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Small Business Jobs Act of 2010

The Small Business Jobs Act of 2010 Provides $12 Billion in Tax Relief to Help Small Businesses Invest in their Firms, Create Jobs:

Extension, Expansion of Tax Cuts — 8 Tax Cuts:

1. The highest small business expensing limit ever, of $500,000
2. Carry-back provisions on net operating losses of up to 5 years
3. Accelerated/bonus depreciation
4. Zero capital gains taxes for those who invest in small businesses
5. Increased deductions for start-ups
6. Deductions for employer-provided cell phones
7. Deductions for health insurance costs for the self-employed
8. Limitations on penalties for errors in tax reporting that disproportionately affect small business

Small Business Jobs Act of 2010: General Information

Congress has passed a small business jobs bill (the Small Business Jobs Act of 2010) with valuable individual and business tax incentives. Many of the $12 billion tax incentives are temporary so taxpayers have only a short window in which to take advantage of them. Others are permanent but require careful planning to maximize your tax benefits. This document highlights the tax incentives and revenue raisers in the new law. As always, please contact our office for more details. We can discuss how you can maximize your tax benefits from the new law.

Although the new law is labeled a "small business bill" it actually is much more. The new law includes a number of provisions targeted to small businesses and investors in small businesses, such as 100 percent exclusion of gain on qualified small business stock, an increase in the amount allowed as a deduction for start-up expenditures, and more.

Other provisions may benefit businesses of all sizes, such as extended bonus depreciation and extended and doubled Code Sec. 179 expensing. Many individuals will benefit from a new rule allowing rollovers from elective deferral plans to Roth designated accounts, along with other retirement savings incentives. Self-employed individuals benefit from a temporary deduction for health insurance costs in computing self-employment income.

To ensure passage of the bill, supporters had to find revenue raisers to pay for the tax incentives. The largest revenue raiser designed to force greater disclosure of taxable income is a new information reporting requirement for rental property expenses, which is projected to raise $2.5 billion over 10 years. The new law also increases information return penalties. An additional revenue provision places curbs on the cellulosic biofuel producer credit, and another shifts corporate estimated taxes in 2015.

General Business Provisions

Bonus depreciation. The new law extends a popular business tax incentive: bonus depreciation. An additional first-year depreciation deduction equal to 50 percent of the adjusted basis was available for qualified property placed in service in 2008 and 2009 (2009 and 2010 for certain longer-lived property and transportation property). The new law extends bonus depreciation for qualified property acquired and placed in service during 2010 (or placed in service during 2011 for certain longer-lived property and transportation property). The new law also includes a special long-term accounting rule for bonus depreciation.

Code Sec. 280F. The limitation under Code Sec. 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year they are used in a business by $8,000 for automobiles that qualify and for which the taxpayer does not elect out of the additional first-year deduction. For 2010, therefore, maximum first-year depreciation for passenger automobiles is $11,060.

Code Sec. 179 expensing. The new law increases the maximum amount a taxpayer may expense under Code Sec. 179 to $500,000 and raises the phase-out threshold

to $2 million. Enhanced Code Sec. 179 expensing is available for tax years beginning in 2010 and 2011. The new law also allows taxpayers to expense qualified leasehold investment property, qualified restaurant property and qualified retail improvement property. The maximum amount with respect to real property that may be expensed, however, is limited to $250,000.

Start-up expenditures. A certain amount of qualified business start-up expenses may be deductible in the tax year in which the active trade or business begins. The new law increases the amount of start-up expenditures that a taxpayer may elect to deduct from $5,000 to $10,000 for tax years beginning in 2010. The new law also increases the deduction phase-out threshold so that the $10,000 is reduced, but not below zero, by the amount by which the cumulative cost of qualified start-up expenses exceeds $60,000.

S corporation built-in gains tax. A C corporation that converts to an S corporation generally must hold any appreciated assets for 10 years following the conversion or, if disposed of earlier, pay tax on the appreciation at the highest corporate level rate (currently 35 percent). The American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) temporarily shortened the usual 10-year holding period to seven years for dispositions in tax years beginning in 2009 and 2010. The new law further shortens the holding period to five years in the case of any tax year beginning in 2011, if the fifth year in the recognition period precedes the tax year beginning in 2011.

Cell phones. In 1989, the IRS identified employer-provided cell phones as "listed property." For listed property, no deduction is allowed unless a taxpayer adequately substantiates the expense and business usage of the property. The listed property designation was imposed on cell phones when they were novel, expensive, and not many individuals owned one. Today, not only are cell phones widely available and used, but also necessary for doing business. In January 2010, the IRS temporarily suspended enforcing the strict substantiation on cell phone use. The new law removes cell phones from the definition of listed property for tax years beginning after December 31, 2009.

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Small Business Provisions

Small business stock. To encourage investment in small businesses, the American Recovery and Reinvestment Act of 2009 temporarily increased the percentage exclusion for qualified small business stock acquired after February 17, 2009 and before January 1, 2011 to 75 percent. The new law raises the exclusion to 100 percent for qualified stock issued after the date of enactment and before January 1, 2011. The stock must be acquired at original issue from a qualified small business and held for at least five years.

General business credit. The new law extends the carryback period for eligible small business credits from one to five years. Eligible small business credits are defined for purposes of the new law as the sum of the general business credits determined for the tax year with respect to an eligible small business. An eligible small business is a corporation whose stock is not publicly traded, a partnership or a sole proprietorship. Additionally, the average annual gross receipts of the corporation, partnership, or sole proprietorship for the prior three tax year periods cannot exceed $50 million. The extended carryback provision is effective for credits determined in the taxpayer's first tax year beginning after December 31, 2009.

Code Sec. 6707A penalty relief. The new law reforms the Code Sec. 6707A penalty regime retroactively for taxpayers failing to disclose participation in reportable and listed transactions. Generally, the penalty would equal 75 percent of the reduction in tax reported on the participant's return as a result of the transaction or that would result if the transaction was respected for federal tax purposes. Under the new law, the maximum penalty for an individual for failing to disclose a reportable transaction is $10,000 ($100,000 in the case of a listed transaction). The maximum penalty for all other taxpayers for failing to disclose a reportable transaction is $50,000 ($200,000 for all other persons).

Provisions for Individuals

Retirement savings. The new law includes several provisions to encourage retirement savings. With many employees now saving for retirement using 401(k) plans, the new law provides a major Roth conversion option that can mean significantly more dollars available at retirement. Under the new law, if a Code Sec. 401(k), 403(b) or governmental 457(b) plan now sets up a qualified designated Roth contribution program, a distribution to an employee or surviving spouse from a non-designated Roth account under a plan may be rolled over to a designated Roth account within the same plan. If an amount is rolled over in 2010, the new law helps ease that tax liability by treating the taxable converted amount as included ratably in income in equal amounts for 2011 and 2012 unless the taxpayer elects otherwise. The designated Roth provisions in the new law are effective for distributions made after the date of enactment.

Self-employment. Individuals who are self-employed may claim a deduction for qualified health insurance costs for income tax purposes. For self-employment taxes, the self-employed individual cannot deduct any health insurance costs. The new law allows the deduction for the cost of health insurance in calculating net earnings from self-employment for purposes of self-employment (FICA) taxes. The provision is temporary and only applies to the self-employed taxpayer's first tax year beginning after December 31, 2009.

Additionally, the new law allows partial annuitization of a nonqualified annuity contract. Holders of nonqualified annuities (annuity contracts held outside of a tax-qualified retirement plan or IRA) may elect to receive a portion of the contract in the form of a stream of annuity contracts, leaving the remainder of the contract to accumulate income on a tax-deferred basis. Only a portion of an annuity, endowment or life insurance contract may be annuitized while the balance is not annuitized. The annuitization period must be for 10 years or more, or for the lives of one or more individuals. The annuitization provision in the new law is effective for amounts received in tax years beginning after December 31, 2010. Annuitization requires careful planning; please contact our office for details.

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Revenue Raisers

Rental property expense payments. Third-party reporting has been shown to increase tax compliance and in recent years Congress has passed a number of new information reporting requirements. The new law imposes information reporting requirements on certain recipients of rental income from real estate. Rental income recipients making payments of $600 or more to a service provider will file an information return with the IRS and the service provider. The new law permits the IRS to exclude individuals for whom reporting would be a hardship and individuals who receive only minimal amounts of rental income from the requirement. Certain members of the military and intelligence services are also excluded. The reporting provision applies to payments made after December 31, 2010.

Information return penalties. The Tax Code provides penalties for failing to file information returns. The penalty is tiered and capped. The maximum amount of the penalty varies depending when the information return is filed and if the taxpayer is a qualified small business. The new law increases the penalty generally across-the-board and imposes new maximum penalty amounts. The new law also revises the penalty for failing to furnish a payee statement to provide tiers and caps similar to the tiers and caps for failing to file the information return. The new penalty regime applies to information returns and payee statements required to be filed on or after January 1, 2011.

Cellulosic biofuel producer credit. The new law makes crude tall oil and certain other substances, which are largely generated as byproducts of paper manufacturing, ineligible for the cellulosic biofuel producer credit. The new limitations on the cellulosic biofuel producer credit are effective for fuels sold or used on or after January 1, 2010. The curbs on the cellulosic biofuel producer credit are estimated to raise more than $1 billion over ten years.

Income on guarantees. Congress was unhappy with the Tax Court's decision in a case about source rules for income on guarantees (Container Corp., 134 TC No. 5, CCH Dec. 58,131), which held that since the guarantee fees were treated as payments for services, the foreign parent was not subject to U.S. tax on them. The new law treats them prospectively as interest payments, whose source is determined by the position of the payor.

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Federal contractors. The new law allows the IRS to issue levies before a collection due process (CDP) hearing in the case of certain federal contractors. The provision is effective for levies issued after the date of enactment.

Corporate estimated tax payments. The new law increases the required payment of estimated tax by large corporations (with assets of at least $1 billion) by 36 percentage points for July, August, September 2015. The next required installment is proportionately reduced to reflect the increase.

As we have highlighted, the new law is much more than a small business bill, although many small businesses and their owners will benefit greatly from its provisions. Many provisions within the new law are broad-based and far-reaching. Moreover, many of the tax incentives are temporary, requiring prompt action to take full advantage of them. Please contact our office so we can help you design a tax strategy to maximize your benefits from the new law.