



The Small Business Owner's Guide to the Economic Stimulus Package

Generating Cash with the *American Recovery and Reinvestment Act's* Investment Incentives

March, 2009

EVERY BUSINESS OWNER SHOULD BE AWARE OF THE INVESTMENT INCENTIVES IN THE ECONOMIC STIMULUS PACKAGE THAT ALLOW COMPANIES TO GENERATE CASH IMMEDIATELY SIMPLY BY INVESTING IN EQUIPMENT AND/OR SOFTWARE...

Executive Summary

On February 17, 2009, President Barack Obama signed the *American Recovery and Reinvestment Act* (also known as the *Economic Stimulus Package*) into law as the new Administration's initial response to the growing economic slowdown gripping the US.

With the primary goal of easing consumer pain in a weakening economy, this *Stimulus Package* focuses mainly on providing immediate personal tax cuts and creating jobs through massive investment in public infrastructure.

There are, however, billions of dollars of tax incentives for small and midsized businesses (SMBs) that are included within the *Stimulus Package* that have received almost no coverage whatsoever from the mainstream press.

Used wisely, these fiscal incentives can allow savvy business owners to acquire the equipment and software based solutions that increase the competitiveness of their firms with little to no net initial cash outlay. **In fact, combining *Economic Stimulus Package* tax benefits and multiyear financing can even generate up to two years positive cash flow for companies investing in qualifying equipment and software, before even \$1 of return on investment is considered.**

This *Small Business Owner's Guide to the Economic Stimulus Package* provides SMB decision makers with (1) the required understanding of available tax reduction programs, (2) a simple means to evaluate the cash flow return on investment that the *Stimulus Package* can help create, and (3) the required steps that must be taken to leverage this unique opportunity.

What's In the Economic Stimulus Package for Small-Midsized Business?

Over 400 pages in length, the *American Recovery and Reinvestment Act* contains hundreds of individual federal spending initiatives that include personal tax breaks, government investment projects, industry-specific subsidies, state and local government grants and the like. For small business owners, however, the *Stimulus Act* presents a unique opportunity to lower 2009 taxes by making targeted investments in equipment and software.

→ THE BIGGEST BENEFITS TO SMBs COME FROM INVESTMENT TAX BREAKS ←

By far the greatest opportunity the *Stimulus Package* provides to small and midsize businesses the option to leverage accelerated depreciation as a means to lower their 2009 tax year bill. Provisions related to accelerated depreciation tax benefits include:

WHAT ELSE CAN SMBs FIND IN THE STIMULUS PACKAGE?

TAX CREDITS FOR HIRING WORKERS IN TARGET GROUPS

The Stimulus Package expands the definition of "target groups" for which businesses may claim work opportunity tax credits. When hiring members of these defined groups, employers may claim 40% of the first \$6,000 of wages as an immediate tax credit.

New target group designations include *unemployed veterans* who have been discharged/released from duty within the last five years and *disconnected youth* between 16 and 25 and have not attended school or been regularly employed in the past 6 months

NEW LOSS-CARRYBACK ACCOUNTING RULES

Small businesses with gross receipts of \$15 Million or less can now carry back net operating losses (NOLs) for as many as five years to offset prior profits and the resulting tax liability.

In other words, companies that book losses in 2009 may receive refunds of tax dollars paid to the federal government over the previous five years.

REDUCED CAPITAL GAINS FOR INVESTMENTS IN SMBs

The Stimulus Package increases the capital gains tax break to 75% for investors who buy stock in SMBs in 2009 and hold onto it for at least 5 years.

Increased Section 179 Accelerated Depreciation for 2009

The *American Recovery and Reinvestment Act* increases the investment limit that a company can claim under Section 179 to \$250,000 during tax year 2009, far beyond the initial IRS limit of \$25,000. That means that 100% of qualifying investments – up to a quarter million dollars – can be purchased and expensed in 2009.

Access to 50% Bonus Accelerated Depreciation for 2009

The *Stimulus Package* further allows companies with investment levels that exceed the \$250,000 limit on Section 179 to claim 50% first-year "Bonus" depreciation for the excess amount. That means that at the very least, 50% of qualifying investments can be expensed in 2009, even when Section 179 limits have been exceeded.

Standard (MACRS) Depreciation Still Applies

Whatever excess investment is left over after applying the extended access to Section 179 and Bonus depreciation can still be expensed over normal depreciation schedules using the Modified Accelerated Cost Recovery System (MACRS) schedules published by the IRS.

→ CALCULATE DEPRECIATION STARTING WITH SECTION 179 ←

When qualifying investments made by a company in 2009 are less than \$250,000, the entire amount may be claimed for first year, accelerated depreciation expense under IRS Section 179. When the investment total exceeds \$250,000, Section 179, Bonus and MACRS depreciation are combined as in the example on page 4 of this document.

→ EQUIPMENT AND SOFTWARE THAT QUALIFIES ←

IRS Publication 946 sets guidelines related to MACRS and Section 179 depreciation. By and large, the same guidelines that define eligibility for Section 179 treatment apply to Bonus depreciation, as well.

It is important to note that business software purchases can qualify for the accelerated depreciation regimen set forth in the *Stimulus Act* as long as the software is considered to be "off the shelf" with minimum set-up and configuration. Investments in custom programming and standalone databases do not qualify for Section 179 or bonus depreciation treatment.

Accelerated Depreciation Tax Reductions, Pre-ROI Positive Project Cash Flow and the 3% ROI Rule

Even though accelerated depreciation is a vital component of effective tax planning, a surprisingly small percentage of small business owners understand the three most important truths that it enables.

It is the responsibility of every business owner to understand these simple concepts during tax year 2009, however, as the *American Recovery and Reinvestment Act* set in motion the mechanism that allows companies to generate a short-term cash surplus through a combination of accelerated depreciation tax reductions, investment financing and modest monthly return on investment.

→ ACCELERATED DEPRECIATION LOWERS TAX BILLS NOW ←

IRS publication 946 specifies that specified equipment and software with a useful life of greater than one year may qualify for 100% Section 179 expensing in the year it is acquired and placed into service.

For example: if \$100,000 of Section 179 eligible business software is purchased and placed into service during the current tax year, the full amount could be expensed immediately, lowering the company's tax liability by about \$33,000 (\$100,000 times a 33% tax rate). If no accelerated depreciation were available, the software would likely be depreciated on a five year schedule, with only one-fifth (\$20,000) expensed yearly.

→ FINANCING ENABLES PRE-ROI POSITIVE CASH FLOW ←

Accelerated depreciation tax reductions are so large that they can cover up to two years of monthly payments if the project is financed for a five year term, even before considering \$1 of return on investment.

A typical five year financing plan would include monthly payments of about \$2,100, meaning that the tax savings of \$33,000 calculated above would be greater than 15 payments. The investment would be cash flow positive for over a year even before any ROI were considered.

→ THE 3% ROI RULE SECURES CASH GENERATION ←

This rule of thumb states that for any investment for which 100% accelerated depreciation is claimed via Section 179 and a five year financing program used, that a monthly return on investment of only 3% of the investment total is sufficient to generate immediate positive cash flow throughout the financing term and beyond.

Continuing with our example, if the investment can generate only a 3% (\$3,000) monthly ROI, the business software investment will initiate with minimal cash out, generate a significant surplus by the month that accelerated depreciation tax reductions are realized and will benefit from increasing cash generation through the end of the financing term and beyond.

COMMON ACCELERATED DEPRECIATION QUESTIONS

CAN ACCELERATED DEPRECIATION BE USED WITH LEASING?

In short, capital leases that specify a fixed dollar buy out (typically \$1) **CAN** be combined with accelerated depreciation. Leases with end of term purchase *options* are expensed as rentals, and cannot benefit from accelerated depreciation.

CAN ACCELERATED DEPRECIATION BE APPLIED TO SERVICES, TOO?

Services related to the purchase and the subsequent "placement into service" of equipment or software are often generally capitalized and subject to depreciation.

Maintenance/support fees and subscription services are typically expensed under amortization schedules, and do not apply.

HOW ARE TAX CREDITS, GRANTS AND REBATES TREATED?

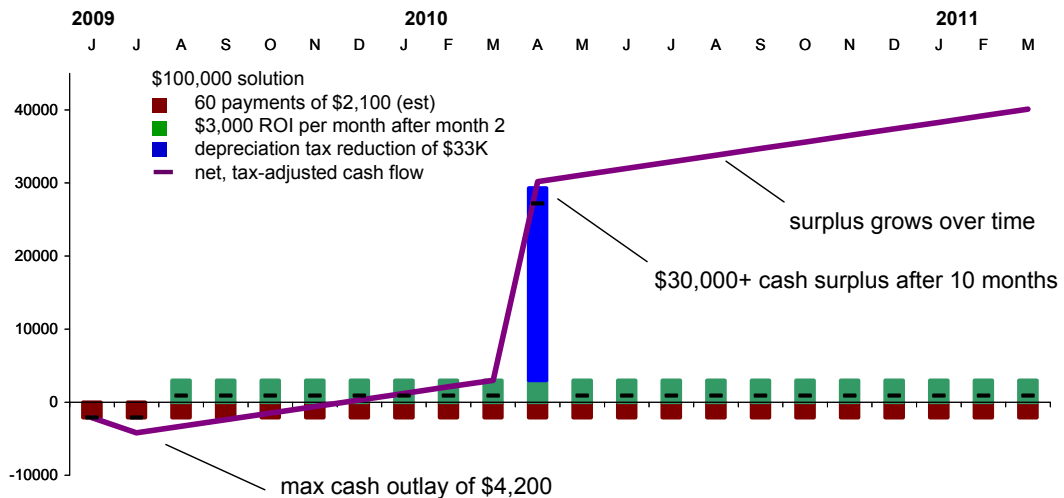
When investment tax credits, grants and/or rebates are claimed, Section 179, Bonus and MACRS depreciation are still applied to the *net investment cost*, which is the gross cost minus the sum of such subsidies.

See IRS Publication 946 for more.

The Economic Stimulus Package and the 3% Percent ROI Rule: a Real World Example

The following example shows how a mid-year 2009 financed investment that qualifies for Section 179 and a modest 3% per month return on investment produces immediate, sustainable positive cash flow.

→ Tax-Adjusted Cash Flow Analysis ←



→ Example Assumptions ←

- Company ABC invests \$100,000 in a software-based solution .
- A five year capital lease is started in June, '09 to finance the project
- Lease monthly payments are \$2,100
- The solution is "placed into service" in August, '09
- The solution generates a \$3,000 per month (3%) ROI
- ABC has a corporate tax rate of 33%
- ABC closes its fiscal year in December and pays taxes in April
- The full investment amount is expensed in tax year 2009 using Section 179 accelerated depreciation.

→ Pre-ROI Positive Project Cash Flow for Nearly 16 Months ←

The \$33,000 (\$100,000 X 33%) tax reduction that Company ABC realizes in April 2010 generates enough cash to cover 15.7 of the monthly payments (\$33,000/\$2,100). Even before monthly ROI is added to our analysis, accelerated depreciation tax reductions mean that Company ABC would have more cash on hand in April 2010 than it would had it not invested at all.

→ The 3% ROI Rule Generates Cash Immediately ←

The modest 3% return on investment (\$3,000 per month) that the investment begins to generate in August of 2009 is enough to minimize total initial outlay to only \$4,200, or two monthly payments. What's more, when aggregate ROI is combined with the \$33,000 tax reduction, the net generation of cash in April 2010 well over \$30,000. Since the monthly ROI contribution is greater than the monthly payment (\$3,000 vs. \$2,100), this cash surplus only grows with time.

WHAT YOU MUST DO IN 2009 TO TAKE ADVANTAGE

BE PROFITABLE DURING 2009

No profit means no tax, and no tax means no accelerated depreciation tax reduction. However, unprofitable companies may use this strategy to claim refunds under the extended loss carry-back rules, as well.

PURCHASE & "PLACE INTO SERVICE" BEFORE YOUR FISCAL YEAR END

In order to claim any depreciation expense (accelerated or not) on a qualifying investment, the IRS requires that you first purchase and "place into service" the associated equipment and/or software.

PAY FOR INVESTMENTS WITH CASH OR CAPITAL LEASE FINANCING:

Given the constrained credit environment that currently exists worldwide, the best practice is to seek prequalification for financing before even seeking quotations for investments.

JUSTIFY A MONTHLY ROI OF NO LESS THAN 3% OF THE INVESTMENT TOTAL

The vast majority of investments that businesses consider have monthly ROI that far exceeds this amount. Take the time, however, to assure that you have this lower threshold covered.

Taking the First Step

It can be downright counterintuitive to see that making a long term investment can generate immediate positive cash flow (even before ROI contribution is considered), but the tax benefits put into effect by the *American Recovery and Reinvestment Act* make it possible.

→ **Request a Complimentary Tax-Adjusted Cash Flow Analysis** ←

The sponsors of this white paper (Baytree Leasing and SophLogic) make it easy to see how easy it can be to generate cash in this credit constrained environment.

Contact us today for a complimentary tax-adjusted cash flow investment analysis and see how yourself how easy it may be to put the *Economic Stimulus Package* to work for your company.



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Baytree Leasing Company, LLC
a subsidiary of Baytree National Bank and Trust, NA
100 Tri-State International #240
Lincolnshire, IL 60069
(224)632-5051



SophLogic
877.SOPHLOGIC (767.4564)
<http://www.sophlogic.com>

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