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Tax Memo

SMALL BUSINESS JOBS ACT

On September 27, the President signed the 2010 Small Business Jobs Act ("Act"). The Act has a number of provisions in it that are aimed directly at the taxes of small businesses. Among the provisions are the following:

Enhanced small business expensing (Section 179 expensing). Many people know Section 179 allows an immediate write-off for the purchase of some equipment and machinery that would otherwise have to be depreciated over a period of years. Under the old rules, taxpayers could generally expense up to \$250,000 of qualifying property—generally, machinery, equipment and software—placed in service during the tax year. This annual limit was reduced by the amount by which the cost of property placed in service exceeded \$800,000. Under the Act, for tax years beginning in 2010 and 2011, the \$250,000 limit is increased to \$500,000 and the investment limit to \$2,000,000. The Act also allows immediate write-offs for certain real property. For property placed in service in any tax year beginning in 2010 or 2011, the \$500,000 amount can include up

to \$250,000 of qualified leasehold improvement, restaurant and retail improvement property.

Extension of 50% bonus first-year depreciation. Before the Act, Congress had made provision for a special 50% bonus depreciation amount. The law allowed businesses to more rapidly deduct capital expenditures for most new tangible personal property placed in service in 2008 or 2009. The rapid write off was accomplished by permitting a special first-year bonus depreciation of 50% of the cost of most property and equipment. The Act extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (as well as 2011 for certain aircraft and long production period property).

Boosted deduction for start-up expenditures. Historically, "start-up" expenditures were capitalized, a portion deducted in the first year and the balance written off over a five-year period. The 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 start-up expenditures exceed \$60,000. Previously, the limit of these

deductions was capped at \$5,000, subject to a \$50,000 phase-out threshold.

100% exclusion of gain from the sale of small business stock. The Act now provides that in some situations, individuals can exclude 100% of the gain from the sale of certain qualifying small business stock. Previously, 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses) was excluded. This percentage exclusion was temporarily increased to 75% for stock acquired after Feb. 17, 2009 and before Jan. 1, 2011. Under the Act, the amount of the exclusion is temporarily increased yet again to 100% of the gain from the sale of qualifying small business stock that is acquired in 2010 after September 27 and held for more than five years. In addition, the Act eliminates the alternative minimum tax (AMT) preference item attributable to such sales.

General business credits of eligible small businesses for 2010 get five-year carryback. Generally, a business's unused general business credits can be carried back to offset taxes paid in the previous year, and

the remaining amount can be carried forward for 20 years to offset future tax liabilities. Under the Act, for the first tax year of the taxpayer beginning in 2010, eligible small businesses can carry back unused general business credits for five years instead of just one. Eligible small businesses are not always very small. Businesses with \$50 million or less in average annual gross receipts for the prior three years will qualify.

General business credits of eligible small businesses not subject to AMT for 2010. Under the AMT, taxpayers can generally only claim allowable general business credits against their regular tax liability and only to the extent that their regular tax liability exceeds their AMT liability. A few credits, such as the credit for small business employee health insurance expenses, can be used to offset AMT liability. The Act allows eligible small businesses to use all types of general business credits to offset their AMT in tax years beginning in 2010.

Deductibility of health insurance for the purpose of calculating self-employment tax. The 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.

Cell phones no longer listed property. Prior to the Act, cell phones were considered listed property. That brought in the rather onerous record-keeping requirements associated with any personal use of listed property (And who among us hasn't had a personal call or text message on his or her business cell phone?). The Act takes cell phones off the list of "listed property."

S corporation holding period for appreciated assets shortened to five years. In a rather significant change for many businesses, the "built-in gains" holding period has been changed by the Act. Generally, a C corporation converting to an S corporation must hold on to any appreciated assets for ten years or face a special tax (the "built-in gains tax") at the highest corporate tax rate of 35%. The Act temporarily shortens the holding period of assets subject to the built-in gains tax from ten to five years if the fifth tax year in the holding period precedes the tax year beginning in 2011.

New tax break for long-term contract accounting. The Act provides that in determining the percentage of completion under the percentage of completion method of accounting, bonus depreciation in 2010 is not taken into account as a cost. This prevents the bonus depreciation from having the effect of accelerating income.

Limitation on penalty for failure to disclose certain reportable transactions. The Act generally limits the penalty to 75% of the decrease in tax resulting from the transaction, applied retroactively to penalties assessed after Dec. 31, 2006. Minimum and maximum penalties apply.

There are many other provisions of the Small Business Jobs Act that we have not described in this brief summary. The tax professionals at Bever Dye, LC are available to discuss these with you when questions arise.

IS 2010 THE BEST YEAR EVER TO MAKE GIFTS??

For the first time since 1916, the United States does not have a federal estate tax. As most people know, the tax is scheduled to come back to life in 2011 with an exemption amount of \$1,000,000 and a top tax rate of 55%. Many of us think it is likely that Congress will act to increase that exemption to the range of last year (\$3,500,000) and impose a top tax rate of something in the range of 35% to 45% but that is still to be decided. Meanwhile, the federal gift tax still exists and applies to all "taxable gifts" in excess of \$1,000,000. What is different this year is the tax rate on those gifts. Instead of last year's rate of 45% or next year's rate of up to 55%, the rate on gifts this year is only 35%. This new, lower gift tax rate, coupled with depressed values for many assets, make 2010 perhaps the best year ever for sophisticated gifting techniques to reduce the ultimate burden of transfer taxes on one's estate. Here is a simple example:

Father has a \$10,000,000 estate and one son. Father gifts \$3,000,000 to son in 2010 and pays gift tax of \$700,000. Father dies three years later, and the son receives the balance of father's property. Son pays an estate tax of \$3,465,000 on what he receives at that time. The estate tax actually could be less than that if the IRS gives the estate credit at the prevailing estate tax rate (55%) for the gift tax paid in 2010 (which was paid at the rate of 35%). To show the savings, contrast this result with what would have happened had the Father not made a gift. If no gift was made in 2010, then the son would have received the full \$10,000,000 in

2013 and paid an estate tax at that time of \$4,950,000. The total tax savings due to the \$3,000,000 gift is \$785,000. Of course, this illustration assumes we have an estate tax in 2013 at the 55% rate. If the tax rate in 2013 is reduced to the same rate as the gift tax (35%), there would still have been a tax savings of \$245,000 because there would have been no estate tax on the funds used to pay the gift tax. There are many factors to consider before embarking on a gifting program, particularly one which involves the payment of tax. The tax professionals at Bever Dye, LC will be happy to help people evaluate the attractiveness of a gifting program at this time.

SHOULD EVERYONE HAVE A "LIVING TRUST"?

A "living trust" arrangement is generally a revocable trust instrument designed to act as a "Will substitute" at death. The instrument usually names the individual creator as the trustee (it may also involve a spouse, child, or financial institution as trustee or co-trustee). The instrument also recites that during the individual's lifetime, the individual has unrestricted access to the property in the trust and can change, modify, or amend it at any time. The instrument goes on to describe how the property is to be held and distributed after death.

These types of trusts are referred to as "living trusts" because individuals set them up well in advance of death. The primary advantage of such an arrangement is to avoid the probate process. By creating such a trust arrangement and retitling all of the property one owns into the trust name, the need

to use a Will and have a probate proceeding is eliminated.

Generally speaking, avoiding the probate process is a good idea. The process is really a normally friendly lawsuit which takes place in the state court where an individual lived. Like any lawsuit, it involves a great deal of paperwork within the court system, published notices, court appearances, and some built-in time periods. The process is also a public process. Interested individuals can check out the probate file of a deceased person to learn what property the individual owned, the value of that property, and to whom it passes. And, if an individual owns property in more than one county or more than one state, the process will need to be repeated in the other jurisdictions.

It is important to realize in some cases it may be better to probate, and the probate process take place in the open and under the supervision of a judge. And, there are some techniques (such as a "descent proceeding") which may simplify the normal probate process.

The tax savings techniques that are often employed in these trust arrangements are equally available when using Wills, so these arrangements do not have any inherent tax advantages. Nevertheless, when one compares the usual cost and publicity of a probate process with the simplicity and ease of a living trust, the living trust arrangement will usually be the desired vehicle. Since the cost of creating and maintaining such an arrangement is somewhat more than the cost of a Will, most people will decide to defer creating such an arrangement until the later stages of life. And, in some

situations, there are some other "probate avoidance" techniques available which are very adequate for individual situations such as a transfer on death deed to transfer ownership of one property to one heir. The estate planning professionals at Bever Dye, LC will be happy to assist individuals in evaluating all available techniques.

HEALTH INSURANCE TAX CREDIT FOR SMALL BUSINESSES

Beginning this year, qualifying small business employers will be eligible to receive a tax credit for providing health care coverage to their employees. The credit is designed to offset part of the employer's cost of providing health insurance. The credit is available to employers who have between 10 and 25 full-time employees. For employers with part-time employees, their working time is accumulated and averaged and goes into the measurement of full-time employees.

The full amount of the credit is available only to an employer with ten or fewer full-time (or equivalent) employees whose wages average less than \$25,000. Employers who have more than 10 but less than 26 full-time (or equivalent) employees may still receive a credit, but it is adjusted downward from the maximum. If the employee wages average more than \$50,000, there will be no credit available.

To be eligible for the subsidy, the eligible employer must pay at least 50% of the premium cost of the qualifying health plan. The credit is then calculated as a percentage of the small business employer's

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premium cost. The credit will be equal to the lesser of:

1. The amount of contributions the employer made on behalf of the employees during the taxable year for the qualifying health coverage multiplied by the applicable tax credit percentage; or

2. The amount of contributions that the employer would have made during the taxable year if each employee had enrolled in coverage with a benchmark premium (based on a comparable group market coverage) multiplied by an applicable tax credit percentage. The benchmark premium will be determined annually by the Department of Health and Human Services and published by the IRS by the end of April.

For purposes of applying the credit, self-employed individuals, including partners and sole proprietors, 2% shareholders of an S corporation, and 5% owners of an employer are disregarded for purposes of the credit. Additionally, special rules apply to tax-exempt organizations.

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