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A Taxing Situation

Mining the benefits from the onslaught of new tax law changes

By Dennis Monroe

Much has been written about taxes this year, so I've asked my partner, Rick Gibson, an attorney and CPA (inactive) to collaborate on this month's column.

This latest onslaught of "tax news" started with Congress not addressing the sunset provisions in the estate tax laws at the end of 2009. This year has been all about health-care reform and the repeal (or possible extension) of the "Bush tax cuts."

The latest in this seemingly non-stop series of tax law changes is the recent enactment of the 2010 Small Business Jobs Act. The new law is touted as providing tax benefits to businesses and is intended to stimulate business spending and activity. Of course, as a new tax law, it is full of complex and technical provisions, some of which may have a familiar sound to them (i.e., extensions or modifications of previous tax law changes). The good news is there are actually opportunities for businesses to reduce tax liabilities with this new law.

Rather than recite the various provisions of this new law, we thought we would draw your attention to some specific provisions that might be helpful to the franchise business community:

Enhanced Small Business Equipment and Expensing (Section 179 Expensing—To help small businesses quickly recover the cost of capital outlays, small businesses can elect to write off these expenditures in the year they are made instead of recovering them through depreciation. Under the old rules, taxpayers could generally expense up to $250,000 of qualifying property—generally, machinery, equipment and software—placed in service in during the tax year. This annual limit was reduced if the cost of property placed in service exceeded $800,000. Under the Small Business Jobs Act, for tax years beginning in 2010 and 2011, the $250,000 limit is increased to $500,000 and the investment limit to $2 million. This provision is a significant opportunity to offset initial costs, or help finance capital improvements through immediate tax deductions.

Expensing of Real Property Expenditures—The new law 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). In view of the typical real estate required in a franchise business, and the normally long tax recovery period, this provision is a real and immediate tax savings for franchise businesses considering new locations.

Extension of 50 percent Bonus First Year Depreciation—Before the Small Business Jobs Act, Congress already allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property placed in service in 2008 or 2009 by permitting the first-year write-off of half the cost. The Small Business Jobs Act extends the first-year 50 percent write-off to apply to qualifying property placed in service in 2010. Together with the Section 179 Expensing, this tax law change provides meaningful tax benefits for franchisees making capital expenditures or opening new locations.

Boosted deduction for start-up expenditures—The Small Business Jobs Act allows taxpayers to deduct up to $10,000 in trade or business start-up expenditures for 2010. The amount that a business can deduct is reduced by the amount by which startup expenditures exceed $60,000. Previously, the limit of these deductions was capped at $5,000, subject to a $50,000 phase-out threshold. This change in the law is a further tax benefit, although limited in amount, to franchise businesses that are expanding.

A 100 percent exclusion of gain from the sale of small business stock—Ordinarily, individuals can exclude 50 percent of their gain on the sale of qualified small business stock (QSBS) held for at least five years. This percentage exclusion was temporarily increased to 75 percent for stock acquired after February 17, 2009 and before January 1, 2011.

Under the Small Business Jobs Act, the amount of the exclusion is temporarily increased yet again, to 100 percent of the gain from the sale of qualifying small business stock that is acquired in 2010 after September 27, 2010 and held for more than five years. In addition, the Small Business Jobs Act eliminates the alternative minimum tax (AMT) preference item attributable to such sales. Unfortunately, due to the technical requirements for the QSBS, these provisions have not previously yielded tax benefits for many in the franchise world and these changes will likely not make much of a difference.

S corporation holding period for appreciated assets shortened to five years—Generally, a C corporation converting to an S corporation must hold onto any appreciated assets for 10 years or face a built-in gain tax at the highest corporate rate of 35 percent. The 2010 Small Business Jobs Act temporarily shortens the holding period of assets subject to the built-in gains tax to 5 years if the 5th tax year in the holding period precedes the tax year beginning in 2011. For businesses considering a sale, this can be a significant boost in net tax proceeds from a sale transaction.

Monroe Moxness Partner Richard Gibson also contributed to this article.

Cell phones are no longer listed as property—This means that cell phones can be deducted or depreciated like other business property, without onerous record-keeping requirements. This change eliminates a previous administrative burden on businesses.

Deductibility of health insurance for the purpose of calculating self-employment tax—The Small Business Jobs Act allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

In view of the increased use of LLCs in today's business world and individuals reporting self employment income, this can be a meaningful deduction.

Of course these tax breaks come at a cost. In today's legislative environment, almost all "tax benefits" in new tax laws are subject to offsetting provisions to raise revenue. To mention a few of these unfavorable provisions, information reporting will generally be required for rental property expense payments made after December 31, 2010, and increased information return penalties will be imposed.

Are there really tax law changes that help businesses? Yes. The 2010 Small Business Jobs Act has several provisions that are beneficial to the franchise business community. If you have questions about the details of these new laws or how they may help your business, please contact us or consult your tax professional. FT

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