

TAX RELIEF INCLUDED IN “THE AMERICAN RECOVERY AND REINVESTMENT PLAN”

JANUARY 22, 2009

Summary: The tax provisions included in “The American Recovery and Reinvestment Plan” will provide approximately \$275 billion in tax relief for individuals, businesses, and State and local governments.

I. RECOVERY FOR INDIVIDUALS

“Making Work Pay” tax credit. The bill would cut taxes for more than 95% of working families in the United States. For 2009 and 2010, the bill would provide a refundable tax credit of up to \$500 for working individuals and \$1,000 for working families. This tax credit would be calculated at a rate of 6.2% of earned income, and would phase out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 for married couples filing jointly). Taxpayers can receive this benefit through a reduction in the amount of income tax that is withheld from their paychecks, or through claiming the credit on their tax returns. *This proposal is estimated to cost \$145.309 billion over 10 years.*

Increase in earned income tax credit. The bill would temporarily increase the earned income tax credit for working families with three or more children. Under current law, working families with two or more children currently qualify for an earned income tax credit equal to forty percent (40%) of the family’s first \$12,570 of earned income. This credit is subject to a phase-out for working families with adjusted gross income in excess of \$16,420 (\$19,540 for married couples filing jointly). The bill would increase the earned income tax credit to forty-five percent (45%) of the family’s first \$12,570 of earned income for families with three or more children and would increase the beginning point of the phase-out range for all married couples filing a joint return (regardless of the number of children) by \$1,880. *This proposal is estimated to cost \$4.663 billion over 10 years.*

Increase eligibility for the refundable portion of child credit. The bill would increase the eligibility for the refundable child tax credit in 2009 and 2010. For 2008, the child tax credit is refundable to the extent of 15 percent of the taxpayer’s earned income in excess of \$8,500. The bill would eliminate this floor for 2009 and 2010. *This proposal is estimated to cost \$18.272 billion over 10 years.*

“American Opportunity” education tax credit. The bill would provide financial assistance for individuals seeking a college education. For 2009 and 2010, the bill would provide taxpayers with a new “American Opportunity” tax credit of up to \$2,500 of the cost of tuition and related

expenses paid during the taxable year. Under this new tax credit, taxpayers will receive a tax credit based on one hundred percent (100%) of the first \$2,000 of tuition and related expenses (including books) paid during the taxable year and twenty-five percent (25%) of the next \$2,000 of tuition and related expenses paid during the taxable year. Forty percent (40%) of the credit would be refundable. This tax credit will be subject to a phase-out for taxpayers with adjusted gross income in excess of \$80,000 (\$160,000 for married couples filing jointly). *This proposal is estimated to cost \$13.707 billion over 10 years.*

Refundable first-time home buyer credit. Last year, Congress provided taxpayers with a refundable tax credit that was equivalent to an interest-free loan equal to 10 percent of the purchase of a home (up to \$7,500) by first-time home buyers. The provision applies to homes purchased on or after April 9, 2008 and before July 1, 2009. Taxpayers receiving this tax credit are currently required to repay any amount received under this provision back to the government over 15 years in equal installments, or, if earlier, when the home is sold. The credit phases out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return). The bill would eliminate the repayment obligation for taxpayers that purchase homes after January 1, 2009. The provision would retain the credit recapture if the house is sold within three years of purchase. *This proposal is estimated to cost \$2.562 billion over 10 years.*

II. RECOVERY FOR BUSINESSES

Extension of bonus depreciation. Businesses are allowed to recover the cost of capital expenditures over time according to a depreciation schedule. Last year, Congress temporarily allowed businesses to recover the costs of capital expenditures made in 2008 faster than the ordinary depreciation schedule would allow by permitting these businesses to immediately write-off fifty percent of the cost of depreciable property (e.g., equipment, tractors, wind turbines, solar panels, and computers) acquired in 2008 for use in the United States. The bill would extend this temporary benefit for capital expenditures incurred in 2009. *This proposal is estimated to cost \$5.074 billion over 10 years.*

Extension of enhanced small business expensing. In order to help small businesses quickly recover the cost of certain capital expenses, small business taxpayers may elect to write-off the cost of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. Until the end of 2010, small business taxpayers are allowed to write-off up to \$125,000 (indexed for inflation) of capital expenditures subject to a phase-out once capital expenditures exceed \$500,000 (indexed for inflation). Last year, Congress temporarily increased the amount that small businesses could write-off for capital expenditures incurred in 2008 to \$250,000 and increased the phase-out threshold for 2008 to \$800,000. The bill would extend these temporary increases for capital expenditures incurred in 2009. *This proposal is estimated to cost \$41 million over 10 years.*

5-year carryback of net operating losses. Under current law, net operating losses may be carried back to the two years before the year that the loss arises (the “carryback period”) and carried forward to each of the succeeding twenty years after the year that the loss arises (the “carryforward period”). Losses that are carried back may generally only be used to offset ninety percent (90%) of a taxpayer’s alternative minimum tax liability. For 2008 losses and 2009 losses, the bill would extend the maximum carryback period for net operating losses from two years to five years and would allow net operating loss carry backs to be used to offset one hundred percent (100%) of the taxpayer’s alternative minimum tax liability. The 2008 losses and 2009 losses eligible for this carry back provision will be, at the election of the taxpayer, for either (1) losses incurred in taxable years ending in 2008 and 2009 or (2) losses incurred in taxable years beginning in 2008 and 2009. The net operating losses of companies electing this carry back provision will be reduced by ten percent (10%). This benefit would be denied to companies that received money from the Temporary Asset Relief Program, Fannie Mae, and Freddie Mac. *This proposal is estimated to cost \$15.041 billion over 10 years.*

Incentives to hire unemployed veterans and disconnected youth. Under current law, businesses are allowed to claim a work opportunity tax credit equal to 40 percent of the first \$6,000 of wages paid to employees of one of nine targeted groups. The bill would create two new targeted groups of prospective employees: (1) unemployed veterans; and (2) disconnected youth. An individual would qualify as an unemployed veteran if they were discharged or released from active duty from the Armed Forces during 2008, 2009 or 2010 and received unemployment compensation for more than four weeks during the year before being hired. An individual qualifies as a disconnected youth if they are between the ages of 16 and 25 and have not been regularly employed or attended school in the past 6 months. *This proposal is estimated to cost \$208 million over 10 years.*

Repeal of Treasury Section 382 Notice. Last year, the Treasury Department issued Notice 2008-83, which liberalized rules in the tax code that are intended to prevent taxpayers that acquire companies from claiming losses that were incurred by the acquired company prior to the taxpayer’s ownership of the company. The bill would repeal this Notice prospectively. *This proposal is estimated to raise \$6.977 billion over 10 years.*

III. RECOVERY FOR STATE AND LOCAL GOVERNMENTS

De minimis safe harbor exception for tax-exempt interest expense for financial institutions. Under current law, financial institutions are not allowed to take a deduction for the portion of their interest expense that is allocable to such institution’s investments in tax-exempt municipal bonds. In determining the portion of interest expense that is allocable to investments in tax-exempt municipal bonds, the bill would exclude investments in tax-exempt municipal bonds issued during 2009 and 2010 to the extent that these investments constitute less than two percent

(2%) of the average adjusted bases of all the assets of the financial institution. *The cost of this proposal is included in the estimated cost of the next provision.*

Modification of small issuer exception to tax-exempt interest expense allocation rules for financial institutions. As described above, financial institutions are not allowed to take a deduction for the portion of their interest expense that is allocable to such institution's investments in tax-exempt municipal bonds. For purposes of this interest disallowance rule, bonds that are issued by a "qualified small issuers" are not taken into account as investments in tax-exempt municipal bonds. Under current law, a "qualified small issuer" is defined as any issuer that reasonably anticipates that the amount of its tax-exempt obligations (other than certain private activity bonds) will not exceed \$10,000,000. The bill would increase this dollar threshold to \$30,000,000 when determining whether a tax-exempt obligation issued in 2009 and 2010 qualifies for this small issuer exception. The small issuer exception would also apply to an issue if all of the ultimate borrowers in such issue would separately qualify for the exception. For these purposes, the issuer of a qualified 501(c)(3) bond shall be deemed to be the ultimate borrower on whose behalf a bond was issued. *These proposals are estimated to cost \$3.234 billion over 10 years.*

Eliminate costs imposed on State and local governments by the alternative minimum tax. The alternative minimum tax (AMT) can increase the costs of issuing tax-exempt private activity bonds imposed on State and local governments. Under current law, interest on tax-exempt private activity bonds is generally subject to the AMT. This limits the marketability of these bonds and, therefore, forces State and local governments to issue these bonds at higher interest rates. Last year, Congress excluded one category of private activity bonds (i.e., tax-exempt housing bonds) from the AMT. The bill would exclude the remaining categories of private activity bonds from the AMT if the bond is issued in 2009 or 2010. *This proposal is estimated to cost \$481 million over 10 years.*

Qualified school construction bonds. The bill creates a new category of tax credit bonds for the construction, rehabilitation, or repair of public school facilities or for the acquisition of land on which a public school facility will be constructed. There is a national limitation on the amount of qualified school construction bonds that may be issued by State and local governments of \$22 billion (\$11 billion allocated initially in 2009 and the remainder allocated in 2010). There is a national limitation on the amount of qualified school construction bonds that may be issued by Indian tribal governments of \$400 million (\$200 million allocated initially in 2009 and the remainder allocated in 2010). *This proposal is estimated to cost \$9.877 billion over 10 years.*

Extension and increase in authorization for qualified zone academy bonds (QZAB). The bill would allow an additional \$1.4 billion of QZAB issuing authority to State and local governments in 2009 and 2010, which can be used to finance renovations, equipment purchases, developing course material, and training teachers and personnel at a qualified zone academy. In

general, a qualified zone academy is any public school (or academic program within a public school) below college level that is located in an empowerment zone or enterprise community and is designed to cooperate with businesses to enhance the academic curriculum and increase graduation and employment rates. QZABs are a form of tax credit bonds which offer the holder a Federal tax credit instead of interest. *This proposal is estimated to cost \$1.045 billion over 10 years.*

Tax credit bond option for State and local governments. The Federal government provides significant financial support to State and local governments through the federal tax exemption for interest on municipal bonds. Both tax credit bonds and tax-exempt bonds provide a subsidy to municipalities by reducing the cash interest payments that a State or local government must make on its debt. Tax credit bonds differ from tax-exempt bonds in two principal ways: (1) interest paid on tax credit bonds is taxable; and (2) a portion of the interest paid on tax credit bonds takes the form of a Federal tax credit. The Federal tax credit offsets a portion of the cash interest payment that the State or local government would otherwise need to make on the borrowing. The bill would provide State and local governments with the option of issuing a tax credit bond instead of a tax-exempt governmental obligation bond. Because the market for tax credits is currently small given current economic conditions, the bill would allow the State or local government to elect to receive a direct payment from the Federal government equal to the subsidy that would have otherwise been delivered through the Federal tax credit for bonds issued in 2009 and 2010. *This proposal is estimated to cost \$18.270 billion over 10 years.*

Repeal three percent (3%) withholding on government contractors. For payments made after December 31, 2010, current law requires withholding at a three percent rate on certain payments to persons providing property or services made by Federal, State, and local governments. The withholding is required regardless of whether the government entity making the payment is the recipient of the property or services (those with less than \$100 million in annual expenditures for property or services are exempt). Numerous government entities and taxpayers have raised concerns about the application of this provision. The bill would repeal this provision. *This proposal is estimated to cost \$10.946 billion over 10 years.*

IV. RECOVERY ZONES

Recovery Zone Bonds. The bill would create a new category of tax credit bonds for investment in economic recovery zones. The bill would authorize \$10 billion in recovery zone economic development bonds and \$15 billion in recovery zone facility bonds. These bonds could be issued during 2009 and 2010. Each state would receive a share of the national allocation based on that state's job losses in 2008 as a percentage of national job losses in 2008. That allocation would be sub-allocated to local municipalities. Municipalities receiving an allocation of these bonds would be permitted to use these bonds to invest in infrastructure, job training, education, and

economic development in areas within the boundaries of the State, city or county (as the case may be) that has significant poverty, unemployment or home foreclosures. *This proposal is estimated to cost \$5.989 billion over 10 years.*

Tribal Economic Development Bonds. Under current law, tribal governments are limited in their ability to issue tax-exempt bonds. Projects funded by bonds issued by tribal governments must satisfy an “essential governmental function” requirement. This requirement is not imposed on projects funded by bonds issued by State and local governments, and can limit the ability of tribal governments to use tax-exempt bonds for economic development. The bill would temporarily allow tribal governments to issue \$2 billion in tax-exempt bonds for projects without this restriction in order to spur economic development on tribal lands, and would require the Secretary of the Treasury to study whether this restriction should be repealed on a permanent basis. *This proposal is estimated to cost \$315 million over 10 years.*

V. REINVESTMENT IN RENEWABLE ENERGY

Long-term extension and modification of renewable energy production tax credit. The bill would extend the placed-in-service date for wind facilities for three years (through December 31, 2012). The bill would also extend the placed-in-service date for three years (through December 31, 2013) for certain other qualifying facilities: closed-loop biomass; open-loop biomass; geothermal; small irrigation; hydropower; landfill gas; waste-to-energy; and marine renewable facilities. *This proposal is estimated to cost \$13.143 billion over 10 years.*

Temporary election to claim the investment tax credit in lieu of the production tax credit. Under current law, facilities that produce electricity from solar facilities are eligible to take a thirty percent (30%) investment tax credit in the year that the facility is placed in service. Facilities that produce electricity from wind, closed-loop biomass, open-loop biomass, geothermal, small irrigation, hydropower, landfill gas, waste-to-energy, and marine renewable facilities are eligible for a production tax credit. The production tax credit is payable over a ten-year period. Because of current market conditions, it is difficult for many renewable projects to find financing due to the uncertain future tax positions of potential investors in these projects. The bill would allow facilities that are placed-in-service in 2009 and 2010 to elect to claim the investment tax credit in lieu of the production tax credit. *This proposal is estimated to cost \$218 million over 10 years.*

Repeal subsidized energy financing limitation on the investment tax credit. Under current law, the investment tax credit must be reduced if the property qualifying for the investment tax credit is also financed with industrial development bonds or through any other Federal, State, or local subsidized financing program. The bill would repeal this subsidized energy financing limitation on the investment tax credit in order to allow businesses and individuals to qualify for the full amount of the investment tax credit even if such property is financed with industrial

development bonds or through any other subsidized energy financing. *The cost of this proposal is included in the estimated cost of the next provision.*

Removal of dollar limitations on certain energy credits. Under current law, businesses are allowed to claim a thirty percent (30%) tax credit for qualified small wind energy property (capped at \$4,000). Individuals are allowed to claim a thirty percent (30%) tax credit for qualified solar water heating property (capped at \$2,000), qualified small wind energy property (capped at \$500 per kilowatt of capacity, up to \$4,000), and qualified geothermal heat pumps (capped at \$2,000). The bill would repeal the individual dollar caps. As a result, each of these properties would be eligible for an uncapped thirty percent (30%) credit. *This proposal is estimated to cost \$872 million over 10 years.*

Clean Renewable Energy Bonds (“CREBs”). The bill authorizes an additional \$1.6 billion of new clean renewable energy bonds to finance facilities that generate electricity from the following resources: wind; closed-loop biomass; open-loop biomass; geothermal; small irrigation; hydropower; landfill gas; marine renewable; and trash combustion facilities. This \$1.6 billion authorization will be subdivided into thirds: 1/3 will be available for qualifying projects of State/local/tribal governments; 1/3 for qualifying projects of public power providers; and 1/3 for qualifying projects of electric cooperatives. *This proposal is estimated to cost \$578 million over 10 years.*

Qualified Energy Conservation Bonds. The bill authorizes an addition \$2.4 billion of qualified energy conservation bonds to finance State, municipal and tribal government programs and initiatives designed to reduce greenhouse gas emissions. The bill would also clarify that qualified energy conservation bonds may be issued to make loans and grants for capital expenditures to implement green community programs. *This proposal is estimated to cost \$803 million over 10 years.*

Tax credits for energy-efficient improvements to existing homes. The bill would extend the tax credits for improvements to energy-efficient existing homes through 2010. Under current law, individuals are allowed a tax credit equal to ten percent (10%) of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during the taxable year. This tax credit is capped at \$50 for any advanced main air circulating fan, \$150 for any qualified natural gas, propane, oil furnace or hot water boiler, and \$300 for any item of energy-efficient building property. For 2009 and 2010, the bill would increase the amount of the tax credit to thirty percent (30%) of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements during the taxable year. The bill would also eliminate the property-by-property dollar caps on this tax credit and provide an aggregate \$1,500 cap on all property qualifying for the credit. *This proposal is estimated to cost \$4.275 billion over 10 years.*

Tax credits for alternative fuel pumps. The alternative refueling property credit provides a tax credit to businesses (e.g., gas stations) that install alternative fuel pumps, such as fuel pumps that dispense E85 fuel, hydrogen, and natural gas. For 2009 and 2010, the bill would increase the 30% alternative refueling property credit for businesses (capped at \$30,000) to 50% (capped at \$50,000). Hydrogen refueling pumps would remain at a 30% credit percentage; however, the cap for hydrogen refueling pumps will be increased to \$200,000. In addition, the bill would increase the 30% alternative refueling property credit for individuals (capped at \$1,000) to 50% (capped at \$2,000). *This proposal is estimated to cost \$54 million over 10 years.*

Enhanced R&D credit. The bill would provide for an enhanced twenty percent (20%) R&D credit in taxable years beginning in 2009 and 2010 for research expenditures incurred in the fields of fuel cells, battery technology, renewable energy, energy conservation technology, efficient transmission and distribution of electricity, and carbon capture and sequestration. *This proposal is estimated to cost \$18 million over 10 years.*