
President Signs Small Business Jobs Act of 2010



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On September 23, 2010, the House passed the Small Business Jobs Act of 2010 (the "Act"), which had been approved by the Senate on September 16, 2010. President Obama signed the Act on September 27, 2010. The Act includes several important tax breaks for California businesses. Following is a brief description of some of these provisions.

Exclusion of 100% Gain on Certain Small Business Stock. The Act would allow shareholders to exclude 100% of the gain for qualified small business stock acquired during 2010. Generally, stock would need to be held for at least 5 years and when the stock is issued, the gross assets of the corporation may not exceed \$50 million. The amount of gain eligible for exclusion by an individual is the greater of (1) 10 times the taxpayer's basis in the stock or (2) \$10 million.

5-Year Carryback of General Business Credits. Under current law, general business credits generally may only be carried back one year and carried forward 20 years. The Act would allow small businesses to carry back general business credits up to five years. An eligible small business is a corporation or a partnership whose gross receipts average less than \$5 million over a 3-year period. This provision would be effective for general business credits after December 31, 2009.

Exclusion of the Eligible Business Credits from the Alternative Minimum Tax. An eligible small business would be allowed to carry forward its business credits for purposes of the alternative minimum tax. Essentially, the tentative minimum tax for a business whose gross receipts averaged under \$5 million over a 3-year period of time would be deemed zero. Credits determined with respect to a partnership or S corporation would be determined by measuring the gross receipts test at the partner or shareholder level. This provision would be effective after December 31, 2009.

Reduction in Built-In Gains Tax. Under prior law, an S corporation is generally subject to a built-in corporate tax up to a 10-year period of time if it has converted from a C or taxable corporation. During 2010, the built-in gains tax provision period was reduced to seven years. Beginning in 2011, the Act provides the built-in gain tax period would be reduced to 5 years.

Increase in Expensing Certain Depreciable Business Assets. The Act would increase the amount that a taxpayer may expense for purchases of depreciable business assets to \$500,000 subject to a reduction to the extent the cost of qualifying property placed in service during the taxable year exceeded \$2 million. This provision would be effective for 2010 and 2011. In addition, the existing definition of qualified property would be expanded to include qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property. The amount of the deduction is limited to the taxpayer's active trade or business income. However, if the expenditure is attributable to qualified real property, the disallowed amounts may be carried over to 2011. This provision would be effective for tax years beginning after December 31, 2009.

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Extension of Bonus Depreciation. The Act would extend 50% bonus depreciation to assets purchased in 2010. Generally, eligible property includes tangible personal property applicable recovery period of 20 years or less, public utility property, computer software or qualified leasehold improvement property. Further, the original use of the property must commence with the taxpayer. Bonus depreciation would be ignored for purposes of computing taxable income under the percentage of completion method.

Increase in the Deduction for Start-Up Expenditures. The existing \$5,000 limit on the deduction of start-up expenditures in the year in which an active trade or business commences would be increased to \$10,000. The deduction would be subject to a phase-out to the extent that the cumulative start-up expenditure exceeds \$60,000. This provision would be effective after December 31, 2009.

Change to Reportable Transaction Penalty. The Act would change the existing \$100,000 penalty for engaging in a reportable transaction to a minimum penalty of \$5,000 for natural persons and \$200,000 for all other persons. The penalty would be equal to 75% of the reduction of tax attributable to the reportable transaction. The maximum penalty would be \$10,000 for a natural person and \$50,000 for everyone else. The maximum annual penalty would be \$100,000 for a natural person and \$200,000 for everyone else. This provision would be effective for all penalties assessed under Section 6707A after December 31, 2006.

Temporary Deduction for Health Insurance Costs and Computing Self-Employment Income. A deduction for cost of health insurance would be allowed for purposes of calculating net earnings from self-employment for health insurance for self-employed individuals, their spouses, dependents and children under the age of 27. Current law disallows the deduction for self-employment tax purposes for any self-employed individual who is participating in an employer subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. This provision would apply to tax years beginning after December 31, 2009.

Remove Cellular Phones from the Definition of Listed Property. The Act removes cell phones from the definition of listed property for tax years beginning after December 31, 2009. This means that tax-exempt entities would be able to deduct these costs and no longer to be required to include the cost of the cell phones and cell phone service in their employees' income.

Information Reporting for Rental Property Expense Payments. Rental income recipients making payments of \$600 or more to a service provider, such as a plumber, painter or accountant in the ordinary course of running rental business would be required to provide the service provider with information return (typically Form 1099-MISC) to the IRS and the service provider. This provision would apply to payments made after December 31, 2010.

Increase in Information Return Penalties. The penalty on failure to file an information return, such as a Form 1099, would increase from \$15 to \$30 per return, with the calendar year maximum increase from \$75,000 to \$250,000. If the information return is not filed by August 1, the penalty would increase from \$30 per return to \$60 per return, or the calendar year maximum increase from \$150,000 to \$500,000. Intentional disregard of the filing requirements would result in a \$100 per year per return penalty with the maximum increase from \$250,000 to \$1.5 million. This provision would apply to information returns filed on or after January 1, 2011.

If you would like any information concerning any of these provisions, please contact Phil Jelsma at 619.699.2565, or pjelsma@luce.com.