Congress Approves Small Business Bill

September 2010

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On September 27, 2010, President Obama signed legislation containing several tax incentives intended to promote capital and operational investment by large and small businesses alike. The legislation is part of a larger bill known as the "Small Business Jobs Act of 2010" ("SBJA"). Some of the key provisions allow for extension of bonus depreciation, the doubling of Code Sec. 179 expensing, and exclusion of 100 percent of the gain for qualified small business stock. The legislation also provides a more generous exclusion of the built-in gain for a sale of assets of an S corp that was previously a C corp.

Bonus Depreciation

The legislation allows for first-year 50% bonus depreciation for most new property, originally used by the taxpayer taking the deduction, through calendar year ending 2010. Eligible property generally includes new depreciable property with a recovery period of 20 years or less, computer software and qualified leasehold improvements. Unlike the Code Section 179 expensing deduction, there is no taxable income limitation on the bonus depreciation allowance. Taxpayers who have already made qualifying purchases in 2010 should be sure to take advantage of the available deduction when returns are filed.

Expensing Election Extended and Expanded

Under the new law, the Section 179 expensing election allows businesses with active trade or business income to immediately expense up to $500,000 of tangible personal property placed into service in 2010 and 2011. The maximum amount of the deduction begins to phase out when total eligible purchases exceed $2,000,000 (versus the existing $800,000 limit). Also, taxpayers may elect to expense up to $250,000 of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

If a taxpayer cannot deduct the full amount of the Section 179 deduction due to taxable income limitations, the excess deduction will carry forward to future years until there is sufficient taxable income available to offset the deduction. With respect to the new real estate provisions, any amount subject to the election that cannot be utilized in the tax year beginning in 2010 will be carried forward to 2011 and thereafter subject to normal depreciation rules for succeeding tax years as if a Section 179 election had not been made.

Built-in Gain on Disposal of S Corp Assets

In the past, an S corporation that had converted from a C corporation generally was required to pay built-in gains tax on any assets disposed of within the first ten years of converting to S corporation status. In 2009 and 2010, the holding period was decreased to seven years. The new law reduces the holding period further, to five years, on these assets disposed of in 2011. This means that C corporations that filed Subchapter S elections effective no later than the 2006 tax year will satisfy the five-year holding period at the end of the 2010 tax year.

Other key provisions provide a deduction for health insurance costs of self employed individuals, relax the strict business substantiation rules for cell phones, allow a carry back of up to five years for eligible small business credits and increase the deduction for start up costs for entrepreneurs. Business taxpayers should take note of the SBJA legislation and plan accordingly for the remainder of 2010 and into 2011.

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