



October 2010

To our business clients and friends:

On 9/27/10, President Obama signed into law the new Small Business Jobs Act of 2010. The legislation includes a number of taxpayer-friendly changes, which we are summarizing in this letter.

First-year Depreciation Deductions (IRC Section 179) Doubled for 2010 and 2011

The Section 179 deduction privilege allows many small and medium-sized businesses to immediately write off most, or all, of the cost of qualifying new and used assets in the first year instead of having to depreciate the cost off over a number of years. The new law doubles the maximum annual Section 179 deduction to \$500,000 for eligible assets placed in service in tax years beginning in 2010 and 2011 (up from the \$250,000 maximum that applied for tax years beginning in 2009). Most types of depreciable personal property (including computers, other equipment, and furniture) and most purchased software qualify. For the first time, some types of real estate improvement costs also qualify (more on that later).

However, larger businesses can lose all or part of the Section 179 deduction allowance due to an unfavorable phase-out rule. Under that rule, the allowance is reduced dollar for dollar by the cost of qualifying assets placed in service during the year (those that would otherwise be eligible for the Section 179 privilege) in excess of the applicable threshold. For tax years beginning in 2010 and 2011, the new law greatly increases the phase-out threshold to the quite-generous level of \$2 million (way up from the \$800,000 threshold for tax years beginning in 2009). Thanks to this change, far fewer businesses will be tripped up by the phase-out rule in 2010 and 2011.

Note: Watch out if your business already has a tax loss for the year, before considering any Section 179 deduction. You can't claim a Section 179 write-off that would create or increase an overall business tax loss for the year.

Some Real Property Improvement Costs Qualify for Section 179 Depreciation Deductions

Until now, real property improvement costs were ineligible for the Section 179 deduction. That's no longer true. For tax years beginning in 2010 and 2011, up to \$250,000 of qualified improvement costs for the following types of real property can be immediately deducted under the Section 179 deduction provision:

- Interiors of leased non-residential buildings.
- Restaurant buildings.
- Interiors of retail buildings.

The \$250,000 Section 179 allowance for real estate improvements is part of the overall \$500,000 allowance. Again, watch out if your business already has a tax loss for the year (or close) before considering any Section 179 deduction. You can't claim a Section 179 write-off that would create or increase an overall business tax loss for the year.

50% First-year Bonus Depreciation Retroactively Re-instated for 2010

The new law retroactively reinstates 50% first-year bonus depreciation for one year, to cover qualifying new (not used) personal property assets, and purchased software, placed in service by December 31, 2010. Before this retroactive change, the bonus depreciation provision had expired as of 12/31/09. It's now back for eligible assets placed in service by the end of this year.

Unlike Section 179 deductions, bonus depreciation is available to even the largest businesses. However, small and medium-sized outfits that can take advantage of both the Section 179 deduction, and bonus depreciation are the biggest winners.

Bigger First-year New Auto and Light Truck Depreciation Deductions for 2010

Say your business buys a new (not used) passenger auto or light truck during 2010 that's subject to the dreaded luxury auto depreciation limitations (most passenger vehicles are except for big SUVs, pickups, and vans). The reinstated 50% bonus depreciation write-off increases the maximum first-year depreciation deduction by \$8,000 for vehicles placed in service by 12/31/10.

- For new cars, bonus depreciation raises to the maximum first-year depreciation write-off for 2010 to \$11,060 (assuming 100% business use).
- For new light trucks, the maximum first-year depreciation deduction for 2010 is raised to \$11,160 (assuming 100% business use).

Start-up Cost Deduction Rule Liberalized for 2010

For tax years beginning in 2010, the new law increases the maximum deduction that can be claimed for start-up costs in the year when a new business commences operations to \$10,000 (up from \$5,000). However, the \$10,000 deduction allowance is phased out once cumulative start-up costs exceed \$60,000. Start-up costs that cannot be deducted in the year when business commences, under the \$10,000 allowance, can be amortized over 180 months, starting with the month when business commences.

QSBC Stock Sale Rules Liberalized for Shares Issued in Narrow Three-month Window

Before the new law, non-C corporation sellers of Qualified Small Business Corporation (QSBC) shares generally paid a 28% capital gains tax on only 50% to 25% of the gain on the sale of these shares (depending on when the QSBC shares were purchased). However, a percentage of the excluded gain was potentially subject to the Alternative Minimum Tax (AMT). To encourage new investments in QSBC stock, the new law exempts 100% of the gain realized on qualifying sales of QSBC shares that are issued between 9/28/10 and 12/31/10. This 100% exclusion applies for both the 28% capital gains tax and the AMT.

Note: The QSBC shares must be held for over five years to qualify for any of these gain exclusion breaks. Therefore, for the 100% exclusion to apply, we are talking about sales that will occur in 2015 and beyond. Also, there's only a three-month window of opportunity to acquire QSBC shares that qualify for the 100% exclusion. If you're interested in taking advantage of this, you'll need to close the deal by 12/31/10. Also, there are numerous additional rules that must be met for the stock to qualify as QSBC shares.

Break for S Corporation Built-in Gains Recognized in 2011

When a C corporation converts to S corporation status, the corporate-level built-in gains tax generally applies when built-in gain assets (including receivables and inventories) are turned into cash or sold within the recognition period. The recognition period is normally the 10-year period that begins on the conversion date. For tax years beginning in 2011, the new law exempts



gains from the built-in gains tax if the fifth year of the recognition period has gone by before the start of the 2011 tax year. Therefore, deferring asset sales that would generate built-in gains until 2011 is something to consider.

Eligible Small Businesses Get Special Treatment for 2010 General Business Credits

Effective for tax years beginning after 2009, cell phones and similar telecommunications devices used for business are no longer subject to the ultra-strict recordkeeping requirements that formerly applied. This retroactive change has some taxpayer-friendly consequences. For instance, a self-employed individual is no longer required to keep detailed usage records to prove that a cell phone is used for business. However, if the individual has only one cell phone that is used for both personal and business purposes, some sort of recordkeeping will still be necessary to determine allowable business deductions. An employee, who uses a personal cell phone for his or her employer's business, can claim the related costs as a miscellaneous itemized deduction, without having to prove the phone usage was for the employer's convenience.

Note: There's some speculation that the IRS might soon issue rules that would allow employers to provide cell phones to employees as a tax-free fringe benefit.

Health Insurance Premiums Can Be Deducted in Calculating 2010 Self-employment Taxes

Until now, a self-employed individual's federal income tax deduction for health insurance premiums could not be deducted as an expense, when calculating his or her self-employment tax liability, on Schedule SE.

Good news: For 2010, the health insurance premium deduction is allowed as an expense on Schedule SE. This can be a fairly big deal, especially if your health insurance deduction is significant.

Rental Property Owners Must Issue Form 1099's to Service Providers

Starting next year, owning a rental property will generally be considered a business, for purposes of the new Form 1099 reporting requirements. Therefore, rental property owners will generally be required to file a 2011 Form 1099, for any service provider that is paid \$600 or more, during 2011 (for things like yard care, painting, and accounting). Also, a copy of the Form 1099 must be provided to each payee.

Note: Starting in 2012, another tax-law change included in the healthcare reform legislation will impose onerous new Form 1099 reporting requirements for payments by all businesses. Since owning rental property is now considered a business, for reporting purposes under the Form 1099 rules, rental property owners will be impacted by the new reporting requirements.

Harsher Penalties for Failure to Comply with Form 1099 Reporting Rules

Starting next year, the IRS can assess much harsher penalties for failing to file Form 1099 information returns with the IRS, and for failing to send copies to payees (so-called payee statements). In many cases, the penalties will be doubled. The new rules will apply to Form 1099 reports due in 2011 and beyond.

Conclusion

We wanted to bring to your attention some of the more important aspects of the new legislation, but don't hesitate to contact us if you'd like to discuss how the new rules pertain to your particular circumstances.

We also want to let those of you who haven't heard already, know that Jennifer Seil has taken



over Sheril Walter's role, as staff accountant with our firm, so please welcome Jennifer when the opportunity arises.

Finally, with the rash of spam email activity attempting to steal your identity, and more, remember that the IRS does not send out email notices for error notification purposes, so if you receive an email notice that appears to be from the IRS, consider it a malicious spam email, and identify it in your spam filtering as such. If you have any specific concerns or questions about email correspondence you've received, don't hesitate to contact us about its authenticity.

As the year winds down, we will be sending out additional email correspondence, and tax season planning information, however if you have any specific tax or accounting concerns, please contact us by either phone or email, to discuss specifics and/or to set up an appointment.

Best Regards,
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