Tax Breaks for Entrepreneurs and Small Businesses in Small Business Jobs Act of 2010

President Obama recently signed into law H.R. 5297, the Small Business Lending Funding Act. The tax title of this bill, the “Small Business Jobs Act of 2010” (the Act, P.L. 111-240), contains a number of significant tax provisions affecting individuals and businesses. The Act includes approximately $12 billion in tax cuts - most notably an increase in asset expensing and a continuation of bonus depreciation - and attempts to ease credit lending to small businesses.

This blog entry highlights some of the Act’s tax breaks and incentives that may provide an immediate benefit to entrepreneurs and small businesses, including:

- Increased Deduction for Start-up Expenses;
- Increased Expensing Deductions plus Extension of Bonus Depreciation;
- First-Year Depreciation for Autos and Trucks Increased by $8,000;
- Cell Phones Removed from Definition of “Listed Property;” and
- Deduction for the cost of Health Insurance in Calculating Self Employment Taxes.

The blog entries to follow summarize the key provisions of these tax breaks and incentives, and address whether the provisions apply immediately, retroactively or prospectively.

<u>Promoting Entrepreneurship in 2010 - Increased Deduction for Start-up Expenditures</u>

For entrepreneurs that started a new business or who are planning to start a new business in 2010, the Act provides an increased deduction for start-up expenditures.

For tax years beginning in 2010 only, the Act increases the amount of start-up expenditures a taxpayer can elect to deduct from $5,000 to $10,000. The Act also increased the deduction phase-out threshold from $50,000 to $60,000 (i.e., the $10,000 amount is reduced, but not below zero, by the amount in which the cumulative start-up expenditures exceeds $60,000). The remainder of the start-up expenditures can be claimed as a deduction over the 180 month period beginning with the month the active trade or business began.

<u>Increased Expensing Deductions in 2010 and 2011 and Extension of Bonus Depreciation in 2010</u>

In order to help small businesses quickly recover the cost of certain qualifying property - generally, machinery, equipment and certain software - small business taxpayers had, subject to Internal Revenue Code Section 179 limitations, been able to elect to write off the cost of some or all of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. The Act encourages capital investments by allowing for faster cost recovery of business property, *including certain qualified real property*, and extends bonus first-year depreciation through 2010.

Section 179 Expensing Increased to $500,000, but only for 2010 and 2011

For tax years beginning in 2010 and 2011, the Act increases the Section 179 limit from $250,000 to $500,000, and the investment ceiling/phase-out threshold from $800,000 to $2,000,000. These expensing changes will create a windfall for those businesses that have already placed in service Section 179 eligible property in 2010 and which would not have been able to expense the full cost under prior law, but who are now able to under the Act.

These expensing changes may also have a windfall effect for small businesses in 2011. Under pre-Act law, the dollar limitation for tax years beginning after 2010 was set to be $25,000 and the phase-out threshold was set to be $200,000. The Act’s changes result in an increase of $475,000 to the limit and an increase of $1,800,000 to the phase-out threshold.

Considering the fact that the $25,000 dollar limit on expensing and the $200,000 phase-out threshold amount are both set to return for tax years beginning after 2011, the Act creates a huge incentive for small businesses to invest in capital in 2010 and 2011.

Section 179 Amended for 2010 and 2011 to Include Qualified Real Property

Under pre-Act law, qualifying property for purposes of the Code Section 179 expensing election was limited to depreciable tangible personal property purchased for use in an active conduct of a trade or business, including "off the shelf" computer software placed in service in tax years beginning before 2011.

The Act, however, also makes certain real property eligible for expensing. For property placed in service in any tax year beginning in 2010 or 2011, the 'up to $500,000' of property that can be expensed can include up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property).

Extension of 50% Bonus First-Year Depreciation

Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. The Act extends the first-year write-off of 50% of the cost to apply to qualifying property placed in service in 2010 (2011 for certain property).

<u>First-Year Depreciation for Autos and Trucks Increased by $8,000 for 2010</u>

Under Section 280F, first-year depreciation deductions for passenger autos, light trucks and vans are subject to dollar limits that are annually adjusted for inflation. For 2010, the dollar limit cap for passenger autos is $3,060, and $3,160 for light trucks and vans. The Act, however, increases the first-year depreciation limit by $8,000. Therefore, the maximum depreciation deduction for a passenger auto that is put into use in 2010 just increased from $3,060 to $11,060 (i.e., this deduction is more than tripled in 2010). If the vehicle is a light truck or van, the maximum first-year depreciation just increased from $3,160 to $11,160.

<u>Cell Phones Removed from Definition of "Listed Property"</u>

The Act removes cell phones and similar telecommunications equipment from the definition of "listed property." Consequently, for tax years beginning after December 31, 2009, the heightened substantiation requirements and special depreciation rules that apply to listed property no longer apply to cell phones. This makes it easier for almost all small businesses to deduct or expense the use of cell phones.

<u>Deduction for the cost of Health Insurance in Calculating 2010 Self Employment Taxes</u>

The Act creates a special rule that allows self-employed individuals to deduct health insurance costs incurred in 2010 for determining net earnings from self-employment for the purposes of calculating the tax on self-employment income.

Authored by: Stephen A. Stafford, J.D., LL.M.
Brown & Streza LLP
(949) 453-2900 x149
stephen.stafford@brownandstreza.com