annual installments of estimated income tax of any qualified individual, "required annual payment" is the lesser of 1) 90% of the tax shown on the return of the tax year, or 2) 90% of the tax shown on the return of the individual for the preceding tax year. A "qualified individual is one with an AGI of less than \$500k (\$250 if married filing separately), and 50% of the gross income on the preceding-year's tax return was income from a small trade or business (defined as a business that employed no more than 500 persons on average during the preceding tax year.

**NEW.** Deferral of debt forgiveness income on repurchase of debt. It's complicated, but in a nutshell this was a gift primarily to the private equity folks - and allows businesses to recognize cancellation of debt income over 10 years (deferred for the first four/five years and then recognized over a five-year period). It applies to certain types of business debt repurchased by the business in 2009/2010.

**CHANGED.** Qualified small business stock. Expands the exclusion of qualified small business stock (1202 stock) from 50% to 75%. The stock must be acquired after Feb. 17 2009 and before Jan. 1, 2011.

**DELAYED.** Withholding tax for payments of 3% for government contracts. This was supposed to start in 2011, but was pushed back to 2012. I think this is an indication of Congress backing away from earlier commitments to fight the fight of "tax gap." Unfortunately the IRS still hasn't gotten the signal, as it continues to put coal in the furnace for audits of small and medium business under the heading of "tax gap."

Those are the major changes on the business side as well a significant number of energy incentives (\$17 billion) that I discussed in general last time (although the expanded R&D credit for energy was

dropped). With more bond provisions than I've seen in any tax bill before (primarily benefitting government activities), the bill is certainly a stimulus for bond lawyers and underwriters.

### Individuals in the Stimulus Bill - Highlights

**AMT Patch.** In place for 2009. Thanks to my old boss, Senator Grassley, we kick the can down the road one more year and millions more won't be hit by AMT this year.

**Families Making less than \$150,000.** Another round of payments/relief for families making less than \$150,000 (married) and \$75,000 (single). Payments of \$800 for families and \$400 for single individuals.

**SSI, veterans, Social Security Beneficiaries.** Payments of \$250 to SSI, veterans, Social Security beneficiaries.

**Unemployment compensation.** Exclusion for first \$2,400 of unemployment benefits received in 2009.

**EITC/Refundable Child Credit.** Expanded.

**Higher Education Tax Credit.** Higher education tax credit of \$2,500 for the first four years of college (phase-out \$80K single and \$160K married). Happily, the University of the District of Columbia yesterday announced their reaction to this good news with a major increase in tuition, and Harvard just announced a 3.5 percent tuition increase. I never saw it coming that colleges would react to increased federal payments by hiking tuition.

**Car purchase.** Taxpayers can deduct state and local sales taxes paid on the purchase of a new car, truck, motorcycle. This phases out at \$125K for single and \$250K for joint filers. Do the different phase-out levels for the education credit (see above) and car purchases suggest a Congressional policy that it is more important to make sure the middle class buy a motorcycle for their son then send them to college? Alas for

Harley-Davidson fans, the answer is no; as readers know from my columns, it reflects the golden rule: the cost of the provision as scored by JCT is what is driving the policy.

**Homebuyer credit.** The stimulus bill extends the first-time homebuyer credit to include residences purchased before December 1, 2009 (July 1, 2009 previously) and raises the credit cap from \$7,500 to \$8,000. The cap increase included in the final stimulus bill is significantly smaller than the original \$7,500 increase in the Senate bill, but at least it is an increase. The stimulus also eliminates the previous credit's recapture provisions unless the home is disposed of or ceases to be the taxpayer's primary residence within three years from the date of purchase.

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