



2010 Small Business Jobs Act

CHANGES AND LIKELY IMPACTS
OF THE LEGISLATION



The Small Business Jobs Act of 2010 (SBJA) has just been passed by Congress, and it benefits more than just small businesses. It also provides tax-saving opportunities for larger businesses and individuals — including small-business investors, the self-employed and employees saving for retirement.

BUSINESS CAPITAL COST RECOVERY INCENTIVES

Bonus Depreciation Extended

The Act retroactively extends bonus depreciation deductions that were allowed in 2008 and 2009 through 2010 and provides limited additional depreciation in 2011. Bonus depreciation applies to qualified property acquired and placed in service during 2010 or placed in service during 2011 if the property is long production period property¹ or transportation property.² The additional deduction is equal to 50 percent of the adjusted property basis and is allowed for both regular tax and alternative minimum tax (AMT) purposes but is not allowed for purposes of computing earnings and profits. Qualifying property must be (1) MACRS property with a recovery period of 20 years or less; (2) water utility property; (3) non section 197 computer software; or (4) qualified leasehold improvement property.

The basis of the property and the depreciation allowances for the property must be adjusted to reflect the additional first-year depreciation deduction and regular MACRS depreciation applies to the remaining basis. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income for bonus depreciation property. The amount of the additional depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

First Year Depreciation Cap for Autos and Trucks Increased

The Act also increases the limitation under section 280F on the amount of depreciation deductions allowed for certain passenger automobiles by \$8,000 in the first year from \$3,060 for autos and \$3,160 for SUVs and minivans. The \$8,000 increase is not indexed for inflation.

Application of Bonus Depreciation to Long-Term Contracts

Additionally, the Act provides that for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted, which allows contractors to take advantage of bonus depreciation even if they do not complete their project in 2010. Qualified property is property otherwise eligible for bonus depreciation that has a MACRS recovery period of 7 years or less and that is placed in service in 2010.³

The usefulness of these depreciation provisions will be enhanced by the nontax lending incentives found in the Act that will help to open up credit markets for small business that want to purchase equipment.

Section 179 Expensing

Prior to the Act, a taxpayer could elect under section 179 to expense up to \$250,000 of the cost of qualifying property placed into service in 2008 through 2010 rather than to recover such costs through depreciation deductions. The allowable expense amount was phased-out once a taxpayer spent more than \$800,000 on qualified property. For 2011, the expense limitation was set to drop to \$25,000 and the phase-out was set to drop to \$200,000. The Act increases the maximum expense amount for 2010 and 2011

to \$500,000 and increases the phase-out threshold amount to \$2 million. The Act also temporarily expands the definition of qualified property to include qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property but sets the maximum that can be expensed at \$250,000.

The expense amount may not exceed taxable income for any taxable year. Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years. No general business credit under section 38 is allowed for any amount expensed under section 179. The Act also permits a taxpayer to elect to exclude real property from the definition of section 179 property, which may prove useful to some business that are close to reaching the \$2 million limit. Like the bonus depreciation provisions, the usefulness of this provision will be enhanced by the nontax lending incentives found in the Act.

Increase to Startup Expense Deduction

A taxpayer can currently elect to deduct up to \$5,000 of start-up expenditures in the year in which its trade or business begins. The \$5,000 deduction is reduced by the amount that start-up expenditures exceed \$50,000. For taxable years beginning in 2010, the Act increases the deductible amount to \$10,000 and increases the deduction phase-out threshold to \$60,000. Start-up expenditures that are not immediately deductible must be amortized over 15-years. Start-up expenditures are amounts that would have been deductible as trade or business expenses had they not been paid or incurred before business began.

Cell Phones Removed from Listed Property Treatment

Property, including cellular telephones and similar telecommunications equipment, used in carrying on a trade or business is subject to the general rules for deducting ordinary and necessary expenses under section 162. In the case of certain listed property, no deduction is allowed unless the taxpayer adequately substantiates the expense and business usage of the property and special depreciation rules apply. The Act removes cell phones from the definition of listed property.



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SMALL BUSINESS TAX RELIEF PROVISIONS

Increase to Capital Gain Exclusion for Small Business Stock

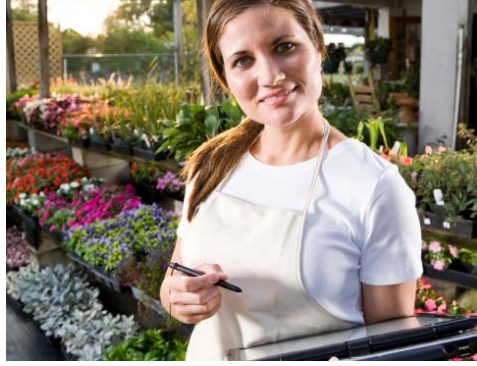
Currently, individuals may exclude 75 percent of the gain from qualified small business stock ("QSBS") acquired at original issue after February 17, 2009, and before January 1, 2011 and held for at least five years. For QSBS acquired before February 18, 2009 or after 2010, the exclusion rate is 50 percent. The Act increases the exclusion percentage after the enactment date from 75 percent to 100 percent. The amount of gain eligible for the exclusion by an individual with respect to any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) \$10 million. To qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed \$50 million. The corporation also must meet certain active trade or business requirements.

5 Year Carryback and AMT Offset for Eligible Small Business Credits

The Act extends the carryback period for eligible small businesses to use the general business credit from one to five years. The general business credit generally may not exceed the excess of the taxpayer's net income tax over the greater of the taxpayer's tentative minimum tax or 25 percent of so much of the taxpayer's net regular tax liability as exceeds \$25,000. Currently, general business credits in excess of this limitation may be carried back one year and forward up to 20 years. An eligible small business is a corporation (the stock of which is not publicly traded) or a partnership that has no than \$50 million in average annual gross receipts for the prior three years. The bill also provides that the tentative minimum tax under the alternative minimum tax is treated as being zero for eligible small business credits. For any taxable year, the general business credit may not exceed the excess of the taxpayer's net income tax over the greater of the taxpayer's tentative minimum tax.

Thus, an eligible small business credit may offset both regular and alternative minimum tax liability.

Reduction of S Corporation Built-In Gain Period
The bill also includes a provision that helps S corporations by providing that for taxable years beginning in 2011, for purposes of computing the built-in gains tax that is imposed on an C corporation that converts to an S corporation, the recognition period is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation. This should allow more flexibility for these corporations to dispose of assets that either no longer meet business needs or can provide additional capital through sale.



SMALL BUSINESS LENDING PROVISIONS

The Act includes a number of important nontax provisions that will open up the credit markets to small businesses so that they can purchase capital and hire employees. To this end, the Act establishes a Small Business Lending Fund of \$30 billion to provide capital investments to small community banks to increase small business lending. The fund is limited to banks that hold less than \$10 billion in assets. The lending program is performance-based and incentivizes lenders that extend new credit by decreasing the dividend rate that these banks pay as they increase lending. The Act also establishes the State Small Business Credit Initiative to provide \$1.5 billion in grants to existing successful state small business programs that help private lenders extend more credit to small businesses.

The Act raises the cap on small business loans to increase lending by \$5 billion in the first year after enactment, and refinances commercial real estate debt into long-term, fixed-rate loans, provisions that are expected to be budget neutral and could create or save 200,000 jobs. It also makes changes to the Small Business Administration's (SBA) two largest lending programs and to its microloan program and extends these lending provisions through December 31, 2010. The Act extends the American Recovery and Reinvestment Act small business lending program that eliminates the fees normally charged for loans through the SBA 7(a) and 504 loan programs and increases the government guarantees on 7(a) loans from 75 percent to 90 percent.

MISCELLANEOUS PROVISIONS

The Act also contains various miscellaneous provisions aimed at helping small businesses.

In calculating adjusted gross income for income tax purposes, self-employed individuals may deduct the cost of health insurance for themselves and their spouses, dependents, and any children who have not attained age 27 as of the end of the taxable year. These individuals must also pay Self-Employment Contributions Act (SECA) taxes on their net earnings. The tax is composed of two parts: (1) the old age, survivors, and disability insurance (OASDI) tax – equal to 12.4 percent of income; and (2) the hospital insurance (HI) tax – equal to 2.9 percent of income. The OASDI tax applies to self-employment income up to the Federal Insurance Contributions Act (FICA) taxable wage base (\$106,800 in 2010). Prior to the Act, the health insurance deduction was not taken in account in determining an individual's net earnings from self employment for purposes of SECA taxes. Under the Act, the deduction is taken into account for the taxpayer's first taxable year beginning after December 31, 2009, thus reducing the earnings subject to self-employment tax.

The reporting requirements of sections 6011 through 6112 create disclosure obligations for both taxpayers and advisors. Each of these disclosure statutes has a parallel penalty provision that enforces it. Prior to enactment of the American Jobs Creation Act of 2004, no penalty was imposed on taxpayers who failed to disclose participation in transactions subject to section 6011. For disclosures that were due after enactment of that legislation, a strict liability penalty under section 6707A applies to any failure to disclose a reportable transaction. The Act changes the general rule to achieve proportionality between the penalty and the tax savings that were the object

of the transaction, retains the current penalty amounts as the maximum penalty that may be imposed, and establishes a minimum penalty. First, the Act provides that a participant in a reportable transaction who fails to disclose the transaction is subject to a penalty equal to 75 percent of the reduction in tax reported as a result of participation in the transaction. Regardless of the amount determined under the general rule, the annual penalty for each failure to disclose is \$10,000 in the case of a natural person and \$50,000 for all other persons. The maximum annual penalty for listed transaction increases to \$100,000 in the case of a natural person and \$200,000, for all other persons. The minimum penalty is set at \$5,000 for natural persons and \$10,000 for all other persons.

The Act authorizes \$5,230,000 in additional fund to the United States Trade Representative to analyze and develop opportunities for U.S. businesses to access foreign markets and to enforce trade agreements

OFFSETS

The Act's tax benefit provisions are paid for by a number of revenue offsets. The largest of which provides that if a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan has a qualified designated Roth contribution program, a distribution to an employee (or a surviving spouse) from an account under the plan that is not a designated

Roth account is permitted to be rolled over into a designated Roth account under the plan for the individual. In the case of a permitted rollover contribution, the individual must include the distribution in gross income (subject to basis recovery) in the same manner as if the distribution were rolled over into a Roth IRA. The taxpayer is allowed to include the amount in income in equal parts in 2011 and 2012. The special recapture rule for the 10-percent early distribution tax also applies if distributions are made from the designated Roth account in the relevant five year period.

The bill also requires recipients of rental income from real estate generally to adhere to the same information reporting requirements as taxpayers engaged in a trade or business. In particular, rental income recipients making payments of \$600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income are required to provide an information return (typically Form 1099-MISC) to the IRS and to the service provider. Exceptions to this reporting requirement are made for (i) members of the military or employees of the intelligence community who rent their principal residence on a temporary basis, (ii) individuals who receive only minimal amounts of rental income, as determined by the Secretary in accordance with regulations, and (iii) individuals for whom the requirements would cause hardship, as determined by the Secretary in accordance with regulations.

Other offsets include:

- Increasing penalties related to information returns and payee statements
 - Applying continuous levies to tax liabilities of certain Federal contractors
 - Allowing participants in governmental 457 plans to treat elective deferrals as Roth contributions
 - Permitting partial annuitization of a nonqualified annuity contract
 - Making crude tall oil ineligible for cellulosic biofuel producer credit
 - Adjusting source rules for income on guarantees
- The Act also increases the required payment of estimated taxes by corporations with assets of at least \$1 billion (determined as of the end of the preceding taxable year) otherwise due in July, August, or September, 2015, by 36 percentage points.

¹ Long production period property is defined as property with a recovery period of 10 years or longer. ² Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property. ³ 2011 in the case of property described in section 168(k)(2)(B), which generally applies to property having longer production periods.



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