In This Issue...

Comprehensive Financial Solutions™

PRIZM Financial Advisors, Inc.

Dean Zayed
JD, LLM, CFP®
Sr. Financial Advisor

1751 S. Naperville Rd.
Suite 203
Wheaton, IL 60189

(630) 665-4848 x12 • dzayed@att.net • Fax: (630) 665-4343

Special Issue

SPECIAL ISSUE 2009

Stimulating the Economy with Tax Breaks

The American Recovery and Reinvestment Act of 2009 (ARRA) contains over $300 billion in tax breaks for individuals and businesses. The hope is that people will spend, rather than save, those tax breaks, helping to stimulate the economy. Thus, most of the tax breaks were designed for middle- and lower-income taxpayers, who were considered more likely to spend whatever money they received. The majority of the tax breaks are designed to last only a year or two. The major provisions include:

- **Making Work Pay credit** — This is a payroll tax credit for wage earners and self-employed individuals, effective for 2009 and 2010. Unlike prior tax laws, the government will not issue checks to taxpayers but will adjust withholding tables so individuals pay less in taxes. The credit equals the lesser of 6.2% of earned income or $400 ($800 for married couples filing jointly). The full credit is available to single individuals with modified adjusted gross income (AGI) of $75,000 or less and to married couples filing jointly with modified AGI of $150,000 or less. The credit is then phased out at a 2% rate, with the credit totally phased out at modified AGI of $95,000 for single taxpayers and $190,000 for married taxpayers filing jointly. Single individuals receiving the full credit will receive additional take-home pay of approximately $7.69 per week, while married couples will receive $15.38. Estimated cost: $116 billion
- **$250 one-time payment** — In 2009, individuals who receive Social Security benefits, government pension benefits, railroad retirement benefits, supplemental

Continued on page 2

Will the ARRA Help the Economy?

Every week, the economic news seems to get worse. Are we in a recession or a depression? If we're not in a depression, are we headed for one? Will the ARRA turn the economy around?

Recession: A Shrinking Economy

The widely accepted definition of an economic recession is two consecutive quarters of economic contraction or negative growth in gross domestic product (GDP). However, the definition used by the National Bureau of Economic Research (NBER), the private, nonprofit research organization that determines business cycles in our country, uses a more complicated definition. According to the NBER, a recession is "a significant decline in economic activity spread across the country, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."

On December 1, 2008, the NBER indicated that the U.S. had been in a recession since December 2007, which was before any contraction in U.S. economic output. The GDP declined 0.5% in the third quarter of 2008 and 3.8% in the fourth quarter.

It is difficult to tell a recession from a depression. Even the NBER does not make the distinction — it tracks the start and end dates of business cycle peaks and troughs. It does not define downturns as recessions or depressions.

However, putting the current economy in perspective, from 1929 through 1933, our GDP dropped by 30%, and the unemployment rate was at 25%. So, while things might be bad right now, we still have a long way to go before we reach Depression-era levels.

Will the ARRA Prevent a Depression?

We may not be in a depression right now. However, the problem is that we are in unprecedented

Continued on page 3

Tax Breaks

Continued from page 1

security income payments, and veterans' administration pension and disability benefits will receive a one-time check of $250. The payment will reduce any Making Work Pay credit that the individual is entitled to. Estimated cost: $14.2 billion

❍ **Child tax credit** — In 2009 and 2010, the refundable portion of the $1,000 child tax credit for each qualifying child under the age of 17 is increased. The refundable portion is now 15% of earned income in excess of $3,000, instead of $12,550 under previous law. Estimated cost: $14.8 billion

❍ **Earned income tax credit** — The earned income tax credit has been increased for 2009 and 2010. The phaseout for eligibility starts at $21,420 of income, an increase of $1,880, to help eliminate the marriage penalty. The amount of the credit increases from 40% to 45% of the first $12,750 of earned income for families with three or more children. Estimated cost: $4.6 billion

❍ **First-time homebuyer credit** — The first-time homebuyer tax credit has been increased from $7,500 to $8,000 for homes purchased between January 1, 2009, and November 30, 2009. As long as the home is not resold within three years, the credit does not have to be repaid. The credit phases out for single taxpayers with AGI in excess of $75,000 and for married couples filing jointly with AGI in excess of $150,000. Estimated cost: $6.6 billion

❍ **Deduction for new car purchases** — Taxpayers who purchase a new car, light truck, sports utility vehicle, motorcycle, or motor home between February 18, 2009, and December 31, 2009, can deduct state sales or excise taxes paid on the first $49,500 of the vehicle's cost, even if the taxpayer does not itemize deductions. This deduction is phased out at AGI over $125,000 for single taxpayers and $250,000 for married couples filing jointly. The deduction is completely eliminated at AGI of $135,000 for single taxpayers and AGI of $260,000 for married couples filing jointly. Estimated cost: $1.7 billion

❍ **American Opportunity Tax credit** — The Hope scholarship credit was expanded for 2009 and 2010 and renamed the American opportunity tax credit. The credit has been increased from a maximum of $1,800 to $2,500 per year and applies to college expenses for all four years of college, rather than just the first two years of college. The tax credit equals 100% of the first $2,000 of tuition and fees and 25% of the next $2,000 paid for a taxpayer, spouse, or dependent. Qualified expenses were expanded under the ARRA to cover course materials. The credit can be claimed for more than one student in a given year. Formerly a nonrefundable tax credit, the ARRA made the credit 40% refundable. However, if the taxpayer claiming the credit is a child subject to the kiddie tax, no portion of the credit is refundable. In 2009, the credit is phased out for single taxpayers with modified AGI between $80,000 and $90,000 and for married couples filing jointly with modified AGI between $160,000 and $180,000. Estimated cost: $13.9 billion

❍ **Qualified tuition programs** — For 2009 and 2010, tax-free distributions from qualified tuition programs can be used to pay for computers and computer technology, including Internet access.

❍ **Transit benefits** — Employees can exclude from income qualified transportation fringe benefits, such as transit passes, van pooling, and qualified parking, up to specified dollar limits. For 2009, the income exclusion amount for transit passes and van pooling is increased from $120 per month to

$230 per month. The amount will be adjusted for inflation in 2010.

❍ **Unemployment compensation** — Currently, unemployment compensation benefits are included in the taxpayer's gross income for federal income tax purposes. For 2009 only, taxpayers can exclude up to $2,400 of unemployment compensation from gross income. Estimated cost: $4.7 billion

❍ **COBRA coverage** — Individuals who are involuntarily separated from employment between September 1, 2008, and January 1, 2010, can elect to pay 35%, instead of 100%, of COBRA coverage costs. The former employer must pay the remaining 65% but will be reimbursed by crediting those amounts against income tax withholding and payroll tax payments. This subsidy will last for up to nine months. Individuals who were laid off between September 1, 2008, and February 17, 2009, and did not sign up for COBRA coverage, have an additional 60 days to do so. This subsidy is limited to single taxpayers with AGI of $125,000 or less and for married couples filing jointly with AGI of $250,000 or less. Estimated cost: $24.7 billion

❍ **AMT changes** — For 2009, the alternative minimum tax (AMT) exemption amounts were increased to $70,950 for married couples filing jointly and surviving spouses (up from $69,950 in 2008) and $46,700 for single taxpayers and heads of households (up from $46,200 in 2008). The change is designed to prevent approximately 26 million middle-income taxpayers from paying the AMT. Estimated cost: $70 billion ❍❍❍

Help the Economy

Continued from page 1

territory, making it difficult to judge whether the ARRA contains the right mix of spending at the right time for the right amount. However, there is cause for optimism.

For years, consumers fueled our economy's growth through spending. Now, millions of families are cutting back due to layoffs, lower home values, and reduced retirement savings. That reduces demand for goods and services, forcing companies to lay off more workers, compounding the downward spiral. Something needs to be done to reverse the downward trend. With the ARRA, the government will step in and spend hundreds of billions of dollars, creating jobs and increasing production. Hundreds of billions of dollars will also be given to consumers with the hope that they will spend rather than save that money.

Mark Zandi, chief economist at Moody's Economy.com, believes that the ARRA will provide a vital boost to the economy, preventing the current recession from turning into a depression. He believes that there will be four million more jobs and the unemployment rate will be 2% less at the end of 2010 than without the ARRA. With spending of 5.5% of GDP, he believes the ARRA is sufficient to ensure the economy stops contracting by the end of 2009, with GDP returning to prerecession peaks by the end of 2010 (Source: *The Economic Impact of the American Recovery and Reinvestment Act*, January 21, 2009).

The important thing is that the government recognizes the severity of the problem and is working on many fronts to help stimulate the economy. The ARRA is not the first nor the last action the government will use to help turn the economy around. ❍❍❍

Tax Breaks for Businesses

For 2009 and 2010, the ARRA provides businesses with over $75 billion in tax benefits. Major provisions include:

❍ **Bonus depreciation** — The ARRA extends the 50% first-year bonus depreciation, which had ended in 2008. Bonus depreciation is now available for assets bought and placed in service by the end of 2009, and includes most types of new property except for buildings. The ARRA also extends through 2010 the additional year of bonus depreciation for property with a recovery period of 10 years or longer, transportation property, and certain aircraft.

❍ **Vehicle depreciation** — For 2009, the ARRA increased the first-year depreciation dollar limit for qualified vehicles placed in service by $8,000, the same amount as 2008. The IRS has not issued the inflation-adjusted maximums for 2009. In 2008, the maximums were $2,960 for automobiles and $3,160 for light trucks and vans.

❍ **Credits in lieu of bonus depreciation** — Extending a 2008 tax provision, businesses that don't take bonus depreciation can use a portion of their AMT and research and development credit carryovers for assets placed in service in 2009.

❍ **Section 179 expensing** — Extending provisions from 2008, the ARRA allows businesses to expense up to $250,000 of Section 179 assets in 2009, with the threshold for reducing the deduction increased to $800,000. Prior law limits were $125,000, adjusted for inflation, and $500,000. The current $800,000 limit effectively limits this tax break to small businesses.

❍ **Net operating loss carrybacks** — Businesses with average gross receipts of $15 million or less over the past three years can carry back net operating losses from 2008 for three, four, or five years, instead of two years. Net operating losses from 2009 can only be carried back two years.

❍ **Discharge of indebtedness** – Certain businesses that buy back their debt at a discount in 2009 or 2010 can defer tax on the forgiven debt until 2014. Then, the income is recognized over five years at 20% per year.

❍ **Small business stock** — For qualified small business stock sold between February 17, 2009, and January 1, 2011, taxpayers can exclude 75% of the gain, increased from 50%. The stock must be acquired and held for at least five years. The business cannot have assets over $50 million and must operate an active trade or business.

❍ **Estimated taxes** — In 2009, individuals whose income is primarily derived from a small business can make estimated tax payments equal to 90% of their 2008 tax liability, down from 100%.

❍ **S corporation gains** — For C corporations that convert to S corporation status in 2009 or 2010, the holding period for the built-in gains tax is temporarily shortened from 10 years to seven years.

❍ **Work opportunity tax credit** — The ARRA extends this credit to cover two new categories of individuals — unemployed veterans and disconnected youth. Individuals must be hired and begin work in 2009 or 2010. ❍❍❍

The Overall Objectives

The ARRA is designed to combat the economic problems facing the country. In the 13 months before the ARRA was signed into law, the economy lost 3.6 million jobs. The ARRA represents the most ambitious effort to stimulate the economy in our country's history, with an overall purpose of creating jobs and transforming the economy to compete in the 21st century. According to the White House, the ARRA will:

- **Create or save 3.5 million jobs over the next two years.** This number is based on an analysis by the Council of Economic Advisers. Jobs will be created in numerous industries, with over 90% in the private sector.
- **Provide direct relief to working and middle-class families.** Approximately 38% of the ARRA's total cost is geared to tax breaks for families. The Making Work Pay tax credit will help 95% of workers. Other direct relief includes expanding unemployment compensation and making payments to Social Security beneficiaries and veterans. The other 62% of the cost of the ARRA provides state fiscal relief and investments, which will also benefit working families.
- **Double renewable energy generating capacity over three years.** While it took 30 years to reach current levels of renewable energy production, the ARRA will double that production level over three years.
- **Create a Clean Energy Finance Authority and renewable tax credits.** Together, these initiatives will provide another $100-billion investment in the renewable sector. The finance authority will provide loan guarantees and other financial support to help ease credit constraints for renewable energy investors.
- **Invest in the nation's infrastructure.** Over $150 billion will be invested, which is the largest investment since the interstate highway system was built in the 1950s. Investments will be made to improve public transit and high-speed rail, upgrade the nation's electricity grid, and expand broadband coverage throughout the nation.
- **Protect health care coverage for millions of Americans during the recession.** The ARRA provides a temporary increase in the Federal Medical Assistance Percentage, so that no state has to cut eligibility for Medicaid because of budget shortfalls. This will protect nearly 20 million people whose eligibility might be at risk.
- **Invest in our educational system.** The ARRA contains several measures for the educational system, including providing funding so teacher layoffs and education cuts can be prevented, providing a new higher education tax credit for nearly four million students, increasing Pell grants by $500 for seven million college students, and maintaining key education reforms.
- **Enacts significant tax cuts for low- and moderate-income households.** Currently, a family of four earning minimum wage lives below the poverty line. The ARRA provides an $800 Making Work Pay tax credit and expanded child tax credit, bringing more than two million people over the poverty level. ❍❍❍

FX2009-0223-0175

Please Call

The American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law on February 17, 2009. With a cost of approximately $787 billion, the ARRA authorizes government spending and tax incentives designed to pull the U.S. economy out of recession. While the bulk of the cost involves direct spending by the U.S. government, approximately 38% of the cost involves tax cuts for individuals and businesses. Articles in this newsletter cover the major tax cuts for individuals and businesses, the key objectives of the ARRA, an assessment of where the economy currently stands, and whether the ARRA will accomplish its goals. In these unprecedented times, you are likely to have questions about your specific situation, whether it relates to how the ARRA will impact your situation, what you should do with your investments, or what adjustments you should make to your retirement plans. Please feel free to call to discuss your specific questions. ❍❍❍

PRIZM Financial Advisors, Inc.

Comprehensive Financial Solutions™
1751 S. Naperville Rd., Suite 203
Wheaton, IL 60189