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(04/29/09)

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Tax Stimulus For Small Businesses

For this inaugural column of the Experts Forum on tax, the best place to start is with the latest tax legislation, American Recovery and Reinvestment Act of 2009. While this comprehensive document is quite hefty, there are a number of highlights that relate to businesses and individuals that are of particular interest.

In this issue we discuss two business changes that may provide an opportunity in the midst of the current economic climate.

Loss Carryback Provisions

For businesses that were profitable prior to the current recession but have struggled for the past year, Congress has lengthened the number of years a taxpayer can look back in order to get a refund for past taxes paid. Prior to the stimulus package a business could only look at the prior two years to apply their losses to get a refund of previously paid taxes.

Now for either a year ending in the calendar year 2008 or if elected a year beginning in the calendar year 2008 a small business (one that averages less than fifteen million in revenue for the last three years) may elect to look back at any number of years up to five to offset taxes paid. This allows businesses that are organized as either Corporations or pass-through entities; i.e. S Corporations or Partnerships, to look at their tax returns and identify which years the current losses could be carried back to maximize the potential refund.

There are many instances that would be beneficial to carryback to a year where the income was ordinary versus a year with more income but that income was all capital gain. The new law is elective so failure to act will result in the mandatory two year look back. As always allowed the business can elect to forgo the carryback and use it against future income.

Cancellation of Debt Income

As many businesses are working with their financing companies to restructure their debt, some businesses may be surprised to discover they may have just incurred a tax liability without receiving any cash income. Unless the discharge of debt occurs through Title 11 bankruptcy, the business is insolvent or was "qualified farm indebtedness", "qualified real property business indebtedness or a mortgage on your main home, the business will have taxable income on the economic relief that the received.

The new tax law allows a business to elect to defer paying the tax on that income, if the refinancing occurs in either calendar year 2009 or 2010, until beginning in 2014 at which point the business recognizes twenty percent of the income for the next five years. Again this is another tax provision that must be elected.

Failure to elect to apply the new rule will result in income being taxed in the year it is recognized. One important thing to remember is that the test for insolvency or any of the exclusion provisions is done in the year of the cancellation not at the later date of inclusion for income tax purposes.



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