



significant tax law changes under the small business jobs act of 2010

MSK Client Alert

September 27, 2010

The Small Business Jobs Act of 2010 was signed into law by President Obama on September 27, 2010. It includes certain notable changes to the Internal Revenue Code (Code). This Alert provides a brief summary of the following changes:

- Reduction in holding period to avoid S corporation built-in gains tax;
- 100% exclusion of small business capital gains;
- General business credit carried back five years;
- General business credit not subject to alternative minimum tax (AMT);
- Increase of Code section 179 expensing and expansion to certain real property;
- Extension of 50% bonus depreciation;
- Increased deduction for start-up expenditures;
- Deductibility of health insurance from self-employment tax; and
- Removal of cell phones from "listed property."

The Small Business Jobs Act also includes, among others, tax provisions limiting penalties for failure to disclose a reportable transaction, increasing penalties for failure to file correct information returns, requiring information reporting for rental property expense payments of \$600 or more, and allowing rollovers from 401(k), 403(b), and other elective deferral plans to Roth designated accounts.

Companies, individuals, and investors should consider carefully whether the Small Business Jobs Act provides new opportunities or additional tax benefits.

practice areas

tax planning

transactional tax



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Reduction in Holding Period to Avoid S Corporation Built-In Gains Tax (Section 2014 of the Small Business Jobs Act)

Generally, a C corporation converting to an S corporation must hold on to any appreciated assets for 10 years following its conversion to avoid a 35% tax on any built-in gain. In the case of any taxable year beginning in 2009 or 2010, no built-in gains tax is imposed if the 7th taxable year in the holding period preceded such taxable year.

Section 1374 of the Code now adds that no built-in gains tax is imposed in the case of any taxable year beginning in 2011 if the 5th year in the holding period preceded such taxable year. As a result, a seven tax year period applies for the 2009 and 2010 tax years, a five tax year period applies for the 2011 tax year, and the standard ten year tax period is set to be reinstated beginning in the 2012 tax year. Certain S corporations contemplating the sale of assets with "net unrealized built-in gain" may be able to avoid built-in gains tax by delaying the sale until 2011.

100% Exclusion of Small Business Capital Gains (Section 2011 of the Small Business Jobs Act)

Generally, non-corporate taxpayers can exclude 50% of the gain from the sale of "qualified small business stock" acquired at original issue and held for more than five years. For such stock acquired after February 17, 2009, and before January 1, 2011, the exclusion is 75%. At the time of sale, however, 28% of the excluded gain is subject to AMT. Generally, "qualified small business stock" is stock issued in a C corporation that meets an active business test and whose gross assets, at all times after August 10, 1993, and until the stock's issuance, did not exceed \$50 million (including amounts received in the stock issuance). The gain eligible for exclusion is limited to the greater of ten times the taxpayer's basis in the stock or \$10 million.

Section 1202 of the Code now increases the exclusion to 100% of the gain from the sale of qualified small business stock acquired in 2010 after September 27, 2010, and held for more than five years. The AMT preference item attributable to such sale is also eliminated.

General Business Credit Carried Back Five Years (Section 2012 of the Small Business Jobs Act)

Generally, unused general business credits may be carried back to offset taxes paid in the previous year, and any remaining credits may be carried forward for 20 years. There are currently 24 such general business credits including, for example, a credit for small employer pension plan startup costs.

Section 39 of the Code now extends the one-year carryback for general business credits from one year to five years for an "Eligible Small Business." An Eligible Small Business, with respect to any taxable year, includes certain non-publicly traded corporations, partnerships, and sole proprietorships whose average annual gross receipts do not exceed \$50 million for the prior three years, as calculated under the Code. The change applies to credits determined in taxable years beginning after December 31, 2009.

General Business Credit Not Subject to AMT (Section 2013 of the Small Business Jobs Act)



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Under the AMT, taxpayers generally may only claim general business credits against their regular tax liability to the extent that their regular tax liability exceeds their AMT liability. Only certain types of general business credits can offset AMT liability.

Section 38 of the Code now allows Eligible Small Businesses to use any type of general business credit to offset AMT. The change applies to credits determined in taxable years beginning after December 31, 2009.

Increase of Code Section 179 Expensing and Expansion to Certain Real Property (Section 2021 of the Small Business Jobs Act)

Taxpayers generally may deduct, in the year of acquisition, the costs of certain tangible personal property purchased for use in the active conduct of a trade or business (in lieu of future depreciation). For qualifying property placed in service in the taxable year beginning in 2010, taxpayers may deduct up to \$250,000 of such capital expenditures subject to a phase-out once such expenditures exceed \$800,000. After 2010, the thresholds are set to revert to \$25,000 and \$200,000, respectively.

However, section 179 of the Code now increases the thresholds to \$500,000 and \$2,000,000, effective for the taxable years beginning in 2010 and 2011. Within those thresholds, under an expanded definition of qualifying Section 179 property, taxpayers may now expense up to \$250,000 of the cost of "qualified leasehold improvement property," "qualified restaurant property," and "qualified retail improvement property." However, no amount attributable to such "qualified real property" may be carried over to a taxable year beginning after 2011.

Extension of Bonus Depreciation (Section 2022 of the Small Business Jobs Act)

In addition to normally available first-year depreciation deduction amounts, an additional first-year 50% depreciation deduction is available (to offset both regular tax and AMT) for qualified property placed in service during 2008 and 2009 (2009 and 2010 for certain property having longer production periods, transportation property, and certain aircraft).

Section 168(k) of the Code now extends for one year the additional first-year 50% depreciation deduction for qualified property purchased and placed in service during 2010.

Increased Deduction for Start-Up Expenditures (Section 2031 of the Small Business Jobs Act)

Section 195 of the Code now allows taxpayers to deduct up to \$10,000 (up from \$5,000) in trade or business "start-up expenditures." The amount deductible is reduced by the amount by which start-up expenditures exceed \$60,000 (up from \$50,000). Start-up expenditures generally are expenses paid or incurred in connection with creating, or investigating the creation or acquisition of, an active trade or business, which would be deductible if paid or incurred in connection with the operation of an existing active trade or business. The increases are effective for taxable years beginning in 2010.

Deductibility of Health Insurance From Self-Employment Tax (Section 2042 of the Small Business Jobs Act)



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In calculating self-employment tax, business owners generally may not deduct health insurance costs for themselves and their family members. Section 162(l) of the Code now allows business owners to deduct such health insurance costs in calculating their 2010 self-employment tax.

Removal of Cell Phones From "Listed Property" (Section 2043 of the Small Business Jobs Act)

No deduction is allowed for "listed property" unless the taxpayer complies with onerous substantiation requirements. Special depreciation rules also apply to certain listed property. Section 280F of the Code now no longer includes cell phones as listed property, effective for tax years ending after December 31, 2009.

If you have any questions about this Alert or the Small Business Jobs Act, please contact the author or any member of the MSK Tax Department.