2010 Small Business Act

On September 27th, President Obama signed the “Small Business Jobs Act of 2010”. The tax title of this bill is the “Small Business Jobs Act of 2010” but is generally referred to as the “2010 Small Business Act”. The name is a misnomer because the legislation carries many tax provisions affecting large as well as small businesses, plus changes that affect individuals, such as eased Roth IRA rules.

The 2010 Small Business Act includes a number of important tax provisions, including liberalized and expanded expensing for 2010 and 2011, revived bonus depreciation for 2010, five-year carry back of unused general business credits for eligible small businesses, removal of cell phones from the listed property category, and liberalized Code Sec. 6707A (penalty for failure to include reportable transaction information with return) penalty rules.

Below is a detailed summary of the tax changes in the 2010 Small Business Act.

Dollar amounts for expensing liberalized. For tax years beginning in 2010 and 2011 the 2010 Small Business Act increases the maximum Code Sec. 179 expensing limit from $250,000 to $500,000 and the beginning of the phase-out amount from $800,000 to $2,000,000. For tax years beginning after 2010, these amounts were going to revert back to $25,000 and $200,000, respectively.

Virtually all small businesses and many medium sized businesses that don't have heavy machinery and equipment needs would be able to use expensing. For property placed in service in tax years beginning in 2010 or 2011, the Code Sec. 179 deduction wouldn't phase out completely until the cost of expensing-eligible property exceeds $2,500,000 ($2,000,000 beginning-of-phase-out amount) + $500,000 (dollar limitation)).

The small business jobs bill would grant a welcome tax-saving windfall to taxpayers that already have placed in service Code Sec. 179 eligible property and would not have been able to expense the full cost under current law but will be able to if the bill is enacted.

Qualified real property expensing*.* For tax years beginning in 2010 or 2011, a taxpayer could elect to treat up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) as expensing-eligible property. (Certain types of property, such as that used for lodging, would not be eligible (Code Sec. 179(f)(1)). The dollar cap would apply to the aggregate cost of qualified real property. This change would apply to property placed in service after Dec. 31, 2009, in tax years beginning after that date.

This would be the first time that Code Sec. 179 expensing could be claimed for realty. Under current law, the expensing election is limited to depreciable tangible personal property purchased for use in the active conduct of a trade or business, including “off-the-shelf” computer software.

However, no amount attributable to qualified real property could be carried over to a tax year beginning after 2011, but to the extent that any amount could not be carried over to a tax year beginning after 2011, the Code would be applied as if no Code Sec. 179 expensing election had been made for that amount.

Other expensing changes. The 2010 Small Business Act also provides that a taxpayer's ability to revoke a Code Sec. 179 election without IRS consent applies to any tax year beginning after 2002 and before 2012 (instead of before 2011, as under current law (Code Sec. 179(c)(2)). Additionally, computer software would be qualifying property for purposes of the Code Sec. 179 election if it is placed in service in a tax year beginning after 2002 and before 2012 (instead of before 2011, as under current law (Code Sec. 179(d)(1)(A)(ii)).

Bonus first-year depreciation extended through 2010. The small business jobs bill would extend 50% bonus first-year depreciation for one year, i.e., makes it available for qualifying property acquired and placed in service in 2010 (as well as 2011, for certain long-lived property (Code Sec. 168(k)(2)(A)(iv) and Code Sec. 168(k)(2)(A)(iii)).

Bonus depreciation would grant an extra writeoff to all businesses, large or small. And it would be a windfall to taxpayers that already have bought and placed in service bonus-depreciation-eligible property in 2010.

First year dollar cap for autos increased by $8,000. Under Code Sec. 280F, depreciation deductions (including Code Sec. 179 expensing) that can be claimed for passenger autos is subject to dollar limits that are annually adjusted for inflation. For passenger automobiles placed in service in 2010, the adjusted first-year limit is $3,060. The adjusted first year limit is $3,160 for light trucks or vans. These are passenger automobiles built on a truck chassis, including minivans and sport-utility vehicles (SUVs) built on a truck chassis that are subject to the Code Sec. 280F limits because they are rated at 6,000 points gross (loaded) vehicle weight or less.

The 2010 Small Business Act would increase the first year business-auto writeoff by $8,000 (i.e., to $11,060 for autos and $11,160 for light trucks or vans) for vehicles that are qualified property for bonus depreciation purposes (i.e., are new and acquired and placed in service in 2010 (Code Sec. 168(k)(2)(A)(iv)).

Special long-term contract accounting rule for bonus depreciation. Bonus depreciation would be decoupled from allocation of contract costs under the percentage of completion accounting method rules for assets with a depreciable life of seven years or less. More specifically, for property placed in service after Dec. 31, 2009, solely for purposes of determining the percentage of completion under Code Sec. 460(b)(1)(A) , the cost of qualified property would be taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted (Code Sec. 460(c)(6)) Qualified property would be property otherwise eligible for bonus depreciation that has a MACRS recovery period of 7 years or less and that is placed in service after Dec. 31, 2009, and before Jan. 1, 2011 (Jan. 1, 2012, in the case of Code Sec. 168(k)(2)(B) property (certain longer-lived property)).

Deduction for startup expenses would be increased. For tax years beginning in 2010, the deduction for startup expenses under Code Sec. 195 would be increased from $5,000 to $10,000 and the phase-out threshold would be increased from $50,000 to $60,000 (Code Sec. 195(b)(3)).

100% exclusion for gain from qualified small business (QSBS) stock. There would be a 100% exclusion of gain from the sale of QSBS stock (a) acquired after the enactment date of the 2010 Small Business Act and before Jan. 1, 2011, and (b) held for at least five years (Code Sec. 2012).

Five-year carry back of small business unused general business credits. The general business credit (GBC) generally can't exceed the excess of the taxpayer's net income tax over the greater of the taxpayer's tentative minimum tax or 25% of so much of the taxpayer's net regular tax liability as exceeds $25,000. Credits in excess of this limitation may be carried back one year and forward up to 20 years. Under the 2010 Small Business Act, the carry back period for eligible small business (ESB) credits determined in tax years beginning in 2010 would be extended from one to five years (Code Sec. 39(a)(4)).

ESB credits, for a tax year beginning in 2010, would include all of the component credits of the GBC, but *only* as determined with respect to eligible small businesses (ESBs). ESBs would be businesses that (1) are corporations the stock of which isn't publicly traded, partnerships or sole proprietorships *and* (2) have average annual gross receipts, for the three-tax-year period preceding the tax year, of no more than $50 million.

ESB credits not subject to AMT. For ESB credits determined in tax years beginning in 2010, ESBs, as defined above for purposes of the longer credit carry back, would be able to use all types of general business credits to offset their alternative minimum tax (AMT) (Code Sec. 38). More specifically, the tentative minimum tax would be treated as being zero for ESB credits. Thus, an ESB credit could offset both regular and AMT liability.

Reduced recognition period for S Corp built in gains tax. Where a C corporation elects to become an S corporation (or where an S corporation receives property from a C corporation in a nontaxable carryover basis transfer), the S corporation is taxed at 35% on all gains that were built-in at the time of the election if the gains are recognized during the recognition period. The recognition period generally is the first ten S corporation years (or the ten-period after the transfer). For tax years beginning in 2009 and 2010, no tax is imposed on the net unrecognized built-in gain of an S corporation if the seventh tax year in the recognition period preceded the 2009 and 2010 tax years.

For any tax year beginning in 2011, the 2010 Small Business Act shortens the holding period of assets subject to the built-in gains tax to 5 years if the fifth tax year in the recognition period precedes the tax year beginning in 2011 (Code Sec. 1374(d)(7)).

One year self-employment tax break. For tax years beginning after Dec. 31, 2009, but before Jan. 1, 2011, when calculating self-employment taxes, the deduction for health insurance costs of a self-employed taxpayer under Code Sec. 162(l) could be taken into account (i.e., could be deducted) in computing net earnings from self-employment (Code Sec. 162(l)(4)).

The Joint Committee on Taxation's Technical Explanation of H.R. 5297 as taken up by the Senate says that it is intended that earned income within the meaning of Code Sec. 401(c)(2) be computed without regard to the deduction for the cost of health insurance.

Cell phones no longer listed property. Cell phones (and similar telecommunications equipment) would be removed from the definition of listed property under Code Sec. 280F, for tax years beginning after Dec. 31, 2009. (Code Sec. 280F(d)(4)(A)).

Relaxed penalty for failure to include reportable transaction information with return. Retroactively effective to penalties assessed after Dec. 31, 2006, the controversial Code Sec. 6707A penalty would be revised so that the penalty for failure to disclose a reportable transaction to IRS would be commensurate with the tax benefit received from the transaction. Reportable transactions are transactions that IRS has identified as listed tax shelters or that have characteristics of tax shelters, including large losses or confidentiality agreements.

Under the 2010 Small Business Act, the penalty would be 75% of the tax benefit received, with a minimum penalty of $10,000 for corporations and $5,000 for individuals, and for listed transactions a maximum penalty of $200,000 for corporations and $100,000 for individuals (for other reportable transactions, the maximum penalty would be $50,000 for corporations and $10,000 for individuals (Code Sec. 6707A(b)).

The small business jobs bill would pay for its tax breaks with the following revenue raisers:

Information reporting for rental income. For payments made after Dec. 31, 2010, persons receiving rental income from real property would have to file information returns to IRS and to service providers reporting payments of $600 or more during the year for rental property expenses. Exceptions would be provided for individuals temporarily renting their principal residences (including active members of the military), taxpayers whose rental income doesn't exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regs (Code Sec. 6041(h)).

Increased penalty for failure to timely file information returns. For information returns required to be filed after Dec. 31, 2010, the Code Sec. 6721 penalties for failure to timely file information returns to IRS would be increased. The first-tier penalty would go from $15 to $30, and the calendar year maximum from $75,000 to $250,000. The second-tier penalty would be increased from $30 to $60, and the calendar year maximum from $150,000 to $500,000. The third-tier penalty would be increased from $50 to $100, and the calendar year maximum from $250,000 to $1,500,000. For small business filers, the calendar year maximum would go from $25,000 to $75,000 for the first-tier penalty, from $50,000 to

$200,000 for the second-tier penalty, and from $100,000 to $500,000 for the third-tier penalty. The minimum penalty for each failure due to intentional disregard would be increased from $100 to $250.

Increased penalty for failure to furnish a payee statement. The Code Sec. 6722 penalty for failure to furnish a payee statement would be revised to provide tiers and caps similar to those applicable to the penalty for failure to file the information return. A first-tier penalty would be $30, subject to a maximum of $250,000; the second-tier penalty would be $60 per statement, up to $500,000, and the third-tier penalty $100, up to a maximum of $1,500,000. Limitations would apply on penalties for small businesses and increased penalties for intentional disregard that parallel the penalty for failure to furnish information returns.

Exception to pre-levy CDP hearing rule for Federal contractors. For levies issued after the enactment date, the small business jobs bill would allow the IRS to issue levies prior to a CDP hearing with respect to Federal tax liabilities of Federal contractors identified under the Federal Payment Levy Program. When a levy is issued prior to a CDP hearing, the taxpayer would have an opportunity for a CDP hearing within a reasonable time after the levy(Code Sec. 6330(f)(4)).

Code Sec. 457(b) plans could include Roth accounts. For tax years beginning after Dec. 31, 2010, retirement savings plans sponsored by state and local governments (i.e., governmental Code Sec. 457(b) plans) would be able to include Roth accounts (Code Sec. 402A(e)(1), Code Sec. 402A(e)(2)).

Certain retirement plans can rollover distributions into Roth accounts. For distributions after the enactment date, 401(k), 403(b), and governmental 457(b) plans could permit participants to roll their pre-tax account balances into a designated Roth account. If the rollover is made in 2010, the participant could elect to pay the tax in 2011 and 2012 (Code Sec. 402A(c)(4)).

Annuitization of nonqualified annuity allowed. For amounts received in tax years beginning after Dec. 31, 2010, he 2010 Small Business Act would permit a portion of an annuity, endowment, or life insurance contract to be annuitized while the balance is not annuitized, provided that the annuitization period is for 10 years or more, or is for the lives of one or more individuals (Code Sec. 72(a)).

Sourcing of guarantee income. Amounts received directly or indirectly for guarantees of indebtedness of the payor issued after the enactment date would be sourced like interest and, as a result, if paid by U.S. taxpayers to foreign persons would generally be subject to withholding tax (Code Sec. 861(a)(9)). The change would prospectively overturn the holding in Container Corporation, Successor to Interest of Container Holdings Corporation, Successor to Interest of Vitro International Corporation, (2010) 134 TC No. 5 , that fees paid by a U.S. subsidiary to its foreign parent for guaranteeing the subsidiary's debt were analogous to payments for a service and therefore were not U.S. source income. No inference would be intended with respect to the treatment of guarantees issued before the enactment date.

Accelerated estimated tax payment for large corporations. Estimated taxes for large corporations (those with assets of not less than $1 billion) otherwise due for July, August, or September of 2015, would be increased by 36%.