Business Tax Update
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Public Law 111-240,
the Small Business Jobs Act of 2010:

- Increases for 2010 tax years the amount of start-up costs that can be expensed from $5,000 to $10,000 with the phaseout in costs increased from $50,000 to $60,000 (amounts not expensed continue to be amortized over 15 years).

- Increases the maximum first year expensing of capital expenditures to $500,000 for 2010 and 2011 tax years with the phaseout commencing at $2 million.

  [MODIFIED BY P.L. 111-312]

- Expands the definition of property which can be expensed for 2010 and 2011 tax years to include up to $250,000 of certain real property (no heating or air conditioning units) including qualified household improvement property, qualified restaurant property and qualified retail improvement property (must be more than three years after building is placed in service; no structural, enlargements, elevators or escalators); amounts expensed which are unused after 2011 because of the income limitation are then treated as if placed in service in 2011.

  [EFFECTIVELY MODIFIED BY P.L.111-312]

- Extends 50 percent bonus depreciation and adds $8,000 first year depreciation for vehicles in the case of property placed in service before January 1, 2011.

  [MODIFIED BY P.L. 111-312]

- Extends the ability to revoke an expensing election and the eligibility of software for the election through 2011.

- Eliminates the strict substantiation requirement for employer-provided cell phones as listed property effective 2010 tax years.

- Allows general business credits from 2010 tax years to be carried back five years irrespective of whether the particular credit was in effect in the carryback year and to be utilized by businesses (except public companies) averaging less than $50 million in revenues from 2007 through 2009 to offset an alternative minimum tax in 2010 or in any carryback year.

- Increases the exclusion for "qualified small business stock" (certain C corporation stock) from 75 percent to 100 percent of gain and eliminates the alternative minimum tax preference in each case on such stock held for more than five years if acquired after September 27, 2010 and before January 1, 2011.

  [EXTENDED BY P.L. 111-312]

- Eliminates the built-in-gain tax for 2011 tax years of S corporations if five years as a C corporation have passed before the start of 2011.

- Provides for 2010 tax years that a self-employed individual's family health insurance costs are deductible in determining net earnings from self-employment for purpose of the SE tax.

- Increases penalties for failure to file most types of information returns effective for filings required after 2010 but reduces the penalties for failing to report "reportable" and "listed" transactions for post-2006 assessments.

- Provides that IRS may levy prior to the collection due process (CDP) hearing on federal contractors.

Public Law 111-312, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010:

- Creates 100 percent bonus depreciation (not subject to income limitations) for most new tangible personal property placed in service after September 8, 2010 and before 2012, retaining 50 percent bonus depreciation for 2012; the $8,000 additional first year added bonus depreciation for new vehicles continues through 2012.

- Sets a limit on expensing of most tangible personal property for 2012 tax years of $125,000 indexed with the phaseout commencing at $500,000 indexed of such acquisitions.

- Continues through 2011 the 15-year writeoff for qualifying leasehold improvements, restaurant improvements and retail improvements not eligible for expensing (applied after bonus depreciation for qualifying leasehold improvements).

- Extends the research credit, the differential wage payment credit for service members and (for most groups) the work opportunity credit through 2011.

- Extends the 100 percent exclusion on disposition of "small business stock" in most C corporations to stock acquisitions in 2011.

Public Law 112-9, the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, repealed the previously enacted expansion of the use of Forms 1099 including its applicability to products and payments made generally to corporations.

Public Law 112-10, the Department of Defense and Full-Year Continuing Appropriations Act, repealed the provisions of the Healthcare Legislation dealing with "free choice vouchers" as an alternative to employer sponsored health insurance.

Proposed Regulations under Code Section 168, permit a dropdown from 100 percent to 50 percent bonus depreciation despite contradictory instructions in the 2010 Form 4562.

Final Regulations under Code Section 3402 delay the three percent withholding requirement on payments to governmental contractors one year until 2013 exempting those made by a state instrumentality or political subdivision making less than $100 million of payments to contractors annually.

Final Regulations under Code Section 6302 eliminate paper deposits and require electronic payment for taxpayers not coming under the existing *de minimis* rules effective January 1, 2011.

In Freda v. Commissioner, 108 AFTR2d 2011-_____, a divided Seventh Circuit Court of Appeals agreed with the Tax Court that a payment to settle trade secret litigation is ordinary income determined by the nature and basis of the action.

In Herrington v. Commissioner, TC Memo 2011-73, a business owner was permitted to deduct a theft loss representing funds taken by her boyfriend where she remained silent because he physically abused her and intimidated her verbally with threats to kill her and her children.

In Gudmundsson v. United States, 107 AFTR2d 2011-852, the Second Circuit Court of Appeals agreed with a New York Federal District Court that income must be recognized by an employee on receipt of an employer's stock despite a one-year inability to transfer the securities in the public market because certain private transfers were permitted; the Court indicated that the trading price set the value despite the fact that it was inflated due to corporate fraud.

In Christy & Swan Profit Sharing Plan v. Commissioner, TC Memo 2011-62, the Tax Court determined that a single participant profit sharing plan which did not make required statutory changes to its documents could lose its exempt status retroactively even though the plan accepted no new contributions.

In Shellito v. Commissioner, 108 AFTR2d 2011-5218, the Ninth Circuit Court of Appeals, accepting that a spouse may be on a payroll to create a valid family medical reimbursement plan despite being the only employee, remanded the case to the Tax Court to determine whether the spouse was a bona fide employee when she received $100 per month plus medical reimbursements and the checks were cut on a joint checking account into her individual account (she did work significant hours on the farm).

In Colosimo v. United States, 107 AFTR2d 2011-622, the Eighth Circuit Court of Appeals agreed with an Iowa Federal District Court that a 50 percent shareholder and president of a corporation with knowledge of unpaid taxes at some point during the nonpayment could not blame a bookkeeper for failure to pay.

In Oppliger v. United States, 107 AFTR2d 2011-1518, the Eighth Circuit Court of Appeals followed the weight of authority and agreed with a Nebraska Federal District Court that business owners were responsible for over $2 million in a trust fund recovery penalty notwithstanding the embezzlement by a bookkeeper who failed to file employment tax returns for more than three years and subsequently committed suicide in that they were responsible parties throughout and used funds for other purposes after they became aware of the liability; the Court indicated that the liability of a newly responsible person is limited to funds on hand upon taking control but this principle does not apply to a responsible person throughout.

In Crisci v. United States, 106 AFTR2d 2010-6848, the Third Circuit Court of Appeals agreed with a Pennsylvania Federal District Court that IRS could apply proceeds of an auction of corporate assets to non-trust liabilities following a levy where IRS had encouraged the taxpayer to sell assets which created an impression of a voluntary sale which would have permitted proceeds to be applied as directed to the trust portion.

In United States v. Quinn, 107 AFTR2d 2011-712, a Kansas Federal District Court ruled that an individual could be prosecuted for willful failure to pay over payroll taxes notwithstanding that she paid the full liability before her trial.

In Watson v. United States, 107 AFTR2d 2011-311, an Iowa Federal District Court found $67,000 of purported dividends from the wholly owned S corporation of a certified public accountant with a masters degree in taxation to constitute additional compensation where the CPA took salary of only $24,000 per year; the Court left alone an average of $122,000 in other distributions for each of the two years in issue.

In Jade Trading, LLC v. United States, 107 AFTR2d 2011-1832, the Court of Federal Claims determined that accuracy related penalties must be determined at the individual level in a TEFRA proceeding where "outside basis" affects the applicability of the penalty.

In Cheryl A. Mayfield Therapy Center v. Commissioner, TC Memo 2010-239, the Tax Court determined that cosmetologists, nail technicians and message therapists who rented their space for the greater of a fixed price or 25 percent of revenues but who set their own hours and paid their other expenses were independent contractors rather than employees.

In Robinson v. Commissioner, TC Memo 2011-99, a vocational instructor teaching police officers and other criminal justice personnel but receiving a paycheck from Temple University under a contract billed to the Commonwealth of Pennsylvania was found to be an independent contractor rather than an employee notwithstanding that he received a W-2 from Temple; the Court looked to the lack of control by the University and the absence of being allowed to participate in benefits given to faculty; in Schramm v. Commissioner, TC Memo 2011-212, IRS found that an adjunct professor who taught online courses was an employee and not an independent contractor.

In Kennedy v. Commissioner, TC Memo 2010-206, the Tax Court overturned an allocation to personal goodwill constituting 75 percent of the overall consideration in the case of a C corporation seller, finding that the allocation was a "tax-motivated afterthought" and that the seller had agreed to continue working for meager compensation; the Court indicated that the nature of the income to the individual (capital gain for personal goodwill or ordinary income for a covenant) was not in issue in the favorable 1998 Tax Court decision in Martin Ice Cream Company.

In United States v. Howard, 108 AFTR2d 2011-_____, the Ninth Circuit Court of Appeals agreed with a Washington Federal District Court that goodwill on the sale of a dental practice by a C corporation was not personal where the individual had entered into restrictive covenants with the corporation; the Court noted that "the incidence of taxation depends upon the substance, not the form of a transaction" and further stated "so having then made himself available to the advantages of using the corporation, and having entered into the agreements that he did with the corporation, then why should we try to allow him … out of what he got himself into."

In Commissioner v. LR Development Company, LLC, TC Memo 2010-2003, the Tax Court denied transferree liability where a buyer assumed the seller's liability to IRS under the sales documents which stated that no third party was entitled to rely upon them.

In Dennis v. Commissioner, TC Memo 2010-216, the Tax Court determined that an individual who worked full time at horse breeding for three years, incurring average losses of just under $100,000 per year before abandoning the activity, was attempting to make a profit; the Court noted that this activity was not as enjoyable as "riding or attending horse shows"; the Court reached a similar result in Blackwell v. Commissioner, TC Memo 2011-188, determining that a couple was engaging in horse breeding activities for profit where they had an elaborate business plan and worked diligently in the activity despite full time jobs despite only $167,000 gross income and $806,000 in expenses over a 7-year period (the couple had discontinued the activity prior to trial).

In DKD Enterprises v. Commissioner, TC Memo 2011-29, the Tax Court determined that two cat lovers who spent 2,000 and 800 hours per year respectively in the activity including breeding, raising, showing and offering for sale cats were not engaging in a trade or business but were carrying on a hobby, thus disallowing vet bills, litter and food, mileage to cat shows and other expenses (the taxpayers' corporation was however found not to be a personal service corporation as alleged by IRS).

In Campbell v. Commissioner, TC Memo 2011-42, the Tax Court determined that an Amway distributorship was not run for profit but was for the purpose of acquiring products at a discount for use in other businesses and for personal consumption under facts indicating that the activity was not conducted in a business-like manner.

In Seven W Enterprises, Inc. v. Commissioner, 136 TC No. 26, the Tax Court determined that a business could not avoid the accuracy related penalty based on professional advice when the CPA was an in-house employee (abating the penalty for the earliest year in which he was an outside accountant and separately paid preparer).

In Custom Stairs and Trim Ltd., Inc. v. Commissioner, TC Memo 2011-155, the Tax Court abated a company's failure to deposit penalty, determining reasonable cause from significant business downturns and from "cascading" penalties because of allocations to the earliest tax liability; the Court noted that certain circuits have taken a contradictory position that financial difficulties can never constitute reasonable cause for failure to deposit.

In Law Offices of Scott E. Combs v. United States, 107 AFTR2d 2011-784, a law firm was unable to challenge a levy on its trust account due to "lack of standing", forcing individual clients to sue for funds; IRS believed that the taxpayer was commingling personal and trust funds.

In Revenue Procedure 2011-29, IRS created a "safe harbor" for "success fees" in transactions, permitting payors to immediately deduct 70 percent of the fees while capitalizing the remaining 30 percent.

In Notice 2011-1, IRS delayed the effective date of the nondiscrimination rules for new group health insurance plans which were scheduled to take effect September 23, 2010 for plans not in existence on enactment of the healthcare legislation until an undetermined date subsequent to the issuance of regulations.

In Notice 2011-28, IRS announced that small employers with under 250 Forms W-2 will not be required to report health coverage cost information on the W-2 at least through 2012.

In Information Letter 2010-0235 and Information Letter 2010-0242, IRS indicated it will not follow the 1995 Ninth Circuit Decision in Boccardo v. Commissioner which held that a law firm was entitled to deduct litigation costs paid under a contingent fee agreement at the time of the expense.

In Field Attorney Advice 2011101, IRS indicated that an automobile dealer could not write off a portion of goodwill acquired when he purchased a franchise containing four lines of automobiles notwithstanding that the manufacturer terminated one line; a 15-year write off continues to apply to all goodwill acquired in the same transaction.

In IRS Memorandum SBSE-05-0711-064, IRS created a policy in which a revenue officer must contact an employer within 15 days following notification through an "alert program" when a semi-weekly payroll tax depositor becomes delinquent (the intent is to catch large delinquencies prior to filing of the quarterly returns).

In Letter Ruling 201114015, IRS allowed 12 subsidiaries engaging in the practice of medicine in separate states to deduct insurance payments to a "captive company" also owned by the parent finding that there was a sufficient shifting of the risk.

In Chief Counsel Advice 201106009 and 201106010, IRS said that "adult entertainment clubs" and other businesses that pay cab drivers to deliver customers must file Form 1099 for each driver paid $600 or more in a calendar year.

The End