GOLENBOCK EISEMAN ASSOR BELL & PESKOE LLP

CLIENT ALERT

The Small Business Jobs Act of 2010 (“SBJA”) has just been enacted, creating $12 billion in tax relief for small businesses and other taxpayers to encourage investment and job creation.

Below is a brief overview of some of the income tax saving opportunities in the SBJA.

Enhanced Section 179 Expensing

Under §179 of the Internal Revenue Code (“IRC”), a taxpayer may elect to expense the cost of certain tangible personal property, such as equipment, furniture and off-the-shelf computer software, <u>in the year of acquisition</u>, instead of deducting the costs more slowly through depreciation deductions. A business can claim the expensing election only to offset its net income, not to reduce net income below zero.

SBJA helps small business owners invest in their own businesses by increasing the IRC §179 expensing limit. For tax years beginning in 2010 and 2011, the limit is increased to $500,000, with a dollar-for-dollar phase-out starting when purchases for the year exceed $2 million. Thus, no expensing is allowed if acquisitions equal $2.5 million or more. Before SBJA, the 2010 expensing limit was $250,000, subject to an $800,000 acquisition limit, and the 2011 expensing limit was scheduled to drop to $25,000, with a $200,000 acquisition limit.

SBJA also temporarily expands the definition of eligible property to include qualified leasehold-improvement, restaurant and retail-improvement property. The maximum amount of such property that can be expensed is $250,000.

Extended Bonus Depreciation

The legislation provides for the extension of the special allowance for certain property, which generally applies if acquired in calendar year 2010. Businesses can recover the costs of qualifying depreciable property more quickly by immediately deducting 50% of the cost.

The following types of property qualify for this special bonus depreciation:

- Tangible property with a recovery period of 20 years or less;
- Computer software purchased by the business;
- Water utility property; and
- Qualified leasehold improvement property.

Bonus depreciation isn't subject to any asset purchase limits, so businesses ineligible for IRC §179 expensing can take advantage of it. In addition businesses that qualify for IRC §179 expensing can take bonus depreciation on asset purchases in excess of the $500,000 IRC §179 limit. Taxpayers should still keep in mind the $2 million IRC §179 phase-out threshold, because IRC §179 expensing is more beneficial than bonus depreciation

Increased Exclusion for Gains on Small Business Stock

To make investing in certain small businesses more attractive, SBJA temporarily increases the qualified small business (QSB) stock gain exclusion. The exclusion will be 100% for stock acquired after SBJA's enactment date (September 27, 2010) and before January 1, 2011, that's held for at least five years. Additionally, the act eliminates the alternative minimum tax (AMT) preference item on such gain, making it tax free for AMT purposes as well.

Extended Carry-Back of General Business Credit

SBJA extends the maximum carry-back period for the general business credit to five years for most privately held businesses. Eligible businesses include sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the previous three years. The extended carry-back period applies to credits generated in the tax year beginning in 2010.

The general business credit (the total of various credits) can't exceed certain limits. Normally, any credit in excess of the limits can be carried back only one year to offset taxes paid in the previous year, with any remainder carried forward up to 20 years to offset future tax liabilities. SBJA also allows the general business credit to offset 2010 AMT liability.

Reduced Recognition Period for S Corporation Built-in Gains Tax

SBJA temporarily reduces the asset holding period that S corporations which have converted from C corporations must meet to avoid built-in gains tax. For assets sold in the tax year beginning in 2011, the holding period will be five years.

Built-in gains tax is a corporate-level tax of 35% that's generally imposed on an S corporation's gain that (i) is the result of a sale of assets acquired before the business converted to an S corporation, and (ii) is recognized by the S corporation during the holding period. Normally, this is the 10-year period that begins on the first day of the first taxable year for which the S election is in effect. So to avoid the 35% tax, the S corporation generally must hold any appreciated assets for 10 years after the conversion.

In 2009, the holding period for assets subject to the built-in gains tax was reduced to seven years for assets sold in tax years beginning in 2009 and 2010.

New Breaks for the Self-Employed and Individuals

For the self-employed, SBJA permits a deduction, for 2010 self-employment tax purposes, of any costs incurred in 2010 for health insurance for a taxpayer and his or her spouse, dependents and children age 26 or under. This is an additional benefit as taxpayers could already deduct these expenses for income tax purposes.

Under SBJA, retirement plans organized under IRC §§401(k), 403(b) or 457(b) may allow (but do not require) a roll-over of any portion of pretax account balance into a Roth account. The amount of the rollover would be includible in your taxable gross income - except to the extent it's the return of any after-tax contributions. If the rollover is made in 2010, a participant can elect to pay the tax over a two-year period in 2011 and 2012.

Information Returns

Recipients of rental income from real estate will become subject to Form 1099-MISC filing requirements when making payments of $600 or more to service providers for payments made after December 31, 2010. Penalties for failing to file correct information returns are increased for all filers.

If you would like more information about the new IRS initiative or to discuss a particular set of facts please contact:

Jeffrey S. Berger: 212-907-7393 jberger@golenbock.com
Donald A. Hamburg: 212-907-7380 dhamburg@golenbock.com
Ian Shane: 212-907-7331 ishane@golenbock.com

October 1, 2010