

PKF PERSPECTIVES

SUMMARY: TAX PROVISIONS OF THE SMALL BUSINESS JOBS ACT OF 2010

With the recently enacted 2010 Small Business Jobs Act (the "Act") comes a number of wide-ranging tax breaks and incentives for businesses and individuals. Below are some of the changes, a few of which may affect your 2010 tax planning.

Enhanced Business Expensing (Section 179)

In order to help businesses quickly recover the cost of certain capital expenses, business taxpayers can elect to write off the cost of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation.

Under the new law, for tax years beginning in 2010 and 2011, the current \$250,000 limit is increased to \$500,000 and the investment ceiling to \$2,000,000 (up from \$800,000).

The new law also makes certain real property eligible for expensing. For property placed in service in any tax year beginning in 2010 or 2011, the up-to-\$500,000 of property expensed can include up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

Gain from Sale of Small Business Stock

Under the new law, the amount of the exclusion is temporarily increased to 100% of the gain from the sale of qualifying small business stock that is acquired in 2010 after date of enactment (September 27, 2010) and before January 1, 2011. The stock must be held for more than five years.

In addition, the new law eliminates the alternative minimum tax (AMT) preference item attributable for that sale.

General Business Credits

Under present law, general business credits of a business are allowed to be carried back to offset taxes paid in the previous year (one-year carryback) and the remaining amount can be carried forward for 20 years.

Under the new law, for the first tax year of the taxpayer beginning in 2010, eligible small businesses can carry back unused general business credits for five years.

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

General business credits of eligible small businesses in 2010 are not subject to AMT. The new law allows eligible small businesses, as defined above, to use all types of general business credits to offset their AMT in tax years beginning in 2010.

S Corporation Holding Period

Generally, a C corporation converting to an S corporation must hold onto any appreciated assets for 10 years following its conversion or face a business-level tax imposed on the built-in gain at the highest corporate rate of 35%.

The Act temporarily shortens the holding period of assets subject to the built-in gains tax to 5 years if the 5th tax year in the holding period precedes the tax year beginning in 2011.

Extension of 50% Bonus First-Year Depreciation

Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. The new law extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (2011 for certain long-lived property).

Special Rule for Long-Term Contract Accounting

The new law provides that in determining the percentage of completion under the percentage of completion method of accounting, bonus depreciation is not taken into account as a cost. This prevents the bonus depreciation from having the effect of accelerating income.

Boosted Deduction for Start-Up Expenditures

The new law allows taxpayers to deduct up to \$10,000 in trade or business start-up expenditures for 2010 (up from \$5,000). The amount that a business can deduct is reduced by the amount by which start-up expenditures exceed \$60,000. The remaining amount is amortized over 180 months.

Limitation on Penalty for Failure to Disclose on a Tax Return Certain Reportable Transactions

The new law limits the penalty to 75% of the decrease in tax resulting from the transaction. The minimum penalty is \$10,000 for corporations and \$5,000 for individuals (for failure to report a listed transaction, the maximum penalty is \$200,000 and \$100,000, respectively). These changes are retroactively effective to penalties assessed after December 31, 2006.

Deductibility of Health Insurance for the Purpose of Calculating Self-Employment Tax

The new law allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

Cell Phones Removed from Listed Property Category

Cell phones can be deducted or depreciated like other business property, without onerous recordkeeping requirements.

Information Reporting Required for Rental Property Expense Payments

For payments made after December 31, 2010, the new law requires persons receiving rental income from real property to file information returns with the IRS and service providers reporting payments of \$600 or more during the tax year for rental property expenses.

Exceptions are provided for individuals renting their principal residences on a temporary basis (including active members of the military), taxpayers whose rental income does not exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regs).

Increased Information Return Penalties

Penalties will be increased for information returns required to be filed after December 31, 2010.

Application of Continuous Levy to Tax Liabilities of Certain Federal Contractors

For levies issued after date of enactment, the new law allows the IRS to issue levies before a collection due process (CDP) hearing on Federal tax liabilities of Federal contractors (taxpayers would have an opportunity for a CDP hearing within a reasonable time after a levy is issued).

Governmental 457(b) Plans

For tax years beginning after December 31, 2010, the new law will allow retirement savings plans sponsored by state and local governments [governmental 457(b) plans] to include designated Roth accounts. Contributions to Roth accounts are made on an after-tax basis, but distributions of both principal and earnings are generally tax-free.

Rollovers from Elective Deferral Plans

The new law allows 401(k), 403(b), and governmental 457(b) plans to permit participants to roll their pre-tax account balances into a designated Roth account. The amount of the rollover will be includible in taxable income except to the extent it is the return of after-tax contributions.

If the rollover is made in 2010, the participant can elect to pay the tax in 2011 and 2012. Plans will be able to allow these rollovers immediately as of date of enactment.

Crude Tall Oil

Crude tall oil (a waste by-product of the paper manufacturing process) is excluded from eligibility for the cellulosic biofuel producer credit. The new law limits eligibility for the tax credit to fuels that are not highly corrosive (i.e., with an acid number of 25 or less), effective for fuels sold or used after December 31, 2009.

Nonqualified Annuity Contracts

The new law permits holders of nonqualified annuities (annuity contracts held outside of a qualified retirement plan or IRA) to elect to receive part of the contract in the form of a stream of annuity payments, leaving the remainder of the contract to accumulate income on a tax-deferred basis.

Guarantee Fees

Amounts received directly or indirectly for guarantees of indebtedness of a U.S. payor issued after date of enactment are sourced, like interest, in the U.S. As a result, amounts paid by U.S. taxpayers to foreign persons will generally be subject to U.S. withholding tax.

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting a professional advisor. This information is not intended to be, nor can it be, used by any taxpayer for the purpose of avoiding tax penalties. For more information, please contact tax partners Leo Parmegiani or Joe Lee.

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