



TAX ALERT

NOVEMBER 1, 2010

THE 2010 SMALL BUSINESS JOBS ACT

The recently enacted 2010 Small Business Jobs Act includes a wide-ranging assortment of tax breaks and incentives for small business which will be paid for with various revenue raisers. Here is a brief overview of the tax changes in the new law.

TAX BREAKS AND INCENTIVES

Section 179 expensing

Businesses normally recover the cost of machinery and equipment, certain software and certain other capital assets by depreciating their cost. Small businesses are permitted a faster write-off by expensing their entire cost in the year of acquisition. Under prior law, the 1st year write-off was limited to \$250,000 of qualifying property. This 1st year write-off was further limited to the extent the cost of qualifying property (investment ceiling) exceeded \$800,000.

NEW LAW —

For 2010 and 2011, the new law increases the maximum 1st year write-off to \$500,000 and increases the investment ceiling to \$2,000,000.

The new law also permits up to \$250,000 of the annual \$500,000 limit to include certain qualified non-residential leasehold improvements, restaurant property, and retail improvement property.

Extension of 50% bonus first-year depreciation

In addition to the expansion of the Section 179 deduction described above, the Act extends the first year 50% bonus depreciation deduction on qualifying new property that expired in 2009 to property placed in service in 2010.

Carryback period of general business credits for eligible small businesses extended to 5 years

Generally, a business's unused general business tax credit can be carried back to offset taxes paid by the business in the previous year, and the unused portion carried forward for up to 20 years to offset its future tax liabilities. The new law extends the carry back period to five years for "eligible small businesses" for their first tax year beginning in 2010. For the purpose of this provision, an "eligible small business" includes sole proprietorships, partnerships and non-publicly traded corporations with \$50 million or less in average annual gross receipts.

Elimination of AMT restrictions on the use of general business credits for eligible small businesses

Under prior law, taxpayers could use only general business credits to offset their regular tax liability that exceeded their AMT tax liability. The Act eliminates this restriction for eligible small businesses (as defined above) in tax years beginning in 2010.

Increased deduction for start-up expenditures

The Act allows a new business to deduct start-up expenditures of up to \$10,000 in 2010 (formerly \$5,000 under prior law). If the total start-up expenses exceed \$60,000 (\$50,000 under prior law) the deduction must be reduced by the excess.

Health insurance deductible for the purpose of calculating self-employment tax

The Act allows business owners to deduct the cost of health insurance paid in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

100% exclusion of gain from the sale of certain Qualified Small Business Stock

Under prior law, individuals generally could exclude 50% of the gain on the sale of their qualified small business stock (QSBS) that was held for at least five years. (To have stock qualify as QSBS a number of conditions must be met including the underlying company's gross assets cannot exceed \$50 million and it must be engaged in an active business). The percentage exclusion for gain on QSBS sold by an individual was increased to 75% for stock acquired after February 17, 2009 and before January 1, 2011.

The Act temporarily increases the exclusion to 100% of the gain from the sale of QSBS that is acquired in 2010 after September 27, 2010 and held for more than five years. In addition, the Act eliminates the negative AMT effects that existed under the prior law for stock acquired after September 27, 2010.

Partial exemption from the S Corporation "built-in gains" tax

Generally, if a C corporation converts to an S corporation and subsequently sells any of the business's underlying assets within 10 years of conversion, the S-corporation must pay tax on

any built-in gain (the fair market value of an asset in excess of the asset's "tax" cost) at the date of conversion. This built in gain is taxed at the highest corporate rate of 35%. For tax years beginning in 2009 and 2010, the 10 year recognition period for the tax was previously reduced to 7 years.

The new law temporarily reduces the recognition period for the tax to 5 years beginning in 2011.

Limitation on penalty for failure to disclose certain reportable transactions

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 penalty is \$200,000 and \$100,000, respectively). These changes are retroactively effective to penalties assessed after December 31, 2006.

Cell phones removed from listed property category

Cell phones used for business can now be deducted or depreciated like other business property, without onerous recordkeeping requirements.

REVENUE RAISERS

Increased Information Reporting Required For Rental Property Owners

For payments made after December 31, 2010, the Act requires most persons receiving rental income from real property to file 1099 information returns with the IRS to report payments to service providers of \$600 or more during the tax year. Exceptions are provided for individuals renting their principal residences on a temporary basis, taxpayers whose rental income falls below an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship.

Allow rollovers from elective deferral plans to designated Roth accounts

This provision is one of the revenue raisers, but it could actually be a major benefit to individual taxpayers who participate in certain company sponsored retirement accounts.

The Act allows participants in 401(k), 403(b), and governmental 457(b) plans 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 a 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 immediately after September 27, 2010.

COST BASIS TO APPEAR ON 1099-Bs

Stockbrokers and mutual funds are required to report the basis, generally the cost, of securities sold beginning January 1, 2011. This requirement arises from legislation enacted in 2008. The basis is used to compute the gain or loss when securities are sold. Brokers furnish the cost basis to their customers and to the IRS on Form 1099-B beginning with securities purchased on January 1, 2011 (2012 for mutual fund shares). These forms will also indicate whether the sale results in a long-term or short-term gain or loss.

2010 ILLINOIS TAX AMNESTY PROGRAM

The State of Illinois in an attempt to increase its short-term cash flow has established a Tax Amnesty Program that offers Illinois taxpayers incentives (the carrot) if they pay their outstanding liabilities to the State. If a taxpayer pays in full any tax liabilities to the State that have arisen after June 30, 2002 and prior to July 1, 2009, Illinois will waive all penalties and interest that have been assessed for those periods. Payment must be made between October 1, and November 8, 2010. The stick is that if the tax for this period is not paid, the penalties and interest will DOUBLE.

Conclusion

Our comments in the Tax Alert are, by design, brief and very general. Please contact us if you have any questions that have been raised but not answered by this Tax Alert.