

TAX AND BUSINESS **Alert**™

December 2010

The President recently signed the Small Business Jobs Act of 2010 (2010 Small Business Act), which includes a number of provisions to spur business activity and create jobs. Listed below are some of the more important provisions of the 2010 Small Business Act. Please contact us if you have questions about these or other provisions of this recent legislation.

Section 179 First-year Depreciation Deductions 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 over a number of years. The 2010 Small Business Act increases 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, equipment, and furniture) and most purchased software qualify. For the first time, some types of real estate improvement costs also qualify (see the following topic).

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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.



Caution: Watch out if your business already has or is close to a tax loss for the year before considering any Section 179 deduction. You cannot claim a Section 179 write-off that would create or increase an overall business tax loss for the year.

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Business Cell Phone Restrictions Removed

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 used for both personal and business purposes, some 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 now claim the related costs as a miscellaneous itemized deduction without having to prove the phone usage was for the employer's convenience. 

New Health Insurance Premium Deduction

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. However, for 2010, a provision of the 2010 Small Business Act allows

the health insurance premium deduction as an expense against computing self-employment tax. This will reduce the self-employment tax liability in addition to reducing the federal income tax bill. This provision can be a fairly big deal, especially if your health insurance deduction is significant. By reducing the after-tax cost of health insurance coverage, this provision makes it easier for the self-employed individual to afford coverage or increase existing coverage. 

Deducting Corrosive Drywall Repair Costs

Numerous taxpayers have sustained damages to their homes from certain imported drywall installed between 2001 and 2008. Reported damage includes blackening or corrosion of copper electrical wiring and copper components of household appliances, as well as the presence of sulfur gas odors. In view of these unique circumstances, the IRS has provided a safe harbor method that treats certain damage resulting from corrosive drywall as a casualty loss and provides a formula for determining the amount of the loss.

A taxpayer who has a pending claim (or

intends to pursue reimbursement) can claim a loss for 75% of the unreimbursed amount paid during the tax year to repair damage to a personal residence and household appliances from corrosive drywall. However, taxpayers may have income or an additional deduction in subsequent years when the actual reimbursement is received.

A taxpayer who does not have a pending claim can claim all unreimbursed amounts paid during the tax year to repair damage from corrosive drywall. A taxpayer who has been fully reimbursed before filing a return for the year the loss was sustained cannot claim a loss.

The IRS will not challenge a taxpayer's treatment of the casualty loss if prescribed procedures are followed.

Please contact us if you have questions concerning this issue or any other tax compliance or planning matter. 



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Some Real Property Improvement Costs Now Qualify for Section 179

Until now, real property improvement costs were ineligible for the Section 179 deduction privilege. That is no longer true. For tax years beginning in 2010 and 2011, up to \$250,000 of qualified improvement costs for (a) interiors of leased nonresidential buildings, (b) restaurant buildings, (c) and interiors of retail buildings can be deducted immediately under the Section 179 deduction provision. However, 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 or is close to tax loss for the year before considering any Section 179 deduction. You cannot 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 Reinstated

The 2010 Small Business Act retroactively reinstates the 50% first-year bonus depreciation provision 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 on December 31, 2009. It is now back for eligible assets placed in service by the end of this year.

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

Bigger First-year Depreciation Deductions for New Autos and Light Trucks

If your business buys a new (not used) passenger auto or light truck during 2010 that is subject to the dreaded luxury auto depreciation limitations, the reinstated 50%

bonus depreciation write-off increases the maximum first-year depreciation deduction by \$8,000 for vehicles placed in service by December 31, 2010. Most passenger vehicles qualify except for big SUVs, pickups, and vans. 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).



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Business Start-up Cost Deduction Rule Liberalized for 2010

For tax years beginning in 2010, the 2010 Small Business Act increases the maximum deduction that can be claimed for start-up costs to \$10,000 (up from \$5,000) in the year when a new business commences operations. 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 business commences can be amortized (written-off) over 180 months, starting with the month business commences.

General Business Credits

Before the 2010 Small Business Act, most general business credits could be used to offset regular income taxes but not AMT. Also, general business credits that could not be used in the current year (unused credits) could be carried back one year or forward 20 years. The 2010 Small Business Act creates an exception that allows general business credits that arise in tax years beginning in 2010 to offset AMT for 2010. Also, unused general business credits from 2010 can be carried back five years or forward 20 years. However, these exceptions are only available to eligible small businesses with average annual gross receipts for the preceding three tax years of \$50 million or less. 

Borrowing from Retirement Plans

If you are unable (or prefer not) to borrow from a bank or other outside source, your qualified retirement plan may be a good option.



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IRS guidelines permit a limited amount of borrowing from corporate qualified retirement plans, including 401(k) plans. In general, borrowings are limited to 50% of the participant's account balance up to a maximum of \$50,000 and must be repaid within five years (unless the loan proceeds are used to purchase a principal residence). Hardship withdrawals (different from a

loan, which must be repaid to the plan) from 401(k) plans are also permissible in certain circumstances. However, hardship withdrawals are taxable and subject to a 10% penalty if made before age 59½.

Tax law generally prohibits borrowing from IRAs. However, a distribution from an IRA followed by a redeposit of the funds into the same account or another IRA within 60 days of receipt of the funds will qualify as a tax-free rollover transaction. Once you have made such a tax-free rollover, you must wait at least one year from the date of receipt of the amount

withdrawn from that particular IRA before becoming eligible to participate in another similar transaction. This once-per-year rule is applied individually to each IRA. Therefore, a person who has more than one IRA may make a rollover once per year on each account. Your use of the funds for the 60-day rollover period is, in effect, a short-term loan. It is recommended that you not implement this strategy without careful planning.

Example: Borrowing from an IRA.

Sue needs \$8,000 to pay her income taxes on April 15th. Her only liquid asset is her IRA account with a balance of \$63,000. However, she expects to receive an accident settlement of \$20,000 around May 15th. Sue can take an \$8,000 distribution from her IRA account and use these funds to pay her taxes due April 15th. If she redeposits the funds within 60 days, there are no tax consequences. She can use a portion of her settlement or other available funds for the redeposit to her IRA. If Sue does not receive her insurance settlement within 60 days and has no other source from which to repay the \$8,000 distribution, severe tax consequences can result. The distribution becomes taxable and is subject to the 10% penalty if Sue is under age 59½.

Please contact us if you have questions about the tax ramifications of borrowing from retirement accounts.



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