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Selected Highlights of U.S. 2009 Tax Act Law Changes For Business

On Tuesday, February 17, 2009, President Barack Obama signed The American Recovery and Reinvestment Act of 2009 ("the 2009 Tax Act") into law. This article will highlight selected provisions of the legislation which should be of particular interest to Canadian-based companies doing business in the U.S.

Of paramount importance to Canadian based businesses doing business in the U.S. are the following provisions:

- The enhanced depreciation and asset expensing rules.
- An extension of the NOL carryback period to five years for certain small businesses.
- Deferral provisions for debt forgiveness income.

Enhanced Depreciation Rules

The tax changes with the broadest application to business are the changes to the rules for depreciating and expensing the assets of U.S. taxpayers. The following is a synopsis of said rules:

Extension of 50% Depreciation of Tangible Property

The Economic Stimulus Act of 2008 allowed an additional depreciation equal to 50% of the adjusted basis of "qualified property" placed into service in 2008.

The 2009 Tax Act extends the bonus depreciation provisions introduced in 2008 into 2009 for original use "qualified property" and into 2010 for property with a depreciation recovery period of at least ten years and certain transportation property.

To qualify for the bonus 50% depreciation, an asset must fall into one of the following four asset classes:

1. Property to which MACRS applies with a recovery period of 20 years or less. MACRS is the accelerated U.S. depreciation system. It is unavailable for property located outside of the U.S. Accordingly, foreign based property will not satisfy this requirement.
2. Water utility property.
3. Computer software, other than software covered under the intangible/goodwill amortization rules of Internal Revenue Code ("IRC") section 197. Generally, software acquired in the context of a business acquisition is not afforded accelerated depreciation.
4. Qualified leasehold improvements.

Enhancement of Expensing Rules for New Equipment

Under IRC Section 179, a taxpayer other than an estate, trust and certain noncorporate lessors can elect to deduct as an expense, rather than to depreciate, the cost of new or used tangible personal property placed into service in a tax year.

The 2008 Act temporarily raised the annual deduction limitation to \$250,000. The limit was set to revert to \$125,000 plus an inflation adjustment beginning in 2009.

Under the 2009 Act, the expense limitation will remain at \$250,000. The maximum amount of tangible property which can be purchased before a dollar for dollar reduction of the limitation is \$800,000. As well, the deduction cannot exceed the taxable income derived from the taxpayer's active conduct of a trade or business.

Increase of the NOL Carryback Period for Small Businesses

For net operating losses ("NOLs") arising in tax years ending after 2007, the NOL carryback period for "small businesses" has been increased from two years to five years.

A "small business" is defined as one with \$15 million or less in gross receipts. Further clarification is warranted but, typically, U.S. gross receipt threshold tests are applied to the U.S. taxpayer by including all domestic and foreign related companies.

In weighing the merits of whether or not a taxpayer should automatically elect to carryback losses for more than two years, the impact of state carryback rules should be considered. As of this writing, it is unclear which, of any, states will allow for an extended NOL carryback especially in light of significant budgetary pressures in individual states. As well, many states do not allow an NOL carryforward in excess

of the NOL carryforward claimed for federal tax purposes. Therefore, if an NOL is carried back for federal purposes, the ability to access it on the state level prospectively may be inhibited.

As a rule of thumb, barring significant current cash flow demands, if there is reasonable certainty that a taxpayer will revert from a tax loss position to a taxable income position in the near term, it may be worthwhile to forgo an automatic NOL carryback. An examination of the state conformance with the NOL carryback extension rules and other related rules should be considered.

Deferral of Debt Forgiveness

Under U.S. rules, gross income generally includes income realized by a debtor from the discharge of debt subject to certain exceptions including, but not limited to, a Title 11 bankruptcy and insolvency of the debtor. Where discharge of the debt is excluded from gross income under the exceptions noted, a grind down of tax attributes such as NOLs, minimum tax credits, capital loss carryforwards and general business credits is required. For all taxpayers, the amount of income or attribution grind is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt.

For debt discharges in tax years ending in 2009 and 2010, the taxpayer can elect to have debt discharge income from the reacquisition of an applicable debt instrument included in income ratably over five years from 2014 through 2018.

These rules apply to:

- The exchange of an old obligation for certain new obligations.
- A modification of debt that is treated as an exchange.
- A debtor repurchasing its debt instrument for an amount that is less than the adjusted issue price of the instrument.
- Debt acquired by certain related parties of the taxpayer.
- The exchange of the debt instrument for corporate stock or a partnership interest.

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