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Small Business Jobs Act of 2010 September 24, 2010

Yesterday the House voted to send to the desk of President Obama the Small Business Jobs Act of 2010 (the "Act"). The President is expected to sign the Act into law as soon as it reaches the White House. The Act has a wide-ranging assortment of tax breaks and incentives for small business, paid for with various revenue raisers. The Act also contains tax incentives for businesses of all sizes and generally beneficial retirement plan changes. Some of these provisions require immediate attention and quick action, since many are temporary and last only through the end of 2010. Below is a summary of some of the most important tax and retirement plan provisions covered by the Act.

1. 100% exclusion of gain from sale of qualified small business stock acquired after date of enactment and by the end of 2010. The Act increases the exclusion from gross income of gain from the sale or exchange of qualified small business stock from a temporary 75% to 100%. No regular tax or alternative minimum tax is imposed on the sale of this stock if held for at least five years. The provision is effective for stock acquired after the date of enactment and before January 1, 2011. At that time the permanent percentage exclusion of 50% on the sale of such stock is restored.
2. General business credits carryback extended to five years and offset AMT. The carryback period for eligible small business credits is extended from one to five years. An eligible small business is a corporation that is not publicly traded, a partnership or a sole proprietorship. The average annual gross receipts of the business for the prior three tax periods cannot exceed \$50 million. The provision is effective for credits determined in the taxpayer's first taxable year beginning after December 31, 2009. The general business credit of an eligible small business will not be subject to the alternative minimum tax. Thus, an eligible small business credit may offset both regular and alternative minimum tax liability.
3. S-Corporation built-in gains period shortened to five years. The highest marginal rate applicable to corporations (currently 35%) is imposed on an S corporation's gain that arose prior to the conversion of the C corporation to an S corporation and recognized during the "recognition period," usually a 10-year period beginning with the first day of the taxable year for which an S election is effective. 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 taxable years beginning in 2011, the Act temporarily reduces the recognition period from ten years to five years.

4. Enhanced Section 179 expensing. The maximum amount a taxpayer may expense under section 179 is increased to \$500,000 for two taxable years beginning after 2009 and before 2012. This maximum amount is reduced by the amount by which the cost of qualifying property exceeds \$2 million. For any tax year beginning in 2010 or 2011, a taxpayer can elect to treat up to \$250,000 of qualified real property (specifically, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) as expensing-eligible property. Additionally, off-the-shelf computer software will be continue to be qualifying property for purposes of the Code Section 179 election if it is placed in service in a tax year beginning in 2010 or 2011.
5. 50% bonus depreciation extended. The bonus depreciation deduction is extended to apply to qualified property acquired and placed in service during 2010 (or placed in service during 2011 for certain long-lived property and transportation property). The bill also boosts the first year business-auto write-offs by \$8,000 to \$11,060 for autos and \$11,160 for light trucks or vans for vehicles that are new and acquired and placed in service in 2010.
6. Beneficial rule for bonus depreciation and long-term contracting. In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method. The Act provides that solely 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. This provision prevents the bonus depreciation from having the effect of accelerating income. 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 after December 31, 2009, and before January 1, 2011.
7. Deductible start-up expenses amount increased. For taxable years beginning in 2010, the amount allowed as a deduction for start-up expenditures is increased from \$5,000 to \$10,000. Also, the deduction phase-out threshold is increased from \$50,000 to \$60,000, such that the \$10,000 is reduced, but not below zero, by the amount by which the cumulative cost of start-up expenditures exceeds \$60,000. The provision is effective for taxable years beginning in 2010.
8. Limitation on penalty for failure to disclose certain reportable and listed transactions. Regulations under section 6011 require a taxpayer to disclose with its tax return reportable transactions in which the taxpayer participates. Section 6707A imposes a penalty for failure to comply with the reporting requirements of 6011. Retroactively effective to penalties assessed after December 31, 2006, the controversial section 6707A penalty is revised so that the penalty for failure to disclose a reportable transaction to the IRS is commensurate with the tax benefit received from the transaction. The penalty is limited to 75% of the tax benefit received, with a minimum penalty of \$ 5,000 for individuals and \$10,000 for corporations and other filers, and a maximum annual penalty of \$10,000 for individuals and \$50,000 for corporations and other filers. For listed transactions a maximum annual penalty is \$100,000 for individuals and \$200,000 for corporations and other filers.
9. Deduction for self-employed health insurance in computing self-employment tax. The deduction for income tax purposes allowed to self-employed individuals for the cost of health insurance for themselves, their spouses, dependents, and children who have not attained age 27 as of the end of the taxable year can also be deducted in calculating net earnings from self-employment for purposes of self-employment taxes. The provision only applies for 2010.

10. Cell phones removed from listed property category. The Act removes cell phones and similar telecommunications equipment from the definition of listed property; therefore, the strict substantiation requirements and special depreciation rules no longer apply to cell phones. The provision is effective for all taxable years ending after December 31, 2009.

11. Information reporting required for rental property expenses. 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. A person that fails to comply is subject to penalties. The provision applies to payments made after December 31, 2010.

12. Penalties increased for failure to file information returns. Information return penalties are increased and adjusted for inflation every five years. The penalty amounts depend on a lateness-of-filing tier. The first-tier penalty is increased to \$30 per return with a maximum penalty of \$250,000. The second-tier penalty is increased to \$60 per return with a maximum penalty of \$500,000. The third-tier penalty is increased to \$100 per return with a maximum penalty of \$1,500,000. For qualified small business filers, the calendar year maximum is \$75,000 for the first-tier penalty, \$200,000 for the second-tier penalty, and \$500,000 for the third-tier penalty. The minimum penalty for each failure due to intentional disregard is increased \$250. Similar penalties apply to failure to furnish a payee statement. The provision applies with respect to information returns required to be filed on or after January 1, 2011.

13. Participants in governmental Section 457 plan allowed to treat elective deferrals as Roth contributions. The bill allows participants in government Section 457 plans to treat elective deferrals as Roth contributions, effective for tax years beginning after 2010. A similar provision already applies to 401(k) and 403(b) plans.

14. Allow rollovers from elective deferrals plans to designated Roth accounts. For distributions after the enactment date, 401(k), 403(b), and governmental 457(b) plans permit participants to roll their pre-tax account balances into a designated Roth account in the plan. If the rollover is made in 2010, the taxpayer is allowed to include the amount recognized in the rollover in income in equal parts in 2011 and 2012. Prompt action is required to amend plans to allow Roth account rollovers in 2010.

15. Partial annuitization of nonqualified annuity allowed. The Act permits a portion of a non-qualified 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. The provision is effective for amounts received in taxable years beginning after December 31, 2010.

16. U.S. sourcing of income from guarantees. The Act prospectively overrides the Tax Court's recent decision in *Container Corp.*, 134 TC No.5 (2010), by amending the section 861 and 862 source rules to address income from guarantees. Under new IRC Section 861(a)(9), income from sources within the U.S. includes amounts received, whether directly or indirectly, from a noncorporate resident or a domestic corporation for the provision of a guarantee of indebtedness of such person. As a result, if paid by U.S. taxpayers to foreign persons, a guarantee fee will generally be subject to withholding tax. This provision applies to guarantees issued after the date of enactment.

17. Corporate estimated taxes. The Act increases the required payment of estimated tax for large corporations (those with assets of more than \$1 billion) otherwise due in July, August, or September of 2015 to 158.25% of the tax otherwise due. The next required installment is proportionately reduced to reflect the increase.

Please keep in mind that we have described only the highlights of some of the most important changes in the new law affecting income tax and retirement plans.

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Please contact your HM&M executive with any questions at 972/404-1010.

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