Congress passes economic stimulus package

Responding to a challenge from President Bush issued on Jan. 18, Congress passed the Economic Stimulus Act of 2008 on Feb. 7. The president signed the new law on Feb. 13, less than one month after his original proposal.

In calling on Congress to enact a stimulus package, the President set forth four goals:

1. The stimulus should be big enough to make a difference in an economy as large and dynamic as the U.S. economy.
2. The package should provide broad-based tax relief that will directly affect economic growth, rather than increased federal spending.
3. The relief should be temporary and take effect immediately.
4. The package should not include tax increases.

Congress responded with a two-part stimulus package that includes tax rebate checks for individuals and enhanced depreciation write-offs for businesses.

The government’s hope is that individuals will spend their rebate checks, spurring consumer-driven economic activity. At the same time, the goal of the business package is to entice companies to invest in new production equipment, escalating business expansion and creating new jobs.

Congress also continues to enact legislation designed to alleviate the subprime mortgage crisis. Last December, in the Mortgage Forgiveness Debt Relief Act of 2007, Congress permitted individuals to exclude from gross income in 2007 forgiveness of qualified indebtedness used to acquire a principal residence. In the stimulus package, Congress has acted to increase the maximum mortgage amounts that various government agencies may give to potential homebuyers.

The new law raises the maximum amounts of principal for mortgages issued by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) to 175 percent of the previous limitations. The new limit applies to mortgages originated between July 1, 2007, and Dec. 31, 2008, and to mortgages approved during this period but used to purchase homes at a later date.
Recovery rebates for individual taxpayers

For the 2008 tax year, Congress has authorized two new tax credits and an expansion of an existing tax credit.

Individuals will qualify for only one of the new credits.

➢ The first new credit is equal to the lesser of $600, $1,200 for a married couple filing a joint return, or your net tax liability for the year.
➢ For those with a tax liability less than $300, the law creates a second, alternative credit. The second new credit is $300 per taxpayer, or $600 for a married couple filing a joint return. This credit can exceed an individual’s tax liability, making the excess credit refundable. To qualify for the $300 credit, you must meet one of the following tests:

   1. The sum of your earned income, Social Security benefits and veteran’s payments for 2008 is at least $3,000, even if you have no tax liability.
   2. Your gross income is greater than the sum of your standard deduction and personal exemption amounts and you have a tax liability of at least $1.

➢ OBSERVATION: Some people will qualify for a refundable credit, even though they are not required to file a tax return. An example would be a person whose only income was $3,000 in Social Security benefits. To prompt the Treasury Department to issue a rebate check, individuals must file a 2007 return reporting their nontaxable income.

Individuals who can be claimed as dependents of another person, nonresident aliens, estates and trusts are ineligible for these new credits.

Enhanced child tax credit

Anyone who is eligible for one of the two new tax credits may also be eligible for a $300 credit for each qualifying child. A qualifying child includes any child who qualifies as your dependent for 2008. However, the child must not have reached age 17 by Dec. 31, 2008.

➢ OBSERVATION: If you have a dependent age 17 or older, you will not qualify for the enhanced child tax credit. In addition, that dependent will not qualify for the new $600 or $300 taxpayer credit.

Income limitation

The amount of your total credit is reduced by 5 percent of your adjusted gross income above $75,000, or $150,000 on a joint return.
Rebate checks

Most people will receive the credits in the form of a rebate check issued by the Department of the Treasury. The amount of the payment will be calculated using the new rules, but will be based on the information shown on your 2007 federal income tax return.

➤ OBSERVATION: No rebate check will be issued until the IRS receives and processes your 2007 return. So it pays to file early.

When you file your 2008 return, you will be required to make a reconciling calculation. If your credit calculation for 2008 results in a higher credit amount that the rebate check you received from the Department of the Treasury, you may claim the difference as a refundable tax credit on your 2008 return. On the other hand, if the rebate check you receive—which is based on information shown on your 2007 return—is greater than the credit calculated based on your 2008 information, you will not be required to return the excess amount to the Treasury.

Rebate Example #1

George, who is widowed, has $14,000 in Social Security income, no qualifying children and no net tax liability. George will be entitled to a $300 refundable credit because he meets the qualifying income test.

Rebate Example #2

Lenore, who is divorced, has $4,000 in earned income, one qualifying child and no net tax liability. Lenore will be entitled to a $600 refundable credit, comprising $300 for meeting the qualifying income test and $300 per child.

Rebate Example #3

Frank and Shirley, who are married and file a joint return, have $40,000 in earned income, two qualifying children and a tax liability of $400. The couple meets the qualifying income test and the net tax liability test. They will be entitled to a refundable credit of $1,000, comprising $400 (lesser of $1,200 or net tax liability), and $300 per child.

Rebate Example #4

Ken and Carol, who are married and file a joint return, have $175,000 in earned income, two qualifying children and a net tax liability of $31,000. The couple meets the qualifying income test and the net tax liability test. Were it not for the income limitation, the couple would be entitled to a refundable credit of $1,800 comprising $1,200 (lesser of $1,200 or net tax liability) and $300 per child. Since their adjusted gross income exceeds $150,000, the phaseout provision reduces the total credit amount by 5 percent of the amount by which their adjusted gross income exceeds $150,000. Five percent of $25,000
($175,000 minus $150,000) equals $1,250. The couple will be entitled to a refundable credit of $550 ($1,800 minus $1,250).

- OBSERVATION: By issuing rebate checks, the government is hoping you will spend the extra cash you receive. However, many financial planners are recommending that taxpayers save their rebate checks by depositing them into retirement accounts or paying down high-interest credit card debt.

Special depreciation allowance for certain property

In an effort to stimulate business economic activity, Congress has increased the first year expensing allowance (the Section 179 deduction) and has reprised the 50 percent bonus depreciation rules that went into effect after Sept. 11, 2001. The Section 179 deduction is temporarily increased to $250,000.

Importantly, the effective dates of these two changes are not quite the same. The bonus depreciation rules apply to property purchased and placed in service on or after Jan. 1, 2008, while the increase in the Section 179 deduction amount takes place in years beginning on or after Jan. 1, 2008. The difference in wording will not affect businesses using the calendar year, but fiscal-year companies will need to apply the rules carefully.

For example, a business that files its tax returns using a fiscal year ending March 31 can, in its return for the year ending March 31, 2008, claim bonus depreciation on qualifying assets purchased and placed in service between Jan. 1 and March 31, 2008. However, that business can claim the higher Section 179 deduction only for assets placed in service after March 31, 2008 – in its year ending March 31, 2009.

Any qualifying assets the business purchases and places in service between April 1, 2008, and Dec. 31, 2008, will be eligible for bonus depreciation in the company’s fiscal year ending March 31, 2009.

The bonus depreciation is in addition to any “section 179 deduction” to which the business may be entitled.

- OBSERVATION: The same item of property may not qualify for both bonus depreciation and the Section 179 deduction. The rules for each are different.

- OBSERVATION: The Section 179 deduction includes a taxable income limitation, which generally prevents businesses operating at a loss from taking advantage of the deduction. The new bonus depreciation has no such limitation. Therefore, bonus depreciation can increase a net operating loss, which may be carried back to gain a refund of taxes paid in prior years.

Congress also raised – from $510,000 to $800,000 – the investment limit at which phaseout of the Section 179 expense deduction begins. Since the Section 179 deduction is reduced dollar-for-dollar for qualified asset purchases in excess of the phaseout threshold, the combination of the new Section 179 limits means that businesses that acquire and
place in service less than $1,050,000 of qualifying assets will receive some benefit from the Section 179 deduction.

- OBSERVATION: Fiscal year businesses are affected in different ways by the effective dates for the bonus depreciation and Section 179 deduction changes. Bonus depreciation applies to qualifying property placed in service after Dec. 31, 2007. The increase in the Section 179 deduction limits applies to tax years beginning after Dec. 31, 2007. That means a business using a fiscal year ending March 31 will not qualify for the higher Section 179 deduction limits until its tax year ending March 31, 2009.

For property to qualify for the new bonus depreciation, it must meet all of the following requirements:

- The property must either:
  - Have an applicable modified accelerated cost recovery system (MACRS) recovery period of 20 years or less
  - Be water utility property
  - Be computer software not covered by the Section 197 amortization rules
  - Be qualified leasehold improvement property
- You must be the original user of the property.
- You must purchase the property after Dec. 31, 2007, and you must not have had a binding contract to purchase the property that was in effect before Jan. 1, 2008.

- OBSERVATION: Some property may be eligible for the bonus depreciation even if it is placed in service after Dec. 31, 2008. However, only the portion of the tax basis, or cost, of the property that reflects progress payments made before Dec. 31, 2008, will generally be eligible for bonus depreciation.

Special depreciation limits apply to passenger automobiles used for business purposes. A passenger automobile includes any four-wheeled vehicle manufactured primarily for use on public streets, roads and highways that has an unloaded gross vehicle weight rating of 6,000 pounds or less. Ambulances, hearses, and vehicles used directly in the trade or business of transporting persons or property for hire, such as taxis and limousines, are not considered passenger automobiles, regardless of weight.

Normally, the first year depreciation deduction for passenger automobiles is limited to $3,060. However, for passenger automobiles qualifying for the new bonus depreciation, the first year limit is increased to $11,060.
**Bonus Depreciation Example #1**

Mega Corporation uses the calendar year as its tax accounting year. During July 2008, Mega acquires and places in service $1,200,000 of assets that qualify for bonus depreciation. The assets have a seven-year MACRS recovery period.

Because of the amount of its new assets, Mega does not qualify for the Section 179 deduction. However, Mega’s depreciation deduction for 2008 is more than $685,000, calculated as follows:

<table>
<thead>
<tr>
<th>New assets</th>
<th>Tax deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>50% bonus depreciation</td>
<td>600,000</td>
</tr>
<tr>
<td>Cost subject to MACRS</td>
<td>600,000</td>
</tr>
<tr>
<td>2008 MACRS depreciation</td>
<td>85,740</td>
</tr>
<tr>
<td>Total 2008 deductions</td>
<td>$685,740</td>
</tr>
<tr>
<td>Percentage of cost deducted in 2008</td>
<td>57.1%</td>
</tr>
</tbody>
</table>

**Bonus Depreciation Example #2**

Mini Corporation uses the calendar year as its tax accounting year. During July 2008, Mini acquires and places in service $500,000 of assets that qualify for bonus depreciation. The assets have a seven-year MACRS recovery period.

Mini’s depreciation deduction for 2008 is over $390,000, calculated as follows:

<table>
<thead>
<tr>
<th>New assets</th>
<th>Tax deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$500,000</td>
</tr>
<tr>
<td>Section 179 expense amount</td>
<td>250,000</td>
</tr>
<tr>
<td>Depreciable cost</td>
<td>250,000</td>
</tr>
<tr>
<td>50% bonus depreciation</td>
<td>125,000</td>
</tr>
<tr>
<td>Cost subject to MACRS</td>
<td>$125,000</td>
</tr>
<tr>
<td>2008 MACRS depreciation</td>
<td>17,863</td>
</tr>
<tr>
<td>Total 2008 deductions</td>
<td>$392,863</td>
</tr>
<tr>
<td>Percentage of cost deducted in 2008</td>
<td>78.6%</td>
</tr>
</tbody>
</table>

The individuals that contributed to the special issue of Federal Tax Watch are Michael Redemske, CPA, and CPAmerica tax experts Mike Koppel, CPA, and Milton Howell, CPA.