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BULLETIN

November 2010

Small Business Jobs Act of 2010

Misnamed, but Useful

By Kathryn Wilson and Susan Sterne

President Obama signed the Small Business Jobs Act of 2010 (SBJA) into law on September 27, 2010. The Act's title is a misnomer – it includes provisions relevant to businesses of all sizes, expands the delayed taxation of Roth rollovers beyond IRAs and contains no direct employment incentives. We've divided the tax provisions of the SBJA into five sections:

Your favorite depreciation accelerants: back and better than ever!

Read this if: you have bought or plan to buy depreciable property in 2010 or 2011.

Business investment: Congress endeavors to sweeten the deal

Read this if:

- You started a new business in 2010
- Your business generates business credits, and its annual gross receipts for the three tax years before 2010 averaged $50 million or less
- Your business in an S-corporation that used to be a C-corporation whose first year as an S-corp began in 2006 or later

Other taxpayer-favorable provisions

Read this if:

- You're self-employed and pay health insurance premiums
- You use a cell phone for a business purpose or your business provides cell phones for employees
- You have a retirement plan such as a 401(k) plan, 403(b) plan or government 457 plan

Miscellaneous tax code clean-up

Read this if:

- You paid or were upset that other people paid disproportionate penalties related to listed and reportable transactions.
- Your business pays fees to a foreign business or person who guarantees your debt or receives such fees

Revenue raisers: 1099 reporting

Read this if:

- You file information returns such as 1099
- You pay any of your business vendors more than $600 a year
- You receive rent

Your favorite depreciation accelerants: back and better than ever!

Section 179

Your accountants are very fond of this deduction, and we were pleased that Congress gave it some more pizzazz in 2009. We were all a little sad when 2010 rolled in with a maximum §179 deduction of $134,000, reduced dollar for dollar when §179 eligible property placed in service for the year was over $530,000 and even more sad thinking ahead to 2011, when the §179 deduction would revert to $25,000 with the phase out starting at $200,000. With the HIRE act, enacted in March 2010, Congress cheered us up by increasing the allowable §179 deduction to $250,000 and the phase-out level to $800,000 for tax years beginning in 2010. Congress didn't stop there though – with the SBJA, they increased the allowable §179 deduction to $500,000 and the phase-out threshold to $2 million for tax years beginning in 2010 and 2011. In addition, they threw in a new wrinkle: you can now elect to include qualified real property (qualified leasehold improvements, qualified restaurant property and qualified retail improvement property) in your pool of §179-eligible property for 2010 and 2011. At most, you may expense $250,000 of qualified real property per year. This gives businesses the potential to expense some improvements that would otherwise have to be depreciated over 15 years. Keep in mind that you can only take §179 expense to the extent of your taxable income this year –but if you elect more §179 expense than you have taxable income, you can carry it forward to later years. The SBJA extends taxpayers' ability to revoke their §179 election without the IRS's permission to tax years beginning in 2011 (the earlier HIRE act extended it to 2010).

50% Bonus Depreciation

Bonus depreciation (the ability to immediately expense half of the cost of most capital improvements) is back for tax years beginning in 2010. Eligible improvements include tangible personal property and qualified real property. Unlike §179 expense, you can still take it even if your business doesn't have taxable income. As in previous versions, taking the 50% bonus also exempts the property you take it on from AMT depreciation adjustments. But you still can't take it on used property, or on property you started building (or had a binding contract with a vendor to build) before 2010. You can still elect out of bonus depreciation if you prefer to save more depreciation deductions for later years.

Passenger Vehicles

First year depreciation allowable for passenger vehicles is increased by $8,000 per vehicle for tax years beginning in 2010, unless you elect out of bonus depreciation.

Section 179 and bonus depreciation—Oregon Taxpayers take heed

Oregon law disconnected from federal law for all taxable years beginning in 2009 or later with regard to §179 and bonus depreciation. This means that you can take an increased deduction for depreciation on your federal return, but you will not be allowed some of that deduction on your Oregon return. The Oregon §179 limits are still $134,000 phased out starting at $530,000 for tax years beginning in 2010 and $25,000 phased out starting at $200,000 for tax years beginning in 2011. No Oregon §179 deduction is allowed for qualified real property. Oregon does not allow bonus depreciation, and thus does not allow the additional $8,000 of first year depreciation for passenger vehicles. While electing to use the higher §179 limits, or using the accelerated expensing permitted by bonus depreciation can reduce your federal tax, the Oregon disconnect prevents any Oregon tax benefit.

Business investment: congress endeavors to sweeten the deal

Start Up Expenses

Did you start a new business in 2010? There's good news just for you. Prior to the SBJA, start up expenses of up to $5,000 could be expensed rather than amortized over 15 years. This allowable expense was reduced dollar for dollar to the extent total start up costs were $50,000 or more. The SBJA increased the allowable expense to $10,000 and the phase-out threshold to $60,000 for tax years beginning in 2010.

General Business Credits

Did your business' gross receipts average $50 million or less for the three tax years prior to 2010? If so, general business credits (such as the research and development tax credit) generated in your tax year beginning in 2010 can now be applied against your alternative minimum (AMT) tax liability. In addition, any general business credits generated in 2010 in excess of your 2010 tax liability can be carried back five years instead of just one year – and can offset AMT in the years to which they are carried back. Since AMT is frequently a barrier to utilization of general business credits, this could be a significant benefit to eligible businesses and their owners.

S-Corporation Built-in Gains Holding Period

If you're an S-corporation that was a C-corporation that elected S status somewhat recently, the SBJA has some good news: for 2011 only, you only have to have held any built-in gain property for at least five years before you're no longer taxed on built-in gain from your C corporation years. Prior to the SBJA, the holding period would have had to have been at least ten years for dispositions in 2011; other recent tax legislation shortened the holding period for 2009 and 2010 to seven years. Recent S corporations considering the disposition of built-in gain property may be able to avoid built-in gains tax by holding the property until 2011… but don't wait too long! Under current law, the holding period will return to ten years for tax years that begin in 2012.

Other taxpayer-favorable provisions

Self-employment

Prior to the SBJA, self-employed people who pay for health insurance for themselves and family members (and who are not eligible for employer-paid health insurance through a spouse) could deduct the cost of the health insurance premiums - but only for income tax purposes, not self-employment tax purposes. For tax years beginning in 2010, the SBJA allows these premiums to be deducted for self-employment tax purposes, too. If you're self-employed, pay quarterly tax estimates and pay health insurance premiums, please contact us for help recalculating your fourth quarter estimated tax payments. This benefit could be significant, especially if your net income from self-employment is $107,000 or less.

Cell Phones

Prior to the SBJA, taking expenses for business or employee use of cell phones required such excessive record keeping that the IRS declined to enforce the substantiation requirements. In the SBJA, Congress repealed the existing rules for documenting business or employee use of cell phones and instructed the Treasury Department to issue more reasonable rules.

Retirement Plans

You know how you can roll all or part of regular IRA into a Roth IRA for 2010 and either pay 50% of the tax in 2011 and 50% of the tax in 2012 or pay all of the tax in 2010? (If this is unfamiliar, see our earlier bulletin on this topic [use tinyurl.com/RothPlanning for print version].) Congress decided this Roth privilege should be expanded to other retirement plans, not just IRAs. For 2010, you can roll all or part of 401(k) plan, a 403(b) annuity plan or a governmental 457 plan into a Roth IRA with the same tax payment options. In addition, if your 401(k) plan, 403(b) plan or 457 plan has a qualified Roth contribution option and permits rollovers, you can roll all or part of your traditional plan into the Roth portion of your plan with the same tax payment options for rollovers that happen in 2010. Determining whether a Roth conversion is beneficial is complicated, so please contact us if you're interested in doing this.

Miscellaneous tax code clean-up

Fees for guaranteeing debts

Congress took the opportunity of the SBJA to set a default income sourcing rule for foreign companies that receive income for guaranteeing a US company's debt. Prior to the SBJA, this income could be considered either US or foreign source income to the guarantor depending on the facts and circumstances. The SBJA indicates that such income for guarantees entered into after September 27, 2010 is considered US source and is thus subject to US taxation and US withholding (Tax treaties that specifically address this issue, including the US/Canada treaty, may overrule this law).

Reportable and Listed Transaction Penalties

Congress used the SBJA to retroactively change the penalties for failing to report reportable and listed transactions. Before these changes, the penalties assessed could be substantially more than the tax savings from the disallowed transaction, so this is a welcome, taxpayer-favorable easing of those penalty provisions. The new penalty structure for penalties assessed after December 31, 2006 is:

- The penalty will be calculated as 75% of the tax saved as a result of the unreported transaction, subject to a minimum and maximum penalty.
- The old minimum penalty (up to $200,000 per transaction) is the new maximum penalty.
- The new minimum penalty is $5,000 for a natural person's unreported transaction and $10,000 for any other entity's unreported transaction.

If the IRS ultimately disallows the deduction, the penalty still applies to the tax you would have saved if the deduction had been allowed. While there are still a multitude of other penalties that can apply to reportable and listed transactions that can increase the penalty burden beyond 100% of the tax saved, realigning the failure to report penalties is a huge step.

Revenue raisers:1099 reporting

Increased 1099 reporting requirements and penalties

As part of the Health Care Act passed in March of this year, Congress expanded information reporting (1099) requirements to include payments incorporated vendors as well as unincorporated vendors, and payments for $600 or more for goods as well as services, for years after 2011. This created a significant controversy in the business community and in Congress. Many organizations, including the American Institute of Certified Public Accountants, have been lobbying to loosen these requirements. Several bills proposing changes to the new requirements have been floated in both the House and the Senate.

In the midst of this, Congress passed the SBJA, which expanded information reporting requirements yet again to people who receive rent but are not in the trade or business of renting property. These rules take effect a year earlier than the already controversial expansion of 1099 reporting in the Health Care Act – they apply to payments made after December 31, 2010. We're not sure which of the new reporting rules will survive, but we are sure some change will result. Since the SBJA also doubles the per-return penalties on information returns and increases the maximum penalties a single filer might have to pay in a year by 300-600%, you and your business will want to think about how to capture the necessary data to comply with whatever those rules ultimately are. We'll be in touch with more information and suggestions when we think the new rules have settled into their final position.

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This bulletin is a summary and is not intended as tax or legal advice. You should consult with your tax advisor to obtain specific advice with respect to your fact pattern.

Based on the most recent "best practice" standards for tax advisors issued by the Treasury Department, commonly referred to as Circular 230, we wish to advise you that this bulletin has not been prepared to be used, and cannot be used, to provide assurance that penalties which may be assessed by the IRS or other taxing authority (including specifically section 6662 understatement penalties) will not be upheld.

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