THE 2010 SMALL BUSINESS JOBS ACT

Client Advisories

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The recently enacted 2010 Small Business Jobs Act includes a wide-ranging assortment of tax breaks and incentives for small businesses. Below is a brief overview of tax changes in the new law.

Enhanced small business expensing (Section 179 expensing). In order to help small businesses quickly recover the cost of certain capital expenses, small business taxpayers are allowed to write off the cost of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. Under pre-2010 Small Business Jobs Act law, taxpayers could expense up to $250,000 of qualifying property (generally, machinery, equipment and certain software) placed in service in tax years beginning in 2010. This annual expensing limit was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service in tax years beginning in 2010 exceeded $800,000 (the investment ceiling). Under the new law, for tax years beginning in 2010 and 2011, the $250,000 limit is increased to $500,000 and the investment ceiling is increased to $2,000,000.

The new law also makes certain real property eligible for expensing. For property placed in service in any tax year beginning in 2010 or 2011, the up-to-$500,000 of property expensed can include up to $250,000 of qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

100% exclusion of gain from the sale of small business stock for qualifying stock acquired after September 27, 2010, and before January 1, 2011. Before the 2009 Recovery Act, individuals could exclude 50% of the gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, the QSBS must meet a number of conditions (e.g., the gross assets of the corporation cannot exceed $50 million and the corporation must meet active business requirements). Under the Recovery Act, the percentage exclusion for gain on the QSBS sold by an individual was increased to 75% for stock acquired after February 17, 2009, and before January 1, 2011. Under the new law, the exclusion percentage is temporarily increased yet again, to 100% of the gain from the sale of QSBS acquired after September 27, 2010, and before January 1, 2011, and held for more than five years. In addition, the new law eliminates the alternative minimum tax (AMT) preference item attributable to the sale.

General business credits of eligible small businesses for 2010 allowed to be carried back five years. Generally, a business's unused general business credits can be carried back to offset taxes paid in the previous year, and the remaining amount can be carried forward for 20 years to offset future tax liabilities. Under the new law, for the first tax year of the taxpayer beginning in 2010, eligible small businesses can carry back unused general business credits for five years. Eligible small businesses consist of sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the prior three years.

General business credits of eligible small businesses in 2010 are not subject to AMT. Under the AMT rules, taxpayers can generally only claim allowable general business credits against their regular tax liability, and only to the extent that their regular tax liability exceeds their AMT liability. A few credits (such as the credit for small business employee health insurance expenses) can be used to offset AMT liability. The new law allows eligible small businesses, as defined above, to use all types of general business credits to offset their AMT in tax years beginning in 2010.

S corporation holding period. Generally, a C corporation converting to an S corporation must hold on to any appreciated assets for 10 years following its conversion or face a business-level tax imposed on the built-in gain at the highest corporate rate of 35%. This holding period is reduced where the seventh tax year in the holding period preceded the tax year beginning in 2009 or 2010. Under the 2010 Small Business Jobs Act, the holding period of assets subject to the built-in gains tax is shortened to five years if the fifth tax year in the holding period precedes the tax year beginning in 2011.

Extension of 50% bonus first-year depreciation. Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, placed in service in 2008 or 2009 (2010 for certain property), by permitting the first-year write-off of 50% of the cost. The new law extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (2011 for certain property).

Special rule for long-term contract accounting. The new law provides that in determining the percentage of completion under the percentage-of-completion method of accounting, the cost of qualified property is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted. This prevents the bonus depreciation from having the effect of accelerating income.

Increased deduction for start-up expenditures. The new law allows taxpayers to deduct up to $10,000 in trade or business start-up expenditures for 2010. The amount that a business can deduct is reduced by the amount by which start-up expenditures exceed $60,000. Previously, the limit of these deductions was capped at $5,000, subject to a $50,000 phase-out threshold.

Limitation on penalty for failure to disclose certain reportable transactions (including listed transactions) on a return. The new law limits the penalty to 75% of the decrease in tax resulting from the transaction. The minimum penalty is $10,000 for corporations and $5,000 for individuals (for failure to report a listed transaction, the maximum penalties are $200,000 and $100,000, respectively). These changes are retroactively effective to penalties assessed after December 31, 2006.

Deductibility of health insurance for the purpose of calculating self-employment tax. The new law allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

Cell phones removed from listed property category. This means that cell phones can be deducted or depreciated like other business property, without onerous recordkeeping requirements.

Information reporting required for rental property expense payments. For payments made after December 31, 2010, the new law requires persons receiving rental income from real property to file information returns with the IRS with respect to payments of $600 or more during the tax year to service providers. Exceptions are provided for individuals renting their principal residences on a temporary basis (including active members of the military), taxpayers whose rental income does not exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regulations).

Increased information return penalties (effective for information returns required to be filed after December 31, 2010). For information returns required to be filed after December 31, 2010, the penalties for failure to timely file information returns with the IRS will be increased. For example, the first-tier penalty will be increased from $15 to $30, and the calendar year maximum will be increased from $75,000 to $250,000. For small filers, the calendar year maximum will be increased from $25,000 to $75,000 for the first-tier penalty. The minimum penalty for each failure due to intentional disregard will be increased from $100 to $250. The penalties for failure to file information returns to payees will be similarly increased.

Application of continuous levy to tax liabilities of certain federal contractors. For levies issued after September 27, 2010, the new law allows the IRS to issue levies before a collection due process (CDP) hearing on federal tax liabilities of federal contractors (taxpayers would have an opportunity for a CDP hearing within a reasonable time after a levy is issued).

Allow participants in governmental 457 plans to treat elective deferrals as Roth contributions. For tax years beginning after December 31, 2010, the new law will allow retirement savings plans sponsored by state and local governments (governmental 457(b) plans) to include designated Roth accounts. Contributions to Roth accounts are made on an after-tax basis, but distributions of both principal and earnings are generally tax-free.

Allow rollovers from elective deferral plans to designated Roth accounts. The new law allows 401(k), 403(b) and governmental 457(b) plans to permit participants to roll their pre-tax account balances into a designated Roth account. The amount of the rollover will be includible in taxable income except to the extent it is the return of after-tax contributions. If the rollover is made in 2010, the participant can elect to pay the tax in 2011 and 2012. Plans will be able to allow these rollovers as of September 27, 2010.

Nonqualified annuity contracts. The new law permits holders of nonqualified annuities (life insurance, endowment or annuity contracts) to elect to receive part of the contract in the form of a stream of annuity payments, leaving the remainder of the contract to accumulate income on a tax-deferred basis. This provision goes to the "partial annuitization" issue with respect to which the IRS had previously declined to rule.

Guarantee fees. Amounts received directly or indirectly for guarantees of indebtedness of a U.S. payor issued after September 27, 2010, are sourced, like interest, in the United States. As a result, amounts paid by U.S. taxpayers to foreign persons will generally be subject to U.S. withholding tax. This provision effectively overrules the result of the Container Corporation case (U.S. Tax Court 2010).

Please keep in mind that we have described only the highlights of the new law. For more details about any aspect of the new legislation, please do not hesitate to call your Archer contact or Gordon Moore, Chair of the firm's Tax Group, at (856) 354-3087 or gmoore@archerlaw.com.

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Related People

Gordon F. Moore
Of Counsel
gmoore@archerlaw.com
856.354.3087

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