

Take Advantage of Expiring Tax Provisions to Encourage Business Investments

Action Required Before December 31, 2011

Last year, Congress passed the Small Business Jobs Act of 2010 and later the Tax Relief Act of 2010. These Acts contained provisions intended to encourage investments in and by businesses. Time is running out to take advantage of a number of these provisions.

100% Exclusion for Qualified Small Business Stock

Section 1202 of the Internal Revenue Code allows a non-corporate taxpayer who has held “qualified small business stock” (or “QSBS”) for more than five years to exclude a portion of the gain recognized on a sale of the stock. For stock to be QSBS, it must have been acquired upon original issuance (or by inheritance, gift or, under certain circumstances, distribution from another who acquired the stock upon original issuance) from a C corporation that, among other things, satisfies certain “qualified small business” and “active business” requirements. The “qualified small business” requirement limits the applicability of Sec-

tion 1202 to stock issued by corporations with aggregate gross assets of \$50 million or less. The “active business” requirement limits the applicability of Section 1202 to corporations most of whose assets are used in one or more “qualified trades or businesses” (which exclude, among other things, providing professional services such as law, engineering, accounting and actuarial science). In addition, the corporation may not have redeemed more than *de minimis* amounts of its outstanding stock within specified periods of time before or after the issuance of the stock in question. “Look-through” rules can allow an S corporation or partnership to pass the benefits of Section 1202 through to its owners.

From the enactment of Section 1202 in 1993, the maximum excludible portion was 50%. Unfortunately, the non-excluded portion has generally been taxed since 2001 at a 28% rate. In addition, a portion of any excluded gain has generally been a preference item under the alternative minimum tax. Given the rate at which the unexcluded portion is taxed, Section 1202 lost much of its luster in 2003 when the maximum rate generally applicable to long-term capital gains from stock sales

was reduced to 15%. The American Recovery and Reinvestment Tax Act of 2009 breathed some new life into Section 1202 by increasing the maximum excludible portion to 75% for QSBS acquired after February 17, 2009 and before January 1, 2011.

Under the Small Business Jobs Act of 2010, the maximum excludible portion of the gain on the sale of QSBS acquired by December 31, 2010 (and after the date of enactment of the Small Business Jobs Act) and held for more than five years was increased to 100%. In addition, no portion of the excluded gain is a preference item under the alternative minimum tax. The Tax Relief Act of 2010 extended the 100% exclusion for qualified small business stock to January 1, 2012.

Extended Bonus Depreciation

The post-9/11 stimulus provisions that Congress added to the Internal Revenue Code included Section 168(k). In general, Section 168(k)

continued...

Tax Alert is intended as an information source for clients and friends of MBBP. It should not be construed as legal advice, and readers should not act upon information in this article without professional counsel.

© 2011 Morse, Barnes-Brown & Pendleton, P.C.

 **MORSE
BARNES-BROWN
PENDLETON** PC
The law firm built for business.®

allowed a taxpayer acquiring and placing certain qualifying property in service by a deadline date to claim a percentage of the cost of the property as “bonus” depreciation for the year in which the property was placed in service. Most recently, the percentage of the cost that was allowed as bonus depreciation was 50%. Qualifying property, for purposes of Section 168(k), was generally new, depreciable, tangible personal (i.e., not real estate) property with a recovery period of 20 years or less. Qualifying property also included computer software not subject to 15-year amortization under Section 197 of the Internal Revenue Code, certain “water utility property” and certain “qualified leasehold improvement property.” Before the enactment of the Small Business Jobs Act, the deadline date by which qualifying property had to be acquired and placed in service was December 31, 2009 (or December 31, 2010 for certain transportation property, aircraft or property with a recovery period of at least 10 years).

The Small Business Jobs Act extended the deadline date by which qualifying property must be acquired and placed in service to December 31, 2010 (or December 31, 2011 for certain transportation property, aircraft or property with a recovery period of at least 10 years). The Tax Relief Act of 2010 expanded the first-year depreciation deduction to 100% of the cost of qualified property placed in service after September 8, 2010 and before January 1, 2012 (or January 1, 2013 for certain transportation property, aircraft or property with a recovery period of at least 10 years).

Please contact one of this article’s tax law authors, Chip Wry, Bob Finkel or Diana Española, to learn more about these expiring tax provisions designed to increase investment in and by businesses.

This article is not intended to constitute legal or tax advice and cannot be used for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing or recommending any transaction or matter addressed herein.

The **MBBP tax practice** focuses on guiding our clients through the minefields of federal and state tax that may impact their transactions, and helping them to structure their transactions in the most tax efficient manner.

Diana C. Española – despanola@mbbp.com

Robert M. Finkel – rfinkel@mbbp.com

Donald W. Parker – dparker@mbbp.com

Charles A. Wry, Jr. – cwry@mbbp.com

