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Big Tax Changes In Small Business Tax Law

In my youth, tax bills had vanilla names, denoting revenue collection ("The Revenue Act of _______") or tax policy shifts ("The Tax Reform Act of __________"). But over the last few decades, Congress puts spin even on titles. There was the "Tax Equity and Fiscal Responsibility Act of 1992," the "Job Creation and Worker Assistance Act of 2002," the "Jobs and Growth Tax Relief Reconciliation Act of 2003," the "Working Families Tax Relief Act of 2004," the "American Jobs Creation Act of 2004" and so many more. You might think every major tax bill will create jobs and give everyone assistance. And the hits just keep on coming.

As tax bill names go these days, the recently enacted 2010 Small Business Jobs Act is pretty generic. But who knows if it will generate any jobs? The good news is that it contains many tax changes that may affect you. Here are some highlights:

Small Business (Section 179) Expensing. An immediate deduction is more attractive than depreciation that recoups costs ratably. Under old rules, you could generally expense up to $250,000 of certain property placed in service during the year. Machinery, equipment and software generally qualified. This $250,000 limit was reduced where the cost of property placed in service exceeded an investment limit of $800,000.

But for tax years beginning in 2010 and 2011, the $250,000 limit is increased to a whopping $500,000 and the investment limit to $2 million. Certain real property is even eligible: for property placed in service beginning in 2010 or 2011, the $500,000 amount can include up to $250,000 of qualified leasehold improvement, restaurant or retail improvement property.

100% Exclusion for Small Business Stock Gains. Ordinarily, individuals can exclude 50% of their gain on selling "qualified small business stock" (QSBS) held for at least five years. For more about QSBS, see Qualified Small Business Stock Ruling. This exclusion was temporarily increased to 75% for stock acquired after February 17, 2009 and before January 1, 2011. But now the exclusion is increased to 100% for QSBS acquired after September 27, 2010 and before January 1, 2011 and held for more than five years. The new law even eliminates the alternative minimum tax (AMT) preference item for these sales. See also Number Crunching and Qualified Small-Business Stock Gains.

Reduced S Corporation Holding Period for Appreciated Assets. A C corporation that converts to S status must retain appreciated assets for 10 years or face a "built-in gain" tax at the highest (35%) corporate rate. This law was enacted to prevent people from converting C corporations to S status and then selling to get just one level of tax. For more, see Transformers: Beware Built-in Gains. But the new law temporarily shortens the holding period to only five years if the fifth tax year precedes the corporation's tax year beginning in 2011.

Extension of 50% Bonus Depreciation. For property placed in service in 2008 or 2009, businesses could take a first-year write-off of 50% of the cost capital expenditures of most new tangible personal property. The new law extends this first-year 50% write-off to 2010 (as well as 2011 for certain aircraft and long production period property).

Startup Expenditures. Startup expenditures usually must be amortized (meaning deducted ratably) over five years, but there's been a limited immediate write-off of up to $5,000. The new law ups the cap to $10,000 for 2010. But if your startup costs get too high, the write-off is reduced by the amount by which startup expenditures exceed $60,000 (it used to be $50,000).

Five-Year Carryback of General Business Credits. Unused general business credits can usually be carried back to offset taxes paid the previous year. Unused amounts can be carried forward for 20 years to offset future tax liabilities. But beginning in 2010, eligible small businesses can carry back unused general business credits for five years instead of one. This applies to sole proprietorships, partnerships and non-publicly traded corporations with $50 million or less in average annual gross receipts for the prior three years.

No AMT for General Business Credits. You generally can claim allowable general business credits only against your regular tax liability, and only to the extent your regular tax liability exceeds your AMT. Only a few credits, like the credit for small business employee health insurance expenses, could be used to offset AMT liability. Now, eligible small businesses can use ***all*** general business credits to offset AMT in tax years beginning in 2010.

Deduction for Health Insurance From Self-Employment Tax. In figuring 2010 self-employment tax, business owners can deduct the costs of health insurance for themselves and family members.

For more about the 2010 Small Business Jobs Act, see:

2010 Small Business Jobs Act Special Report

US Small Business Administration

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