Changes Affecting Businesses

Some significant changes have been made by the Tax Relief Act of 2010 (2010 TRA) to provide and extend incentives for investment in machinery and equipment and increase business activity. Many of these will be advantageous to small business operators, including farmers and ranchers.

Extension of Investment Incentives

Business operators generally deduct the costs of machinery, equipment, or structures, which have a useful life of more than a year, through depreciation. For income tax purposes, the depreciation for most business and investment property is calculated using the Modified Accelerated Cost Recovery System (MACRS).[8] In addition to the MACRS depreciation, business owners may elect to deduct additional depreciation in the year the property is purchased to save taxes and thus, provide an incentive for such investments. Two different elections are available. The first is called the "Section 179 Expensing Election" and the second is "Bonus Depreciation" or additional first-year depreciation. These two elections can also be combined in some situations. The bonus depreciation can be claimed after any section 179 expense deduction and before figuring the regular depreciation under MACRS. Remember, these are elections; taxpayers may opt to forego these additional first-year deductions and stay with the MACRS. The only requirement is that for first-year bonus depreciation, all assets in the same property class must be treated the same. For Section 179 expenses, each asset can be handled differently.

Section 179 Expensing Election. Businesses have the option of taking an immediate deduction in the year of purchase for all or some of the cost of tangible personal property in lieu of depreciation. The purchased property may be new or used, but in the case of a trade-in (like-kind exchange) only the "boot" paid is eligible for expensing. This Section 179 election was expanded by the Small Business Jobs Act of 2010 (SBJA), signed into law on September 27, 2010. The 2010 SBJA increased the maximum amount a taxpayer may elect to expense to $500,000 in 2010 and 2011 (previously $250,000). This maximum amount is reduced dollar-for-dollar when the amount of qualifying property placed in service during the year exceeds $2 million (previously $800,000). The 2010 SBJA also added off-the-shelf computer software as qualifying property for 2010 and 2011.[9] Keep in mind that the amount of Section

[8] The MACRS calculations are explained in the *Farmer's Tax Guide*, published by the IRS, chapter 7. http://www.irs.gov/pub/irs-pdf/p225.pdf

[9] The amount deducted as a Section 179 expense in a tax year may not exceed the taxable income of the trade or business. The amount not allowed as a deduction because of the taxable income limitation may be carried forward.

179 deduction claimed, if any, reduces the property's basis for purposes of regular depreciation deductions in subsequent years.

The 2010 TRA sets the maximum amount of qualifying property purchases a taxpayer may expense under Section 179 to $125,000 (indexed for inflation) for the 2012 tax year. This amount is reduced dollar-for-dollar when the amount of qualifying property placed in service during the year exceeds $500,000. The TRA also extends the definition of off-the-shelf computer software as qualifying property through 2012. After 2012, the maximum amount that can be expensed drops to $25,000 with reductions beginning when the total cost of qualifying property placed in service during the year exceeds $200,000.

Table 5. Changing Provisions for Section 179 Expensing and Bonus Depreciation Options

Year	Max Sec. 179 Deduction	Sec. 179 Purchase Limit	1st Year Bonus Depr.
2009	$250,000	$800,000	50%
2010	$500,000	$2,000,000	50%/100%[a]
2011	$500,000	$2,000,000	100%
2012	$125,000	$500,000	50%
2013	$25,000	$200,000	50%[b]

[a] The deduction is 50% for purchases before 9/9/2010 and 100% for those made 9/9/2010 and after.
[b] The 50% bonus is extended through 12/31/2013 for certain property with a recovery period of 10 years or longer and certain transportation property, defined as tangible personal property used in the trade or business of transporting persons or property.

50% and 100% Bonus Depreciation Options. Under the prior law, additional or bonus depreciation was allowed in the first year for qualified property. This bonus depreciation was equal to 50% of the adjusted basis of the property and allowed for both regular tax and AMT purposes. Among the requirements to qualify for bonus depreciation are that the property must be new; it must be MACRS property with a recovery period of 20 years or less; and it must be purchased and placed in service during the relevant time period. In the case of trade-ins (like-kind exchanges), the bonus depreciation can be claimed on the entire basis (the remaining depreciation or book value of the relinquished property plus the "boot" paid). Any first-year bonus depreciation claimed reduces the property's basis for purposes of regular depreciation deductions in subsequent years.

The 2010 TRA extends and expands the first-year bonus depreciation (Table 5):

- The first-year depreciation options are expanded by allowing businesses a depreciation deduction of up to 100% of the cost of qualified new (not used) property acquired and placed in service from September 9, 2010, through December 31, 2011(with an extension of one year for certain longer-lived and transportation property[10]). The new law does not place a dollar limit on the amount of qualified property eligible for the 100% write-off.

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[10] This includes certain property with a recovery period of 10 years or longer and certain transportation property, defined as tangible personal property used in the trade or business of transporting persons or property.

- For property placed in service after December 31, 2011, and through December 31, 2012, the 2010 TRA extends the 50 percent first-year bonus depreciation option. The 50% bonus depreciation will also apply to certain long-lived and transportation property placed in service in 2013.

Some special constraints apply to the first-year bonus depreciation option:

1. All property in the same class (3-year property, 5-year property) must be treated the same way.[11] The taxpayer may either claim bonus depreciation for all 3-year property purchased during the year or for none of it. For example, if bonus depreciation is claimed for a new truck, which is 5-year property, purchased in 2011, then bonus depreciation must be used for all 5-year property placed in service that year.
2. If the taxpayer claims bonus depreciation, it will be either 50% or 100% depending on when the property was purchased. Assets purchased from September 9, 2010, through December 31, 2011, in the same property class must take 100% – the choice is 0 or 100% for each class. Before September 9, 2010, and after December 31, 2011, the choice is 0 or 50%.

Comparing the Section 179 Expense and Bonus Depreciation Options. Several factors should be considered in deciding whether or not to elect one or both of these options and if so, when.

- Depending on the size of the eligible purchases, these deductions could be potentially large resulting in a significant reduction in taxable income. That may work well in a year when net income is expected to be high, but may not be as advantageous in a less prosperous year.
- The timing of the purchases will affect the amount of the tax benefit. Property purchased in 2011 is eligible for 100% bonus depreciation, but for property purchased in 2012, it will be 50%. The maximum deduction for Section 179 expense is $500,000 in 2011, $125,000 in 2012, and $25,000 after 2012.
- The amount of the Section 179 deduction cannot exceed the taxable income from the taxpayer's trades and businesses. Any excess deduction above the trade or business taxable income can be carried over and deducted in the next year subject to certain Section 179 limits. The first-year bonus depreciation in excess of taxable income, however, creates a net operating loss, which can be carried back to previous tax years or forward.
- The amount of the Section 179 expense that can be deducted is reduced if the total cost of qualifying property purchased exceeds $2,000,000 in 2011 and $500,000 in 2012.
- What types of property will be purchased? Some items, like machinery sheds, shops, and general purpose farm buildings (tangible property with a MACRS depreciable life of 20 years or less and that meet certain requirements), are eligible for bonus depreciation, but not Section 179 expensing.
- Only property purchased new is eligible for the first-year bonus depreciation. Both new and used is eligible for Section 179 Expensing.

[11] The nine typical property classifications are (1) 3-year property, (2) 5-year property, (3) 7-year property, (4) 10-year property, (5) 15-year property, (6) 20-year property, (7) 25-year property, (8) residential rental property, and (9) nonresidential real property.

- If the property is acquired through a trade (like-kind exchange), only the boot portion is eligible for Section 179 expensing. The entire adjusted basis of property acquired through trade-in is eligible for the first-year bonus depreciation.
- If the property qualifies for both options, both can be claimed with the bonus depreciation taken after the Section 179 expensing.
- If several assets are being purchased during the tax year that fall in the same MACRS class, remember that they must all be treated the same with respect to the first-year bonus depreciation. Each asset can be treated differently, however, for Section 179 expensing.

These depreciation options do not increase the total deductions over time. They simply accelerate the cost recovery, moving the deductions to an earlier year and leaving smaller deductions in later years. The enhanced cash flow from the tax saving can be advantageous for paying off any loans or making investments. Accelerating the depreciation, however, will reduce deductions in future years, which may mean result in higher taxable incomes.[12]

Impact of Depreciation Options on AMT. In general, taxpayers must refigure depreciation for purposes of computing taxable income for the Alternative Minimum Tax. Important exceptions are provided, however, for the options discussed here:

- You do not need to refigure depreciation for the AMT for any part of the cost of any property for which you elected to take a Section 179 expense deduction. The Section 179 expense deduction is the same for the regular tax and the AMT.
- Likewise, for assets subject to bonus depreciation, the rules are the same for both regular tax and AMT purposes. The 100% and 50% first-year bonus depreciation rules apply for both regular tax and AMT purposes. In addition, there is no AMT adjustment with respect to regular MACRS depreciation deductions for the remaining 50% of the cost of property subject to 50% bonus depreciation.

Other Business Provisions

Deduction of Health Insurance for Self-Employeds. Self-employed taxpayers have been able to deduct health insurance premiums for purposes of computing their income taxes for several years. However, the deduction for health insurance was not allowed for the purposes of calculating Social Security and Medicare taxes. Now, effective for 2010 returns, the Small Business Jobs Act of 2010 allows self-employed individuals to deduct the cost of health insurance for themselves and their families for the purposes of computing Social Security and Medicare taxes. This provision, however, applies only to the 2010 tax year.[13]

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[12] For new passenger automobiles or light trucks purchased for business use, there are limits on the depreciation deductions allowed. See the IRS 2010 Instructions for Form 4562. http://www.irs.gov/pub/irs-pdf/i4562.pdf.

[13] For more information and an example, go to https://ruraltax.org/htm/se-tax.

Employee Benefits. The following 2010 TRA provisions affect the taxation of benefits provided to employees:

- Under the new law, employers may continue to provide employees up to $5,250 of non-taxable educational assistance (including assistance for undergraduate and graduate-level courses) through 2012.
- The monthly income exclusion limit for employer-provided transit pass and vanpooling benefits will continue to be the same as the limit for parking benefits through 2011.
- The credit for employer-provided child care is extended through 2012. This credit is for employer expenses up to $150,000 for acquiring, constructing, rehabilitating or expanding child care facilities.
- Benefits provided under an employer's adoption assistance program are also income-tax free up to $13,170 for the 2010 tax year, $13,360 for 2011, and $12,170 for 2012 (adjusted for inflation after 2010). The adoption assistance exclusion is phased out once an employee's income exceeds a specified level.

Business Credits. The 2010 TRA extends several business tax credits that expired at the end of 2010 or before. Here are some examples:

- The Work Opportunity Tax Credit is extended by four months to apply to wages paid to certain individuals who begin work for an employer between September 1, 2011, and December 31, 2011. This tax credit is equal to 40 percent of the first $6,000 of wages paid to new hires of one of nine targeted groups.
- The Research Credit is retroactively extended for two years, 2010 and 2011.
- The Differential Wage Credit (for wage payments to employees serving on active duty in the U.S. uniformed services) is retroactively restored and extended two years through 2011.
- Energy-Efficient Appliance Credit with modifications is extended one year for manufacturers and covers appliances manufactured in 2011.
- The Energy-Efficient Home Credit (available to contractors that construct qualified new energy-efficient homes and to energy-efficient manufactured home producers) is retroactively extended two years for homes sold by December 31, 2011, for use as residence.
- The New Markets Tax Credit for equity investments in a qualified community development entity is retroactively extended for two years through 2011, subject to an annual limitation on the amount of equity investments allowed nationwide.

Provisions Related to Biofuels. The following provisions of the 2010 TRA will be of interest to farmers, ranchers, and producers of biofuels:

- The tax incentives (excise tax credit) for alcohol fuel and alcohol mixtures are extended through December 31, 2011. The cellulosic biofuel producer credit will continue to be available through December 31, 2012.

- The biodiesel and renewable diesel fuel credits are extended through 2011. These income tax and excise tax credits are now allowed for biodiesel and renewable diesel fuels produced, sold or used on or before December 31, 2011.
- The excise tax credits and refund rules for alternative fuels and alternative fuel mixtures are extended through December 31, 2011.

Contributions of Capital Gain Real Property for Conservation. The 2010 TRA extends the liberalized deduction rules for qualified contributions of capital gain real property for conservation purposes, which were scheduled to expire at the end of 2009. Qualified conservation contributions are charitable donations of real property interests, including remainder interests and conservation easements that restrict the use of real property. The new law retroactively extends for 2010 and 2011 the rules permitting qualified farmers and ranchers to deduct up to 100% of the fair market value of the contribution and to carryover any unused deduction for up to 15 years.

Additional Provisions Related to Charitable Contributions. The 2010 TRA extends the following provisions through December 31, 2011:

- Taxpayers engaged in a trade or business will be able to continue to claim an enhanced charitable deduction for food inventory contributions. These are items fit for human consumption contributed to a qualified charity or private operating foundation for use in the care of infants, the ill, or the needy.
- C corporations may claim an enhanced charitable deduction for donations of books to public schools (kindergarten through grade 12).
- Corporations making qualified computer contributions to certain educational organizations or public libraries may claim an enhanced deduction.
- For contributions made by a Subchapter S corporation, the shareholders will reduce their stock bases by their pro rata share of the adjusted basis of the contributed property (even if such deductions would exceed such shareholder's adjusted basis in the S corporation), rather than the shareholder's pro rata share of the fair market value of the contributed property.

Extension of small business capital gains exclusion. Small business corporations contemplating the sale of stock have another year, through 2011, to take advantage of a provision that allows non-corporate taxpayers who purchase that stock to exclude the gain from its sale if it is acquired at original issue and held five years.[14] The Small Business Jobs Act of 2010 (enacted last September) temporarily increased the gain exclusion to 100% (within limits) for sales of qualified small business corporation stock issued after September 27, 2010 and before January 1, 2011.[15]

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[14] The 2010 TRA also provides that these excluded gains from selling the stock will not count as an AMT preference item.

[15] Qualifying small business stock is from a C corporation whose gross assets do not exceed $50 million (including the proceeds received from the issuance of the stock) and meets a specific active business requirement.

Accumulated Earnings Tax. The accumulated earnings tax is imposed on regular C corporations that allow earnings and profits to accumulate instead of being divided or distributed to shareholders and subject to income taxes. The 2010 TRA extends the 15% tax rate on accumulated taxable income of C corporations for taxable years beginning in 2011 and 2012. In the absence of this Act, the rate would have been 20%.

Recently Added 1099 Reporting Requirements Repealed. Both the Patient Protection and Affordable Care Act of 2010 (PPACA) and the Small Business Jobs Act of 2010 (SBJA) expanded the form 1099 reporting requirements for payments made by businesses and landlords. Because of concerns about the time and costs that this reporting would impose on taxpayers, on April 5, 2011, Congress repealed the provisions of these two laws that imposed these added requirements. However, information reporting requirements are not completely eliminated as the previous reporting requirements in place prior to the 2010 legislation will continue.

Taxpayers engaged in a trade or business are still required to provide a Form 1099-MISC to every individual payee to whom they made payments for rent, services, or interest totaling $600 or more in any taxable year. Payments to corporations are exempt. If an IRS audit finds that the taxpayer did not file the required forms, the result could be substantial penalties.