

On February 7, Congress passed the Economic Stimulus Act of 2008 (Stimulus Act), and President Bush signed it into law on February 13. The new law includes three big tax breaks:

- So-called tax rebates for most individual taxpayers (however, higher-income individuals are left out).
- Enhanced Section 179 deductions for qualifying assets placed in service in tax years beginning in 2008. Under the Section 179 deduction privilege, small and medium-sized businesses can instantly depreciate most or all of the cost of qualifying new and used assets in the year they are placed in service.
- A return of the 50% first-year bonus depreciation break for new qualifying assets that are purchased and placed in service during calendar-year 2008, including new autos used for business. In addition, 50% first-year bonus depreciation can be claimed for certain longer-lived new assets that are placed in service by 12/31/09. Unlike Section 179 deductions, first-year bonus depreciation is available to large businesses, as well as small and medium-sized outfits.

The remainder of this letter summarizes the most important points about these three taxpayer-friendly changes.

Tax Rebates for Individuals

The centerpiece of the Stimulus Act is a provision that will result in about 130 million individuals automatically receiving over \$100 billion worth of free money—probably starting in May. Technically, these so-called rebates are considered to be a reduction in your 2007 federal income tax bill. However, they are “refundable” which means they can potentially exceed your tax bill, and you can even collect a rebate when you owe nothing to the IRS. If you have children, you may be eligible for a basic rebate as well as an additional child rebate.

Basic Rebate. The basic rebate amount equals the greater of the following two amounts:

- An amount equal to your net federal income tax liability (regular tax plus any alternative minimum tax reduced by all nonrefundable credits other than the child credit). However, this amount cannot exceed a maximum of \$600 or \$1,200 if you are a married joint filer.
- A flat minimum of \$300, or \$600 if you are a married joint filer, and you meet certain requirements. Basically, to collect the minimum \$300 or \$600 rebate, you must have either: (1) at least \$3,000 in total income from earned income, Social Security benefits, and certain veterans’ benefits or (2) net federal income tax liability of at least \$1, as well as gross income that exceeds the sum of the applicable basic standard deduction amount plus one personal exemption amount or two personal exemption amounts if you file jointly.

Example 1: Minimum basic rebate based on Social Security benefits.

Say you are a single filer with no children. Your 2007 net federal income tax liability is zero, but you received \$18,000 of Social Security benefits. You had no other income. You are

entitled to a \$300 minimum basic rebate based on having 2007 Social Security benefits of at least \$3,000.

Example 2: Basic rebate limited to net tax liability.

Say you are a married joint filer with no children. You had \$2,000 of earned income in 2007 and a net federal income tax liability of \$900 (because you also had some investment income for the year). You are entitled to a \$900 basic rebate based on your tax liability.

Child Rebate. If you qualify for a basic rebate, you are also potentially eligible to receive an additional rebate of \$300 for each qualifying child. There is no cap on the number of qualifying children. The definition of qualifying child is the same as the one used for purposes of claiming the more-familiar child tax credit. The child must under age 17 as of 12/31/07 and be your qualifying child for dependency exemption deduction purposes.

Example 3: Maximum basic rebate plus child rebate.

Say you are a married joint filer with \$50,000 of earned income in 2007, three qualifying children, and a net federal income tax liability of \$2,500. You are entitled to a \$1,200 basic rebate based on your tax liability plus three \$300 child rebates for a total rebate of \$2,100.

Phase-out Rule Can Reduce or Eliminate Rebates for Higher-income Taxpayers.

Congress decreed that rebates are only to be received by low and middle-income individuals. Therefore, the rebates are phased-out for unmarried taxpayers with adjusted gross income (AGI) above \$75,000 and for married joint filers with AGI above \$150,000. Under the phase-out rule, your rebate amount is reduced by 5% of any excess AGI above the applicable threshold amount (\$75,000 or \$150,000).

This means that if you're unmarried, a \$600 rebate is completely phased out when AGI reaches \$87,000 (assuming you have no qualifying children). If you're a married joint filer, a \$1,200 rebate is completely phased out when AGI reaches \$174,000 (assuming you have no qualifying children). The same phase-out rule also applies to child rebates. However the top end of the phase-out ranges are higher for those with child rebates because their combined rebate amounts are higher.

Example 4: Impact of phase-out rule without child rebate.

Say you are a single filer with no qualifying children. Your 2007 net federal income tax liability exceeds \$600. Without the phase-out rule, you would be entitled to the maximum basic rebate of \$600. However, if your AGI is \$82,000, your rebate is reduced to only \$250. If your AGI exceeds \$87,000, your rebate is completely eliminated.

Example 5: Impact of phase-out rule with child rebate.

Say you are a married joint filer with two qualifying children. Your 2007 net federal income tax liability exceeds \$1,200. Without the phase-out rule, you would be entitled to the maximum basic rebate of \$1,200 plus two \$300 child rebates for a total of \$1,800. However, if your AGI is \$175,000, your rebate is reduced to only \$550. If your AGI exceeds \$186,000, your rebate is completely eliminated.

How Will You Get Your Rebate? The government will automatically issue rebates based on information regarding income, tax liability, and qualifying children from your 2007 Form 1040. A 2007 Form 1040 must be filed to receive a rebate, even if the return is not otherwise required. The rebate will be direct deposited if you used direct deposit on your 2007 Form 1040. Otherwise you will receive a check.

As you can see, you won't get your rebate until after your 2007 Form 1040 has been filed. If you extend your 2007 Form 1040 to 10/15/08, your rebate won't arrive until around year-end.

Note that you cannot use your rebate to offset your 2007 federal income tax bill, nor can you apply your rebate to your 2008 estimated tax payment obligations. Why? Because Congress wants you to spend your rebate dollars to boost the flagging economy.

"Second Chance" Rule May Give You Cash Back Next Year. If this year's rebate is not all you hoped it would be, you may get another shot next year—based on information reported on your 2008 Form 1040. For example, this favorable "second chance" rule could help if your 2007 AGI was too high to qualify for a full rebate, your 2007 tax liability was too low to qualify for the maximum \$600 or \$1,200 rebate, or you had a child during 2008.

In such cases, you can collect the difference between the amount already received in 2008 (if any) and the larger amount based on your 2008 tax return information. Any additional amount allowed under this second chance rule will be treated as a refundable credit on your 2008 Form 1040. As such, you will collect the cash in 2009. The same second chance concept will also apply to amounts based on Social Security or veterans' benefits.

If the rebate calculated using 2008 return information is less than the rebate you received in 2007, nothing has to be repaid. Also the rebate has no other impact on your 2008 return.

Ineligible Taxpayers. Rebates are not available to nonresident aliens or to estates and trusts. In addition, no rebate is available to an individual who can be claimed as a dependent on another taxpayer's return (such as your college-age child). Finally, Congress stipulated that individuals without Social Security numbers (SSNs) cannot claim rebates, and SSNs must be provided for any qualifying children claimed for child rebate purposes. Individual Taxpayer Identification Numbers (ITINs) cannot be substituted for SSNs.

Enhanced Section 179 Deductions for 2008 Only

The Stimulus Act also significantly enhances the Section 179 instant depreciation deduction break for tax years beginning in 2008. For tax years beginning in 2009 and beyond, the normal Section 179 rules will kick back in. Here's the deal in a nutshell.

- For tax years beginning in 2008, the maximum Section 179 deduction is generally increased to \$250,000 (up from \$128,000 before the new law). For 2009–2010, the maximum deduction will revert back to \$125,000 with inflation adjustments.
- For tax years beginning in 2008, the allowed 179 deduction will begin being phased out once the business's purchases during the year exceed \$800,000 (up from \$510,000 before the new law). The increased phase-out threshold means more medium-sized businesses will be eligible for Section 179 deductions in

2008. Great! For 2009–2010, however, the phase-out threshold will revert back to \$500,000 with inflation adjustments.

Example 6: New Section 179 deduction rules in action.

Acme Corp is a calendar-year taxpayer. In 2008, Acme places in service \$910,000 of qualifying Section 179 property. Acme's maximum Section 179 deduction for 2008 is \$140,000 (\$250,000 maximum minus \$110,000 excess over the \$800,000 phase-out threshold). Before the favorable changes made by the Stimulus Act, Acme would not have been entitled to any Section 179 deduction for 2008 because the phase-out threshold was so much lower.

Warning: If you have a fiscal year business, the increased Section 179 deduction and phase-out threshold do not take effect until the fiscal year *beginning* in 2008. You will want to time purchases accordingly.

First-year Bonus Depreciation Makes a Comeback

Last but not least, the Stimulus Act revives the 50% first-year bonus depreciation break for qualifying assets that are both acquired and placed in service during calendar 2008. However, the placed-in-service deadline is extended through 12/31/09 for certain longer-lived assets.

Under the 50% first-year bonus depreciation deal, your business can immediately write off 50% of the cost of qualifying assets in the first year. The remaining cost can be written off via regular depreciation deductions over the asset's designated recovery period.

To be eligible for 50% first-year bonus depreciation, an asset must be: (1) *qualified property* (2) purchased new during calendar 2008 (no used assets need apply) and (3) be placed in service by 12/31/08 (or by 12/31/09 for certain long-lived assets).

Qualified Property. To be *qualified property*, the asset must fit within one of the following definitions.

- Property with a depreciation recovery period of 20 years or less. This definition encompasses most tangible personal property used in business.
- Depreciable computer software that is *not* amortizable over 15 years. (The 15-year rule rarely applies.)
- Water utility property.
- Qualified leasehold improvement property.

Only New Assets Are Eligible. An asset is eligible for 50% first-year bonus depreciation only if its original use commences with the taxpayer after 12/31/07. In other words, the asset must be new. A special exception applies to assets that are sold and leased back.

Certain Leasehold Improvement Costs Qualify. The 50% first-year bonus depreciation break is available for the cost of "qualified leasehold improvement property." To meet this definition, all of the following tests must be passed.

- The improvement must be to the interior portion of a building.
- The building must be nonresidential real property.
- The improvement must be made pursuant to or under a lease by either the lessee (or sublessee) or the lessor to property that will be occupied exclusively by the lessee (or sublessee).
- The improvement must be placed in service more than three years after the date the building was first placed in service.

Bonus Depreciation for New Autos and Light Trucks. For a new passenger auto or light truck that is used for business and subject to the dreaded luxury auto depreciation limitations, the 50% bonus depreciation break increases the maximum first-year depreciation deduction by \$8,000. So for a new passenger auto acquired and placed in service in 2008, the maximum first-year depreciation deduction is anticipated to be \$11,060. For a new light truck acquired and placed in service in 2008, the maximum first-year depreciation deduction is anticipated to be \$11,160. (The official amounts of 2008 depreciation limits have not yet been released.)

Of course, the full \$11,060 or \$11,160 amount is only available when the new passenger auto or light truck is used 100% for business. For instance, if you use a new passenger auto 80% for business, your maximum first-year depreciation deduction would be \$8,848 ($.80 \times \$11,060$).

Extended Placed-in-service Deadline for Longer-lived Assets. The placed in service deadline for qualifying property with a depreciation recovery period of 10 years or longer, certain transportation property, and certain aircraft is extended to 12/31/09 (compared to the general placed-in-service deadline of 12/31/08).

Warning: Under the extended placed-in-service rule, only the portion of costs that are allocable to calendar 2008 are eligible for 50% first-year bonus depreciation.

Conclusion

You now understand the basics on all the tax provisions included in the new Stimulus Act. As you can see, the changes are not so simple. Please contact us if you have questions or want additional information. We are here to help.