ALERTS AND UPDATES

Small Business Jobs Act Contains Breaks for Businesses and Individuals

November 11, 2010

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (the "Act"), aimed at helping small businesses to access credit and capital and create jobs. It contains a number of key tax provisions, including expanded Section 179 expensing in 2010 and 2011, revived bonus depreciation for 2010, five-year carryback of unused general business credits, the allowance of rollovers from elective deferral plans to Roth accounts, and more. While most provisions are aimed at small businesses, some are also likely to impact large businesses and individuals.

We have provided a chart comparing the old law versus the new provisions enacted by the passage of the Act. An in-depth discussion of the new provisions is provided below.

Provisions Impacting Small Businesses

Eligible small businesses consist of sole proprietorships, partnerships and non-publicly traded corporations with average annual gross receipts of $50 million or less for the preceding three years.

Increased Section 179 Expensing

Under prior law, the total property that could be expensed for 2010 was $250,000 and the phase-out threshold was $800,000. The Act increases the maximum expensing amount to $500,000, and the beginning of the phase-out amount to $2,000,000 for 2010 and 2011. In these years, for each dollar of investment in Section 179 property in excess of $2,000,000, the $500,000 maximum deduction is reduced by one dollar. No Section 179 deduction would be available for property exceeding $2,500,000. Section 179 deductions remain limited to the taxpayer's total taxable income derived from all active businesses during the year. Excess Section 179 deductions not allowed under the taxable income limitation are carried forward indefinitely.

Section 179 Expensing Now Includes Real Property

The Act also expanded Section 179 to make certain real property eligible for expensing. For property placed in service in 2010 or 2011, the $500,000 amount can include up to $250,000 of qualified leasehold improvement, restaurant and retail-improvement property. Special limitation rules apply to excess Section 179 deductions for qualified real property. Excess deductions that cannot be deducted under the taxable income limitation can only be carried over to a tax year that begins in 2011. To the extent excess deductions cannot be deducted in a tax year that begins in 2011, no Section 179 deduction is allowed.

Increased Deduction for Start-up Expenses

The amount of start-up expenditures businesses may deduct has been temporarily increased from $5,000 to $10,000 for tax years beginning after December 31, 2009, and before January 1, 2011. The phase-out threshold is also temporarily increased from $50,000 to $60,000. The amount a business can deduct is reduced by the amount of expenditures exceeding $60,000. Start-up expenses are costs connected with creating or investigating the creation or purchase of a trade or business. Start-up expenses of a trade or business are not deductible, unless the taxpayer elects to do so.

General Business Credits Carried Back Five Years

Sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the preceding three years can now carry back unused general business credits for up to five years. Previously, excess credits could be carried back for only one year. This provision went into effect upon enactment of the Act and applies to tax years beginning in 2010.

General Business Credits Not Subject to AMT

Under previous law, only certain credits could be used to offset Alternative Minimum Tax (AMT) liability. For tax years beginning in 2010, sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the preceding three years may use all types of general business credits against AMT. Unused credits can be carried back for up to five years.

Removal of Cell Phones from Listed Property

Cellular phones and comparable communications equipment are removed from the definition of listed property, beginning in 2010. This provision allows them to be deducted or depreciated like other business assets, without the heightened substantiation requirements applicable to listed property.

Reduced S Corporation Holding Period for Built-in Gains Tax

Generally, when a C corporation elects to become an S corporation, it must hold onto any appreciated assets for 10 years following the conversion or face a 35-percent tax on all gains that were built-in at the time of the election. For tax years starting in 2011, this provision reduces the holding period from 10 to five years. For tax years beginning in 2009 and 2010, no tax is imposed on the net unrecognized built-in gains of an S corporation if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years.

First-Year Dollar Cap for Autos Boosted by $8,000

Under Internal Revenue Code Sec. 280F, depreciation deductions for automobiles are subject to dollar limits that are annually adjusted for inflation. Previously, the adjusted first-year limit for automobiles placed in service in 2010 was $3,060 for passenger autos and $3,160 for light trucks and vans. The Act increases first-year deduction limits by $8,000 to $11,060 for passenger autos and $11,160 for light trucks and vans placed in service in 2010.

Bonus First-Year Depreciation Extended Through 2010

The Act extends bonus depreciation enacted under the American Recovery and Reinvestment Act, allowing businesses to immediately write off 50 percent of the cost of qualifying property placed in service in 2010. Bonus depreciation applies to all businesses, large or small.

Provisions Affecting Individuals

Ability to Deduct Health Insurance When Calculating Self-Employment Tax

Previously, self-employed taxpayers could not deduct the cost of health insurance for purposes of calculating the self-employment tax. Now the Act provides that self-employed taxpayers can now deduct the cost of health insurance incurred in 2010 for themselves and their families (children under age 27 only) when computing self-employment taxes.

Requirement to Report Rental-Property Expense Payments

This revenue raiser requires persons receiving rental income from real property to file Form 1099 information returns for payments of $600 or more made after December 31, 2010, for rental-property expenses (such as yard care, repairs, accounting, etc.). A copy of Form 1099 must also be provided to each payee. Certain exceptions are available for individuals renting their principal residence, as well as active members of the military. Also, starting in 2011, the IRS can assess harsher penalties for failing to file Form 1099 with the IRS and for failing to send a copy to payees.

Participants in Governmental 457 Plans Can Treat Elective Deferrals as Roth Contributions

Beginning in 2011, state- and local-government-sponsored 457(b) retirement plans will include Roth accounts. The Roth option was previously only available to 401(k) and 403(b) participants. Contributions to Roth accounts are made on an after-tax basis and are not deducted from income. However, distributions of both principal and income are generally tax-free, unless the taxpayer is not 59 1/2 years of age and certain other requirements are not met.

Rollovers from Elective Deferral Plans to Roth IRA Accounts

Participants of 401(k), 403(b) and governmental 457(b) plans may now roll their pre-tax accounts into a Roth account for distributions made after September 27, 2010. The rollover is taxable in the year of rollover; however, future distributions of both principal and income will generally be tax-free, unless the taxpayer has not attained age 59 1/2 and certain other conditions are not met. If the rollover is made in 2010, the participant can elect to report 50 percent of the rollover as income in 2011 and 50 percent in 2012.

100-Percent Exclusion of Small Business Capital Gains

This provision excludes 100 percent of the gain from the sale of qualifying small-business stock acquired after September 27, 2010, and before January 1, 2011, and held for more than five years. The exclusion also applies to the AMT. Qualifying small-business stock is from a C corporation whose gross assets do not exceed $50 million and who meet a specific active-business requirement.

For Further Information

If you have any questions regarding this *Alert*, or for further information, please contact Michael A. Gillen, director of the Tax Accounting Group, Steven M. Packer, manager in the Tax Accounting Group, or the practitioner with whom you are regularly in contact.

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