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New Law Provides Significant Tax Breaks to Businesses

The Small Business Jobs Act of 2010 (the "Act"), signed into law by President Obama on September 24, 2010, includes significant tax breaks for businesses. The following summary highlights some of the key tax provisions in the Act.

Increased Expensing Limitations

Most taxpayers are familiar with Code Section 179 which allows the expensing of qualifying property that would otherwise have to be capitalized and depreciated over time. Qualifying property is generally defined as depreciable tangible personal property purchased for use in the active conduct of a trade or business.

Under prior law, the amount that could be expensed under Code Section 179 for the 2010 tax year was limited to $250,000, and that amount would be phased-out as qualifying property placed in service during the year exceeded $800,000. Furthermore, without the passage of the Act, beginning in 2011, the maximum amount that could be expensed under Code Section 179 would revert to $25,000, and that amount would begin to phase-out at $200,000.

The Act, for 2010 and 2011, increases the amount that can be expensed under Code Section 179 to $500,000 and increases the phase-out threshold to $2,000,000.

Certain Real Property Treated as Code Section 179 Property

As previously stated, Code Section 179 generally applies to depreciable tangible personal property. However, for the first time ever, taxpayers will be able to expense "qualified real property" under Code Section 179 for 2010 and 2011. Qualified real property is defined under the Act to include qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

The Act provides that no amount attributable to qualified real property may be carried forward to a taxable year beyond 2011. However, to the extent that any amount is not allowed to be carried forward, the Code shall be applied as if no election under Code Section 179 had been made with respect to such amount.

Bonus Depreciation Extended

Under Code Section 168(k), for property placed in service during 2008 and 2009, taxpayers were entitled to additional first-year depreciation on qualified property equal to 50% of the adjusted basis of such property. Qualified property is defined to include the following i) property to which MACRS applies and has a recovery period of 20 years or less; ii) computer software (not covered by Code Section 197); iii) water utility property; or iv) qualified leasehold property. In

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addition, certain other requirements must be met to constitute qualified property.
The Act extends first-year bonus depreciation for qualified property placed in service during 2010 (certain long-lived property and transportation property may be placed in service in 2011).

General Business Credit Not Subject to Alternative Minimum Tax

The general business credit is the sum of business credits for which a taxpayer is eligible (e.g., the new markets tax credit). In the past, code Section 38 frequently limited the business credits allowed for taxpayers subject to the AMT. Under the Act, in calculating the limitation under Code Section 38, the tentative minimum tax will be treated as being equal to zero for eligible small businesses. The result is that eligible small businesses subject to AMT will no longer be limited to certain business credits in determining the general business credit, but will be eligible to use all business credits that are applicable to the taxpayer. Eligible small businesses are non-publicly traded corporations, partnerships, or sole proprietorships that have average annual gross receipts for the prior three tax years of no more than $50 million. This will be effective in the taxpayer's first taxable year beginning after December 31, 2009.

General Business Credit Carryback Extended

Under prior law, excess general business credits were permitted to be carried back one year and carried forward twenty years.
The Act amends Code Section 39 to allow excess general business credits to be carried back five years and forward twenty years by eligible small businesses. As state above, eligible small businesses are non-publicly traded corporations, partnerships, or sole proprietorships that have average annual gross receipts for the prior three tax years of no more than $50 million. This will be effective in the taxpayer's first taxable year beginning after December 31, 2009.
31, 2009.

Recognition Period Shortened for S Corporation Built-In Gains Tax

Under Code Section 1374, upon conversion of a C corporation to an S corporation, S corporations are taxed the highest marginal corporate tax rate on all built-in gains recognized during the recognition period. Generally, the recognition period is 10 years beginning with the first day of the first taxable year for which the S election is in effect. However, no tax is recognized on built-in gains by S corporations for tax years beginning in 2009 and 2010, if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years.

The Act shortens the recognition period to five years if the fifth year in the recognition period precedes the tax year beginning in 2011. Therefore, if an S corporation disposes of property containing built-in gains after December 31, 2010, and the fifth year in the recognition period precedes the tax year beginning in 2011, the S corporation is no longer required to recognize those gains.

100% Exclusion on Gain from Sale of Qualified Small Business Stock

Qualified small business stock is the stock of a C corporation the gross assets of which do not exceed $50 million. Such stock must generally be acquired at its original issuance. Additionally, the C corporation issuing the stock must meet certain active trade or business requirements.

Under prior Code Section 1202, individuals were allowed to exclude 50% of the gain realized on the sale of qualified small business stock (60% for Empowerment Zone qualified small business stock) that had been held for more than five years. However, the excluded gain was an alternative minimum tax ("AMT") preference, meaning, the entire 50% was not eligible for exclusion by taxpayers subject to the AMT. Temporary legislation served to increase the excluded amount to 75% for qualified small business stock acquired after February 17, 2009 and before January 1, 2011. Because this exclusion was still considered an AMT preference under prior legislation, taxpayers subject to the AMT were still not eligible for the full 75% exclusion.

Under the Act, 100% of gain realized from the sale of qualified small business stock acquired after the date of enactment of this law and before January 1, 2011 and held for more than five years is excluded from taxation and the AMT preference does not apply. Therefore, all taxpayers who acquire qualified small business stock between the date of enactment and December 31, 2010 and hold that stock for more than five years are eligible to exclude 100% of the gain on the sale of that stock.

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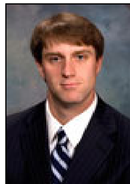

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