TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF H.R. 5140, THE "RECOVERY REBATES AND ECONOMIC STIMULUS FOR THE AMERICAN PEOPLE ACT OF 2008"

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 5140, the revenue provisions of the Recovery Rebates and Economic Stimulus for the American People Act of 2008.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of H.R. 5140, the "Recovery Rebates and Economic Stimulus for the American People Act of 2008,"* (JCX-5-08), January 28, 2008. This document can also be found on our website at www.house.gov/jct.

A. Recovery Rebates for Individual Taxpayers

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or a resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income (sec. 1). This tax liability is then reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

A taxpayer may also be subject to an alternative minimum tax.

Child tax credit

For taxable year 2008, an individual may claim a tax credit of $1,000 for each qualifying child under the age of 17 (sec. 24). Generally, a qualifying child must have the same principal place of abode as the taxpayer for more than one-half the taxable year and satisfy a relationship test. To satisfy the relationship test, the child must be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or descendant of any such individual. A child who is not a citizen, national, or resident of the United States may not be a qualifying child.

Explanation of Provision

The provision includes a recovery rebate credit for 2008 which is refundable. The credit mechanism (and the issuance of checks described below) is intended to deliver an expedited fiscal stimulus to the economy.

The credit is computed with two components in the following manner.

Basic credit

Eligible individuals receive a basic credit (for the first taxable year beginning) in 2008 equal to the greater of the following:

- Net income tax liability not to exceed $600 ($1,200 in the case of a joint return).
- $300 ($600 in the case of a joint return) if the individual has: (1) at least $3,000 of earned income (as defined below); or (2) net income tax liability of at least $1 and gross income greater than the sum of the applicable basic standard deduction amount and one personal exemption (two personal exemptions for a joint return).

An eligible individual is any individual other than: (1) a nonresident alien; (2) an estate or trust; or (3) a dependent. The determination of this status for the relevant year is made on the basis of the information filed on the tax return.

For these purposes, "net income tax liability" means the excess of the sum of the individual's regular tax liability and alternative minimum tax over the sum of all nonrefundable credits (other than the child credit). Net income tax liability as determined for these purposes is not reduced by the credit added by this provision or any credit which is refundable under present law. The definition of earned income has the same meaning as used in the earned income credit except that it includes certain combat pay and does not include net earnings from self-employment which are not taken into account in computing taxable income.

Qualifying child credit

If an individual is eligible for any amount of the basic credit the individual also may be eligible for a qualifying child credit. The qualifying child credit equals $300 for each qualifying child of such individual. For these purposes, the child credit definition of qualifying child will apply.

Limitation based on adjusted gross income

The amount of the credit (including both the basic credit and the qualifying child credit) is phased out at a rate of five percent of adjusted gross income above certain income levels. The beginning point of this phase-out range is $75,000 of adjusted gross income ($150,000 in the case of joint returns).

Rebate checks

Most taxpayers will receive this credit in the form of a check issued by the Department of the Treasury.[2] The amount of the payment will be computed in the same manner as the credit, except that it will be done on the basis of tax returns filed for 2007 (instead of 2008). It is

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[2] To the extent practicable, the Department of the Treasury is expected to utilize individuals' current direct deposit information in its possession to expedite delivery of these amounts rather than the mailing of rebate checks.

anticipated that the Department of the Treasury will make every effort to issue all payments as rapidly as possible to taxpayers who timely filed their 2007 tax returns. (Taxpayers who file late or pursuant to extensions will receive their payments later.)

Taxpayers will reconcile the amount of the credit with the payment they receive in the following manner. They would complete a worksheet calculating the amount of the credit based on their 2008 tax return. They would then subtract from the credit the amount of the payment they received. For many taxpayers, these two amounts would be the same. If, however, the result is a positive number (because, for example, the taxpayer paid no tax in 2007 but is paying tax in 2008), the taxpayer may claim that amount as a credit against 2008 tax liability. If, however, the result is negative (because, for example, the taxpayer paid tax in 2007 but owes no tax for 2008), the taxpayer is not required to repay that amount to the Treasury. Otherwise, the checks have no effect on tax returns filed in 2009; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding.

In no event may the Department of the Treasury issue checks after December 31, 2008. This is designed to prevent errors by taxpayers who might claim the full amount of the credit on their 2008 tax returns and file those returns early in 2009, at the same time the Treasury check might be mailed to them. Payment of the credit (or the check) is treated, for all purposes of the Code, as a payment of tax. Any resulting overpayment under this provision is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

Examples of rebate determination

The following examples show the rebate amounts as calculated from the taxpayer's 2007 tax return.

Example 1.–A head of household taxpayer has $4,000 in earned income, one qualifying child, and no net tax liability prior to the application of refundable credits and the child credit. Such taxpayer would receive a rebate of $600, comprising $300 for meeting the earned income test, and $300 per child.

Example 2.–A married taxpayer filing jointly has $4,000 in earned income, one qualifying child, and no net tax liability prior to the application of refundable credits and the child credit. Such taxpayer would receive a rebate of $900, comprising $600 for meeting the earned income test, and $300 per child.

Example 3.–A married taxpayer filing jointly has $2,000 in earned income, one qualifying child, and $1,100 in net tax liability (resulting from other unearned income) prior to the application of refundable credits and the child credit (the taxpayer's actual liability after the child credit is $100). The earned income test is not met, but the taxpayer has net tax liability for purposes of determining the rebate of $1,100. Such taxpayer would receive a rebate of $1,400, comprising $1,100 of net tax liability, and $300 per child.

Example 4.–A married taxpayer filing jointly has $40,000 in earned income, two qualifying children, and a net tax liability of $1,573 prior to the application of refundable credits and child credits (the taxpayer's actual tax liability after the child credit is -$427). The taxpayer

meets the earned income test and the net tax liability test. Such taxpayer would receive a rebate of $1,800, comprising $1,200 (greater of $600 or net tax liability not to exceed $1,200), and $300 per child.

Example 5.–A married taxpayer filing jointly has $175,000 in earned income, two qualifying children, and a net tax liability of $31,189 (the taxpayer's actual liability after the child credit also is $31,189 as their income is too high to qualify). The taxpayer meets the earned income test and the net tax liability test. Such taxpayer would, in the absence of the rebate phaseout provision, receive a rebate of $1,800, comprising $1,200 (greater of $600 or net tax liability not to exceed $1,200), and $300 per child. The phaseout provision reduces the total rebate amount by five percent of the amount of the taxpayer's adjusted gross income as exceeds $150,000. Five percent of $25,000 ($175,000 minus $150,000) equals $1,250. The taxpayer's rebate is thus $1,800 minus $1,250, or $550.

Treatment of the U.S. possessions

Mirror-Code possessions[3]

Each mirror-Code possession will receive an amount equal to the loss to that possession by reason of the recovery rebate credit. This amount will be determined by the Treasury Secretary based on information provided by the government of the respective possession. For these purposes, a possession is a mirror-Code possession if the income tax liability of residents of the possession under that possession's income tax system is determined by reference to the U.S. income tax laws as if the possession were the United States.

Non mirror-Code possessions[4]

To each possession that does not have a mirror code tax system, the Treasury Secretary will make a payment in an amount estimated by the Secretary as being equal to the aggregate benefits that would have been provided to residents of that possession if a mirror code tax system had been in effect in that possession. This payment will not be made to any U.S. possession unless that possession has a plan that has been approved by the Secretary under which the possession will promptly distribute the payment to its residents.

General rules

For purposes of the rebate credit payment, the Commonwealth of Puerto Rico and the Commonwealth of the Northern Mariana Islands are considered possessions of the United States.

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[3] Possessions with mirror code tax systems are the United States Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands.

[4] Possessions that do not have mirror code tax systems are Puerto Rico and American Samoa.

It is intended that the Secretary will undertake appropriate measures to ensure that the amount of any payment to a possession does not include any amounts of refund credits claimed from the United States under the provision by residents of that possession.

For purposes of the rule permitting the Treasury Secretary to disburse appropriated amounts for refunds due from certain credit provisions of the Internal Revenue Code of 1986, the payments required to be made to possessions under the provision are treated in the same manner as a refund due from the recovery rebate credit.

Effective Date

The provision applies to taxable years beginning after December 31, 2007.

B. Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets

Present Law

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[5] For 2008, the maximum amount that a taxpayer may expense is $128,000 of the cost of qualifying property placed in service for the taxable year. The $128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $510,000.[6] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.[7] For taxable years beginning in 2011 and thereafter, other rules apply.[8]

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[5] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

[6] Amounts applicable for 2008 are set forth in Rev. Proc. 2007-66, 2007-45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

[7] Sec. 179(c)(1).

[8] Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

Explanation of Provision

The provision increases the $128,000 and $510,000 amounts under section 179 for 2008 to $250,000 and $800,000, respectively. The $250,000 and $800,000 amounts are not indexed for inflation.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

C. Special Depreciation Allowance for Certain Property

Present Law

A taxpayer is allowed to recover through annual depreciation deductions the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property range from 3 to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the taxpayer's depreciation deduction would be maximized.

Section 280F limits the annual depreciation deductions with respect to passenger automobiles to specified dollar amounts, indexed for inflation.

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which section 197 applies, are recovered ratably over 36 months.

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.[9] For 2008, the maximum amount that a taxpayer may expense is $128,000 of the cost of qualifying property placed in service for the taxable year. The $128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $510,000.[10] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2010 is treated as qualifying property. For taxable years beginning in 2011 and thereafter, other rules apply.[11]

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[9] Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

[10] Amounts applicable for 2008 are set forth in Rev. Proc. 2007-66, 2007-45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 and $500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

[11] Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a

Explanation of Provision

The provision allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property.[12] The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.[13] The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2008, a taxpayer purchases new depreciable property and places it in service.[14] The property's cost is $1,000, and it is 5-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is $500. The remaining $500 of the cost of the property is deductible under the rules applicable to 5-year property. Thus, 20 percent, or $100, is also allowed as a depreciation deduction in 2008. The total depreciation deduction with respect to the property for 2008 is $600. The remaining $400 cost of the property is recovered under otherwise applicable rules for computing depreciation.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements. First, the property must be (1) property to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property (as defined in section 168(e)(5)), (3) computer software other than computer software covered by section 197, or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).[15] Second, the original use[16] of the property must commence with the taxpayer after December 31,

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trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

[12] The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or instead is subject to capitalization under section 263 or section 263A.

[13] However, the additional first-year depreciation deduction is not allowed for purposes of computing earnings and profits.

[14] Assume that the cost of the property is not eligible for expensing under section 179.

[15] A special rule precludes the additional first-year depreciation deduction for any property that is required to be depreciated under the alternative depreciation system of MACRS.

[16] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer.

2007.[17] Third, the taxpayer must purchase the property within the applicable time period. Finally, the property must be placed in service after December 31, 2007, and before January 1, 2009. An extension of the placed in service date of one year (i.e., to January 1, 2010) is provided for certain property with a recovery period of ten years or longer and certain transportation property.[18] Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property. Special rules, including an extension of the placed-in-service date of one year (i.e., to January 1, 2010) also applies to certain aircraft.

The applicable time period for acquired property is (1) after December 31, 2007, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2009.[19] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2009 ("progress expenditures") is eligible for the additional first-year depreciation.[20]

If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

[17] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

If property is originally placed in service by a lessor (including by operation of section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

[18] In order for property to qualify for the extended placed in service date, the property is required to have an estimated production period exceeding one year and a cost exceeding $1 million.

[19] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[20] For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to sec. 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F) is increased in the first year by $8,000 for automobiles that qualify (and do not elect out of the increased first year deduction). The $8,000 increase is not indexed for inflation.

Effective Date

The provision is effective for property placed in service after December 31, 2007.