



Key tax issues

The American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act of 2009 (the Act), the \$787 billion economic stimulus legislation that President Obama signed into law on February 17, 2009, includes numerous temporary tax incentives that can provide significant tax benefits to manufacturing companies.

Bonus depreciation — The Act extends for one additional year the 50 percent bonus depreciation enacted as part of the *Economic Stimulus Act of 2008*. Under the bonus depreciation rules, 50 percent of the basis of qualified property may be deducted in the year the property is placed in service and the remaining 50 percent recovered under otherwise applicable depreciation rules. Generally, qualified property includes: property with a MACRS recovery period of 20 years or less, water utility property, certain computer software, and qualified leasehold improvement property. Under the Act, the 50 percent bonus depreciation generally is available for qualified property whose original use commences with the taxpayer and which is placed in service during 2008 or 2009 (2010 in the case of certain longer-lived property).

Taxpayer example

The 50 percent bonus depreciation deduction is computed first. The bonus deduction reduces the adjusted basis of the property before computing the amount otherwise allowable as depreciation deduction under section 167(a). For example, assume that on March 1, 2009, a calendar-year taxpayer acquires and places in service qualified property that costs \$1 million. Under the Act, the taxpayer is allowed a first-year bonus depreciation deduction of \$500,000. The remaining \$500,000 of adjusted basis is recovered in 2009 and subsequent years pursuant to the depreciation rules of present law.

Assuming the qualified property was MACRS five-year property, the taxpayer would be allowed to recover 20 percent of the remaining adjusted basis of \$500,000 -- or \$100,000 -- in 2009. The total depreciation deduction for the MACRS five-year-class-life property would be equal to \$600,000 (\$500,000 + \$100,000) or 60 percent of the adjusted basis of the property originally placed in service in 2009.

State tax implications

Federal tax law changes will sometimes affect state taxes, and the impact will depend on whether the state conforms to federal tax law or has decoupled from it. If the past is an indication, budget issues in many states may cause them to decouple from federal conformity so that federal legislation will not impact state revenues. This will increase the complexity of state tax returns and provisions and require detailed recordkeeping so that state and federal differences can be reconciled.

Election to accelerate AMT/research credits in lieu of bonus depreciation

— Manufacturing companies without federal tax liability may be able to elect a refundable cash credit in lieu of bonus depreciation. The Act extends for one additional year the special provision (enacted as part of the *Housing and Economic Recovery Act of 2008*) allowing corporations to accelerate their use of a portion of their carryforward alternative minimum tax (AMT) and research and development (R&D) credits in lieu of claiming 50 percent bonus depreciation. Accordingly, if a corporation elects to forgo 50 percent bonus depreciation, and instead uses straight-line depreciation with respect to qualified property generally placed in service during the period from April 1, 2008, through December 31, 2009 (or during 2010 for certain long-lived property), then the corporation may claim a refundable credit equal to the lowest of: (1) 20 percent of the additional first-year depreciation that otherwise would have been available with respect to such property if bonus depreciation had been claimed; (2) 6 percent of the taxpayer's accumulated AMT credits and R&D credit carryforward amounts generated from taxable years beginning before 2006; or (3) \$30 million.

This election will be made separately with respect to eligible qualified property placed in service during the period from April 1, 2008, through December 31, 2008 (or during 2009 for certain long-lived property). A separate election can be made with respect to so-called "extension property" placed in service during 2009 (or during 2010 for certain long-lived property) which otherwise became eligible for 50 percent bonus depreciation under the Act. The maximum refundable credit amount (up to \$30 million) will be computed separately with respect to each election.

Small businesses

Temporary extension of NOL carrybacks — One significant proposal of great interest to smaller manufacturing companies is an election to extend the net operating loss (NOL) carryback period for losses arising in 2008 from the current-law two years to three, four, or five years. This provision is available only to taxpayers with annual receipts of \$15 million or less.

Taxpayer example

An eligible small business filed its initial tax return in 2004. It reported \$2 million in income in 2004, \$1.5 million in income in 2005, \$500,000 in income in 2006, and a \$2.5 million NOL in 2007, and carried back the 2007 NOL to 2005 and 2006 pursuant to the general two-year carryback period applicable for 2007. The business also has an NOL for 2008. Under the Act, an eligible small business can now elect to carry back the 2008 NOL to 2004. Generally, NOLs from earlier years are utilized prior to NOLs from subsequent years. None of the unabsorbed \$500,000 NOL from 2007 can be carried back to 2004 because it is beyond the general two-year carryback period applicable for the 2007 NOL. Any unabsorbed NOL after the carryback will be carried forward for 20 years from the loss year. For AMT purposes, the 2007 NOL and 2008 NOL cannot exceed 90 percent of alternative minimum taxable income in the carryback years.

One important takeaway: Before claiming 50 percent bonus depreciation or, alternatively, electing the refundable credit, small businesses should analyze the interplay of bonus depreciation with the NOL carryback provision. The extended NOL carryback could allow some small businesses to capture the benefits of bonus depreciation by carrying back (and thereby monetizing) a larger NOL amount to an earlier taxable year for which federal income tax originally was paid.

Enhanced small business expensing — The Act extends through 2009 the increased section 179 expensing limit of \$250,000 and investment phase-out of \$800,000 enacted in the Economic Stimulus Act of 2008.

Taxpayer example

A qualifying business owner who buys a \$250,000 machine can deduct the total cost of the equipment in the year of purchase. If the equipment costs more than \$250,000, but the company spends less than \$800,000 on capital equipment during 2009, the company can couple expanded expensing with accelerated depreciation. Under these provisions, a \$300,000 machine that is MACRS five-year property would qualify for a \$280,000 first-year deduction (93 percent of the cost of the asset), and a \$500,000 machine could qualify for a \$400,000 first-year deduction (80 percent of the cost of the asset). Smaller companies get even more of a “bonus.” They can first take advantage of expensing and then also use the 50 percent expensing allowance described above.

Key energy provisions

Renewable energy promoted — The Act includes a three-year extension of the renewable energy production tax credit and a temporary election to claim the 30 percent investment tax credit in lieu of the production credit.

Grants in lieu of production and investment tax credit — As current economic conditions have undermined the effectiveness of tax credits, it is significant that the Act adds a new provision authorizing the Treasury Secretary to provide grants in lieu of production or investment tax credits for certain property placed in service in 2009 and 2010.

Advanced energy project credit — The Act includes a new 30 percent investment tax credit for eligible property placed in service during the taxable year which is part of a “qualifying advanced energy project.” This new provision, section 48C, operates similar to the “qualifying advanced coal project credit” and the “qualifying gasification project credit” (sections 48A and 48B). Before investment tax credits can be claimed on property placed in service, the qualifying advanced energy project must first obtain certification and an award of credit allocation from the Treasury. The rules governing the application and award process will be provided in future Treasury guidance.

A “qualifying advanced energy project” is one that re-equips, expands, or establishes a facility for the production of property designed to be used to produce energy from renewable resources. The program for certification will be established within 180 days of enactment of the Act. Taxpayers must apply for certification within two years of the establishment of the program and provide evidence of compliance with the credit requirements within one year of acceptance to the program.

Tax-exempt bonds

The Act temporarily expands the definition of a “manufacturing facility” for tax-exempt bond purposes to include any facility that is used in the manufacturing, creation, or production of tangible or intangible property, and permits industrial development bonds to be issued for the purpose of financing facilities used in the manufacturing.

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