

THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009: Summary of Selected Tax Provisions

by Marilyn Barrett and David Graff

Effective February 17, 2009, President Barack Obama signed into law the American Recovery and Reinvestment Act of 2009 (otherwise known as the "Stimulus Bill"), \$787 billion economic stimulus legislation which President Obama said marks a "major milestone on our road to recovery." Tax provisions account for over \$288 billion of this amount. This memorandum summarizes only selected tax provisions contained in the Stimulus Bill. This memorandum is not exhaustive and you should contact your tax advisor to discuss how the new tax provisions will affect you. The first section describes business tax incentives, the second section describes energy-related tax incentives, and the third section describes tax provisions affecting individual taxpayers. Several non-tax provisions have also been included.

TAX INCENTIVES FOR BUSINESS

Extension of Bonus Depreciation

IRC § 168(k) allows additional depreciation in the first year certain assets are placed in service equal to 50% of the basis of the property (referred to as "bonus depreciation"). Bonus depreciation is allowed for both regular tax and the AMT. Property eligible for bonus depreciation is (i) MACRS property with an applicable recovery period of 20 years or less; (ii) water utility property; (iii) computer software

(other than purchased software); or (iv) qualified leasehold improvement property, the original use of which commences with the taxpayer. Bonus depreciation expired at the end of 2008 except for certain transportation property which has an expiration date of December 31, 2009.

The Stimulus Bill extends the expiration date for one year to the end of 2009 and through 2010 for the transportation property.

Section 168(k)(4) provides an election to forego the bonus depreciation on qualifying property in exchange for converting limited amounts of unused pre-2006 research credits and AMT credits into current refundable credits. Prior to the Stimulus Bill, the qualifying property had to be placed in service after March 31, 2008 and before January 1, 2009. The Stimulus Bill extends this election one additional year as well.

Estimated Cost - \$5,074 million

Increase in First Year Expensing

IRC § 179 permits taxpayers to elect to immediately deduct up to \$250,000 the cost of depreciable tangible personal property placed in service during 2008. This amount is reduced to the extent qualifying property placed in service by the taxpayer exceeds \$800,000. After 2008, these limitations were scheduled to be reduced to \$125,000 and \$500,000 respectively. The Stimulus Bill extends the \$250,000 and

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\$800,000 amounts through taxable year 2009.

Estimated Cost - \$41 million

Five-Year Carryback of Losses

Under IRC § 172, net operating losses can generally be carried back two years and carried over 20 years. Under the Stimulus Bill, small businesses whose gross receipts do not exceed \$15 million can elect to carryback net operating losses incurred after 2007 as many as 5 years. This election can only be made for one taxable year.

Estimated Cost - \$947 million

Estimated Tax Payments

The Stimulus Bill permits qualified individuals whose adjusted gross income is less than \$500,000 and who can certify that at least 50% was derived from a small trade or business, to make estimated tax payments equal to 90% of the taxpayer's tax liability for the preceding tax year. Prior to this change, these taxpayers were obligated to make estimated tax payments equal to the lesser of (i) 90% of the tax shown on the return for the current year, or (ii) 100% (110% if gross income exceeded \$150,000) for the preceding tax year. A small trade or business is defined as one that employs on average no more than 500 persons.

Additionally, under the Stimulus Bill the estimated tax payment required to be made by certain large corporations (with least \$1 billion in assets) in July, August or September 2013 has been increased to 120.25% of the amount otherwise due. This represents an increase of

0.5 percentage point. The next required installment due in October, November or December of 2013 is reduced to 79.75% of the amount otherwise due.

Modification of Work Opportunity Credit

IRC § 51 allows employers to take a work opportunity credit for employing individuals from one or more of nine targeted groups. The credit is generally 40% of first year and second year wages limited to caps ranging from \$1,200 to \$9,000, depending on the target group which the employee qualifies under.

The Stimulus Bill creates a new target group for the credit of unemployed veterans and disconnected youth who begin work for the employer in 2009 or 2010.

Estimated Cost - \$231 million

Clarification of Limitations on Built-In Losses Following an Ownership Change

Generally, IRC § 382 imposes substantial limitations on use of net operating losses ("NOLs") where there is a 50% change in ownership in the loss corporation. The purpose of the limitation is to preclude trafficking in NOLs.

Last fall, the Treasury Secretary issued Notice 2008-83 which granted some banks (and only some banks) which acquired distressed banks relief from Section 382 and allowed them to deduct the NOLs of the distressed banks in full. These agreements were extremely controversial, in part because many people did not believe that the Treasury Secretary has the

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legal right to waive the congressional marked provision of Section 382.

The Stimulus Bill clarifies application of Section 382. It states that Congress found the following:

(i) the Treasury Secretary does not have authority to provide exemptions or special rules to particular industries or classes of taxpayers; (ii) the Notice granting 382 relief is inconsistent with Congressional intent and the legal authority of this Notice is doubtful; but (iii) taxpayers should be allowed to rely on the Notice.

The Stimulus Bill provides that the Notice will be effective only for the agreements entered into by the Treasury Secretary with banks before January 16, 2009 that provided that the Section 382 limitations would be waived.

*Estimated Cost - gain of \$6,977 million**

Elimination of IRC § 382 Limitations On NOL Carryovers In Certain EESA Restructurings
Notwithstanding the finding that Notice 2008-83 was invalid, Congress enacted new IRC § 382(n)(l), which provides that the NOL limitation will not apply to a change in ownership resulting from a restructuring plan of a taxpayer that is (i) required under a loan agreement or commitment for a line of credit entered into with the Treasury Department under the Emergency Economic Stabilization Act of 2008, and (ii) intended to result in a rationalization of the costs, capitalization, and capacity with the respect to the manufacturing workforce of, and suppliers to, the taxpayer and its subsidiaries. Nobody knows what the requirement in (ii) means and we will have to await IRS guidance.

Estimated Cost - \$3,163

**This appears to be an example of budgetary magic and must be based on the law as it was and by revoking the law, additional tax will be owed. An alternate estimate for tax revenue resulting from the Notice, which should*

Delay of Withholding Requirement on Certain Payments Made by Government Entities (i.e., Government Contracts)

IRC § 3402(t) requires government entities to begin withholding tax at the rate of 3% on all payments to persons providing goods and services to the governmental entity, beginning for payments made after December 31, 2010. The Stimulus Bill delays this withholding requirement for one year to payments made after December 31, 2011.

Estimated Cost - \$291 million

Deferral of Cancellation of Indebtedness Income

When a debt is settled for less than the full amount due, the debtor generally realizes cancellation of debt income and must pay tax on that amount in the year the debt is canceled to the extent the debtor is solvent (generally, debt cancellation does not cause taxable income to the extent the debtor is insolvent or another exception applies). This can be very burdensome to the taxpayer since debt forgiveness does not generate cash and the taxpayer may not have other cash to pay the tax. The Stimulus Bill permits certain taxpayers who reacquire a business debt at a discount to defer reporting the amount of debt forgiven until the 5th year following the reacquisition for reacquisition in 2009 and the 4th taxable for reacquisition in 2010.

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Estimated Cost - \$1,622 million

Temporary Reduction for Built-In Gain Recognition for S Corporations

When a C corporation is converted to a S corporation, IRC § 1374 provides that a corporate level tax is imposed on the "built-in gain" of the corporate assets at the time of conversion if the assets are disposed of within 10 years from the conversion date.

The Stimulus Bill reduces the recognition period to 7 years for dispositions made in 2009 and 2010, so that gain recognized in those years will not be subject to the corporate level tax if the corporation has been a S corporation for at least 7 years prior to either 2009 or 2010. Since this provision singles out S conversions made in 2003 and 2004 for beneficial treatment, some practitioners have questioned whether it is a disguised "earmark."

Estimated Cost - \$415 million

Executive Compensation Deduction Limits for Entities Receiving TARP Payments

Any entity (not just banks) that receives assistance under the Troubled Asset Relief Program ("TARP") will be subject to a cap of \$500,000 on the amount of compensation it can deduct for specified executives for any year in which the TARP assistance remains outstanding (not including stock warrants held by the Federal government). The number of executives subject to this limitation depends on the amount of TARP assistance received and ranges from the

most highly compensated employee for entities who received less than \$25 million of TARP assistance to the most senior executives and the 20 next most highly compensated employees for those entities which receive more than \$500 million of TARP assistance. This provision is extremely controversial, with its detractors asserting that the compensation limits will cause a brain drain on Wall Street and its advocates countering that Wall Street bankers have nowhere else to go and their value is in question given recent events.

ENERGY INCENTIVES

Extension of Renewable Electricity Production Credit

An income tax credit is allowed under IRC § 45 for the production of electricity from certain renewable energy resources at qualified facilities. Qualified energy resources include wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are generally those that generate electricity from qualified energy resources. To qualify for the credit, the electricity must be sold to unrelated parties.

The amount of the credit depends on the type of energy facility (and that amount is indexed annually for inflation). For electricity produced from wind, closed-loop biomass, geothermal or solar qualified energy facilities, the base amount of the credit is 2.1 cents per kilowatt-hour of electricity produced for 2008. For open-loop

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biomass, small irrigation power, landfill gas, trash combustion, qualified hydropower, and marine and hydrokinetic renewable energy qualified facilities the reduced amount is 1 cent per kilowatt-hour of electricity.

A taxpayer can generally claim the credit for the 10-year period commencing with the date the facility is placed into service. The credit is reduced by the amount of grants, tax-exempt bonds, subsidized energy financing, and other credits. The credit is also phased out over a 3-cent margin as the market price for electricity exceeds a certain threshold level, based on the average contract price per kilowatt hour sold in the prior year. For 2008, the phase out started at 11.8 cents (this threshold level is also indexed annually for inflation).

The Stimulus Bill extends the date by which the facility must be placed in service to obtain the credit. The extension is three years, which means most facilities must be placed in service by December 31, 2013 (by December 31, 2012 for wind facilities). For marine and hydrokinetic renewable energy resources, the period is extended for two years through 2013.

Estimated Cost - \$13,143 million

Special Investment Credit Election

The Stimulus Bill allows taxpayers to irrevocably elect, in lieu of the renewable electricity credit under IRC § 45 described above, to instead elect to treat the qualified property which is part of the qualified facility (other than refined coal, Indian coal, and solar facilities) as energy property eligible for a 30% investment tax credit

under IRC § 48 (described more fully below). The property must be placed in service during the extended years provided above. For this credit, eligible property includes tangible property but does not include a building or its structural components.

Estimated Cost - \$285 million

Increase in Investment Tax Credit

IRC § 48 provides an energy credit for investments in qualified energy property placed in service prior to 2017. The allowable credit is a specified percentage of the basis of each qualified energy property placed in service during the tax year. That percentage is 30% for solar energy property, hybrid solar lighting systems, qualified fuel cell property, and "qualified small wind energy property" (a wind turbine of 100 kilowatts of rated capacity or less). The maximum credit that may be claimed for qualified small wind energy property is \$4,000. The energy credit also allows a credit of 10% of the basis of stationary microturbine property, combined heat and power systems property, geothermal property, and geothermal heat pump systems. The amount of allowable energy credit is reduced if the property is also financed with industrial development bonds or through any other federal, state or local subsidized financing program.

The Stimulus Bill (i) eliminates the \$4,000 cap on the energy credit applicable to qualified small wind energy property investments and (ii) eliminates the requirement that the energy credit be reduced if the property is financed in part by subsidized energy financing or with private

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activity bonds. These changes affect construction or erection of property after 2008, to the extent of the costs incurred after 2008, and to acquisitions made after 2008.

Estimated Cost - \$604 million

Grants for Specified Energy Properties In Lieu of Credits

The Stimulus Bill authorizes the Department of Energy to make grants to persons who place in service during 2009 or 2010 either (i) electricity production facilities otherwise eligible for the renewable electricity production credit or (ii) qualifying property otherwise eligible for the energy credit. In general, the grant is up to 30% of the basis of the property that would qualify for the credit under Section 48 or comprise a facility eligible for the Section 45 credit. For qualified microturbines, combined heat and power systems, and geothermal heat pump property, the credit is 10%.

If a grant is received, no credit under Section 45 or 48 is allowed. Grants must be applied for before October 1, 2011.

The amount of the grant is not includible in income. However, the basis of the property is reduced by 1/2 of the amount of the grant and, if the eligible property is disposed of within 5 years, part of the grant is subject to recapture. (Similar rules apply to the Section 45 and Section 48 credits.)

Estimated Cost - gain of \$5 million

Credit for Investment In Advanced Energy Facilities

The Stimulus Bill adds IRC § 48C to allow a 30% credit for investment in *qualified property* used in a *qualifying advanced energy project* which is certified by the Treasury Department and Department of Energy. This credit is a component of the investment tax credit under IRC § 46. The credit does not apply to any portion of the property financed with nonqualified nonrecourse financing.

Qualifying advanced energy projects include projects that re-equip, expand, or establish a manufacturing facility for the production of (i) property designed to produce energy from the sun, wind or geothermal deposits; (ii) fuel cells, microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles; (iii) electric grids; (iv) property to capture and sequester carbon dioxide emissions; (v) property to refine or blend renewable fuels or produce energy conservation technologies; (vi) new qualified plug-in elective drive motor vehicles, qualified plug-in vehicles, or components which are designed specifically for use with such vehicles; (vii) other property designed to reduce greenhouse gas emissions as approved by the Treasury Department.

Qualified property includes property necessary for the production of qualifying advance energy projects or tangible property that is an integral part of such projects *and* which is depreciable.

Section 48C(e) denies a double benefit. The credit is not allowed under Section 48C for any qualified investment for which a credit is also

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allowed for the energy credit under Section 48, Section 48A or Section 48B.

The Treasury Department must certify that the project is eligible for the credit. The total amount of allowable credits may not exceed \$2.3 billion. The Treasury Department will establish a program for certifying qualified investments by August 16, 2009. The identity of the applicant and the amount of credit allocable to the applicant will, upon receipt of certification, be publicly disclosed.

Estimated Cost - \$1,647 million

Expanded Qualified Energy Conservation Bonds

The Stimulus Bill increases the amount of qualified energy conservation bonds permitted under IRC § 54D, the interest on which will qualify for tax exemption, from \$800 million to \$2.4 billion and makes other changes to expand the uses to which such bonds can be used.

Estimated Cost - \$803 million

Expanded Clean Renewable Energy Bonds

The Stimulus Bill expands the New Clean Renewable Energy Bonds ("New CREBs") program, which was designed for non-profit electricity producers to be able to issue tax credit bonds called clean, renewable energy bonds or "CREBs" under Section 54. Holders of tax credit bonds are generally entitled to an annual tax credit calculated by multiplying the outstanding face amount of the bonds held by the applicable credit rate, as set by the IRS. For New CREBs, the annual tax credit is limited to

70 percent of the face amount times the applicable credit rate.

The Stimulus Bill increases the national limitation on the issuance of New CREBs by \$1.6 billion. One-third of the \$1.6 billion will be available to qualifying public power providers; up to one-third will be available to qualified projects of governmental bodies; and up to one-third will be available to qualifying projects of electric cooperative companies.

Estimated Cost - \$578 million

Modification of High-Speed Intercity Rail Facility Bonds

Prior to the Stimulus Bill, a high-speed intercity rail facility must have used vehicles reasonably expected to operate at speeds in excess of 150 miles per hour. In a distinction that only a bond lawyer could love, the Stimulus Bill modifies that requirement such that, to qualify as a tax-exempt bond, the vehicles used must be capable of attaining a maximum speed in excess of 150 miles per hour.

Despite the subtle difference, the estimated cost of this provision is \$288 million.

Modification of Credit for Nonbusiness Energy Property

Prior to the Stimulus Bill, IRC § 25C provided for a 10% nonrefundable credit for the purchase of qualified energy efficiency improvements to existing homes. This includes energy efficient insulation materials, exterior windows and doors, and metal or asphalt roofs. Certain energy efficient properties qualify for dollar specific

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credits; for example, certain fans qualify for a \$50 credit and certain furnaces and hot water boilers qualify for a \$150 credit.

The Stimulus Bill (i) extends the residential energy property credit to include qualifying property placed in service in 2010, (ii) increases the credit to 30%, subject to a cap of \$1,500 and (iii) includes 30% of residential energy property expenditures (property previously subject to dollar specific credits). The Stimulus Bill also modifies the energy efficiency standards to qualify for the credit. The modifications apply to biomass fuel property placed in service on or after January 1, 2009, and, for other property, February 17, 2009.

Estimated Cost - \$2,034 million

Credit for Residential Energy Efficient Property

IRC § 25D provides a nonrefundable personal tax credit for the purchase of qualified solar electric property and qualified solar water heating property that it is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is 30% of qualifying expenditures. Prior to the Stimulus Bill, Section 25D included a maximum credit cap of \$2,000 for solar water heating property. There was no cap for solar electric property. Section 25D also provides a nonrefundable personal tax credit of 30% for qualified geothermal heat pump property, qualified small wind energy property and qualified fuel cell power plants. Prior to the Stimulus Bill, these credits were also subject to caps. Prior to the Stimulus Bill, no credit was allowed for expenditures made from subsidized

energy financing (i.e., under a Federal, state or local program).

The Stimulus Bill eliminates the credit caps for solar hot water, geothermal and wind property and eliminates the credit reduction for property using subsidized energy financing. These provisions are effective January 1, 2009.

Estimated Cost - \$268 million

Temporary Increase in Credit for Alternative Fuel Vehicle Refueling Property

Prior to the Stimulus Bill, a 30% credit was provided for the cost of installing qualified clean-fuel vehicle refueling property either to be used in a trade or business or at the principal residence of the taxpayer. The credit was limited to \$30,000 for property used in a trade or business and \$1,000 for property used at a principal residence.

For property placed in service in 2009 and 2010, the Stimulus Bill increases the credit rate to 50%, increases the credit limit for business property to \$200,000 for qualified hydrogen refueling property and to \$50,000 for other qualified refueling property, and, for personal residences, increases the credit limit to \$2,000.

Estimated Cost - \$54 million

Modification of Credit for Carbon Dioxide Sequestration

Under IRC § 45Q, a credit of \$20 per metric ton is available for qualified carbon dioxide captured by a taxpayer at a qualified facility and disposed of by such taxpayer in secure geological

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storage. A credit of \$10 per metric ton is allowed for qualified carbon dioxide that is captured and used a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

The Stimulus Bill requires that carbon dioxide used as a tertiary injectant and otherwise eligible for the \$10 per metric ton credit must be sequestered in permanent geological storage and makes other clarifications.

Modification of Plug-In Electric Motor Vehicle Credit

IRC § 30B and § 30D provide for a credit for the purchase of qualified plug-in electric drive motor vehicles. The amount of the credit allowed depends on the type of technology uses, the weight of the vehicle, the amount by which the vehicle exceeds certain fuel economy standards, and, in some cases, the estimated lifetime fuel savings.

Vehicles with at least 4 wheels:

The Stimulus Bill modifies Section 30D for vehicles placed in service after December 31, 2009. For qualifying vehicles the credit will be equal to \$2,500 to \$7,500 depending on kilowatt hour capacity. A qualifying vehicle must be less than 14,000 pounds, designed for transporting persons on streets or highways and be propelled by an electric motor drawing from a battery having at least 4 kilowatt hours capacity.

However, as soon as 200,000 new qualified vehicles have been sold for use in the United States after December 31, 2009 by a certain manufacturer, a phase-out will be triggered as to that manufacturer's vehicles.

For tax years beginning in 2009, the alternative motor vehicle tax credit under Section 30B will be treated as a nonrefundable personal tax credit. This means that it can be used to offset regular tax liability and alternative minimum tax (AMT) liability the same as other nonrefundable personal credits, to the extent permitted.

Vehicles with 2 wheels, 3 wheels and low-speed vehicles:

The Stimulus Bill creates new credit for qualified plug-in electric drive motor vehicles with 2 or 3 wheels and low-speed vehicles. Low-speed vehicles must have 4 wheels, a maximum speed attainable in one mile of no more than 25 miles per hour and a gross weight of less than 3,000 pounds. Generally, the same requirements for 4-wheeled vehicles also apply.

The credit is 10% of the cost of acquiring the vehicle and it is capped at \$2,500. The credit generally applies to vehicles purchased after February 17, 2009 through December 31, 2011, and the credit will not be allowed to the

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extent the vehicle qualifies for the Section 30D credit.

Estimated Cost - \$2,002 million

Parity for Qualified Transportation Fringe Benefits

Up to \$230 per month of employer-provided parking is excludible from income by its employees. However, prior to the Stimulus Bill, only \$120 per month of employer-provided transit and vanpool benefits were excludible. (These monthly amounts are for 2009; these limitations are indexed annually for inflation.)

For 2009 and 2010, the Stimulus Bill increases the monthly exclusion for employer-provided transit and vanpool benefits to the same level as the exclusion for employer-provided parking.

Estimated Cost - \$192 million

INDIVIDUAL TAX PROVISIONS

Modification of Homebuyer Credit

Prior to the Stimulus Bill, first-time homebuyers were generally allowed a refundable tax credit equal to the lesser of \$7,500 (\$3,750 for married taxpayers filing separate returns) or 10% of the purchase price of a principal residence. The credit phases out for individuals with modified adjusted gross income between \$75,000 and \$95,000 (\$150,000 and \$170,000 for joint filers). A taxpayer is considered a first-time homebuyer if the taxpayer had no ownership in a principal residence during the prior three years. This credit originally applied to purchases made between April 9, 2008 and before July 1, 2009.

The Stimulus Bill extends the credit to purchases on or before November 30, 2009 and increases the amount of the credit to \$8,000 (\$4,000 for married taxpayers filing separate returns).

This credit is generally recaptured ratably over 15 years, beginning the second year after the year in which the home was purchased. The Stimulus Bill waives this recapture for homes purchased between January 1, 2009 and November 30, 2009. As under current law, the credit is recaptured if the taxpayer sells the principal residence within 36 months of purchase.

Estimated cost - \$6,638 million

Deduction of Sales Tax and Excise Tax on Purchase of Automobile

The Stimulus Bill allows an above the line deduction for qualified motor vehicle taxes for up to \$49,500 of purchase price of an automobile. The deduction is phased out for taxpayers with modified adjusted gross income between \$125,000 and \$135,000 (\$250,000 and \$260,000 for joint filers). The deduction may be claimed in calculating the taxpayer's regular income tax and alternative minimum tax liability. This provision applies to the purchase of a passenger automobile, light truck or motorcycle which has a gross vehicle weight rating of not more than 8,500 pounds, or a new motor home acquired by the taxpayer between February 17, 2009 and December 31, 2009.

Estimated Cost - \$1,684 million

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Alternative Minimum Tax Relief

The Stimulus Bill increases the exemption from alternative minimum tax for 2009 to \$70,950 for joint filers and surviving spouses, \$46,700 for single taxpayers, and \$33,475 for married taxpayers filing separately. Many people believe this provision is not properly included in the Stimulus Bill since Congress had provided relief from AMT for many taxpayers on an annual basis for a number of years.

Estimated Cost - \$69,759 million

Payroll Tax Credit

The Stimulus Bill provides a \$400 payroll tax credit for workers earning up to \$75,000. Married couples filing jointly qualify for \$800 credit up to \$150,000 of earnings. The only interesting thing about this provision is that it has the single largest cost of any tax provision in the Stimulus Bill, estimated to be \$116,199 million. The payroll tax credit will be seen immediately by means of approximately \$10/week less being withheld from employees' paychecks.

Estimated Cost - \$116,199 million

Unemployment Compensation

The Stimulus Bill provides that an individual may exclude up to \$2,400 of unemployment compensation from his or her gross income in 2009.

Estimated Cost - \$4,740 million

Qualified Tuition Programs

The Stimulus Bill expands the definition of "qualified higher education expenses" for purposes of excludable qualified tuition programs (also known as "529 plans") to include expenses for computer equipment and technology, or for internet access and related services, paid or incurred in 2009 and 2010. However, the new definition specifically excludes any computer software that is designed for games, sports or hobbies unless that software is predominantly educational in nature.

Estimated Cost - \$6 million