



How the Fiscal Cliff Legislation May Affect Your Business

Foster Swift Business & Corporate Law Report

March 5, 2013

On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 (the "Act") into law. Enacted to address the tax side of the "fiscal cliff," the Act permanently extended the Bush-era tax cuts for most taxpayers, revised tax rates on ordinary and capital gain income for high-earners, imposed a new Medicare tax on investment income for high-earners, modified the estate tax, permanently "patched" the AMT, and imposed limits on deductions and exemptions for high-earners. Most business owners are aware of these changes to the tax law by now. However, the Act also made other lesser-known but important changes to the tax law that could affect you and your business. This article summarizes those changes.

ENHANCED SMALL BUSINESS EXPENSING

A business must usually capitalize the cost of property, rather than writing it off in the first year during which it is placed into service. However, many small businesses may write-off the entire cost of qualifying property immediately if they meet the requirements of Section 179 of the Internal Revenue Code. Section 179 limits the total amount of this special write-off and also subjects it to a dollar-for-dollar phase-out for businesses that purchase qualifying property in excess of a threshold. For 2012, the limitation on this write-off had been reduced from 2011 levels to \$139,000 and the phase-out threshold had been reduced from 2011 levels to \$500,000, and both limitations would have decreased even further in 2013. However, the Act retroactively increased the 2012 and 2013 cap to \$500,000 and the 2012 and 2013 phase-out threshold to \$2,000,000, which could allow your business to write-off up to \$500,000 of equipment and other qualifying property that it purchased in 2012 or will purchase in 2013. After 2014 the maximum deduction is scheduled to decrease to \$25,000 and the phase-out level is scheduled to decrease to \$200,000.

EXTENDED BONUS DEPRECIATION

Your business may also be able to take advantage of a special bonus depreciation opportunity. Under these rules, a business is allowed to

AUTHORS/ CONTRIBUTORS

Joel C. Farrar

PRACTICE AREAS

Business & Tax

Business Law

Tax Law

write-off 100% of the cost of certain equipment, machinery, and other personal property immediately in 2011 and 50% of the cost in 2012. The Act extended the 50% bonus depreciation deduction through 2013 for most property, and through 2014 for certain property that has a longer production life and certain aircraft. Therefore, your business may be able to write-off half of the cost of qualifying property that it places into service during 2013 (2014 for certain property), even if it cannot take advantage of Section 179.

OTHER DEPRECIATION CHANGES

The Act retroactively extended and modified several other depreciation provisions that may benefit your business, including:

1. extending through 2013 the placed-in-service deadline for the \$8,000 increase in the bonus depreciation and Section 179 expensing limitation that applies to passenger vehicles;
2. permitting 15-year straight line depreciation for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;
3. permitting a 7-year recovery period for motorsports entertainment complexes;
4. permitting accelerated depreciation for business property on an Indian reservation;
5. allowing a taxpayer to treat certain real property as Section 179 property;
6. providing special expensing rules for certain film and television productions; and
7. permitting the expensing of certain mine safety equipment.

EXTENSION OF RESEARCH AND DEVELOPMENT CREDIT

Prior to 2012, taxpayers were allowed a research and development credit equal to 20% of the excess of qualified research expenses over a base amount. The Act retroactively extended and modified that and certain other research credits through 2013. Fiscal year businesses that filed returns for part of 2012 should consider filing amended returns to claim the 2012 credits retroactively.

EXCLUSION FOR GAIN ON QUALIFIED SMALL BUSINESS STOCK

The Act allows noncorporate taxpayers to exclude 100% of the gain they realize on the sale of "qualified small business stock" that is held for more than five years and is acquired between January 1, 2012 and January 1, 2014, subject to a per-taxpayer limitation. This represents a retroactive restoration of an enhanced version of the qualified small business stock exclusion.

EXTENSION OF EMPLOYER-PROVIDED CHILD CARE CREDIT

The Act makes permanent the credit that employers can claim for certain costs of providing child care to employees. The credit is capped at \$150,000 per year (considered in connection with certain other credits), and is available for

1. 25% of certain costs relating to establishing and operating a qualified child care facility,
2. 25% of certain costs paid to a qualified child care facility, and

3. 10% of certain costs of providing child care resource and referral services to employees.

EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

The Act makes permanent the exclusion for employer-provided educational assistance, including the exclusion for graduate level courses.

WORK OPPORTUNITY CREDIT

The Act retroactively extends the work opportunity tax credit through 2013. This credit permits an employer to claim a credit for a portion of the wages that the employer paid to an employee who began work prior to January 1, 2014 if the employee is a qualified veteran or a member of certain targeted groups.

BUILT-IN GAINS

A former C corporation that has elected to be taxed as an S corporation is taxed at the highest corporate rate on any gain that was "built-in" to its appreciated property (at the time of its S election) when it sells the property during the "recognition period." The recognition period has historically been 10 years from the date of the S election. This means that if a former C corporation sells assets with "built-in" gain within ten years of electing to be taxed as an S corporation, the corporation is taxed on that gain at the highest corporate rate, even though it is otherwise a pass-through entity. However, the Act provides that for tax years 2012 and 2013, the recognition period is only five years. Accordingly, a former C corporation that elected S corporation status more than 5 years but less than 10 years ago should consider closing sales of assets with "built-in" gains during 2013 to avoid paying taxes on "built-in" gains in future years.

OTHER BUSINESS TAX EXTENSIONS

The Act retroactively extended other business tax incentives through 2013, including the new markets tax credit, Indian employment tax credit, railroad track maintenance credit, mine rescue team training credit, and enhanced charitable deduction for contributions of food inventory.

ENERGY RELATED TAX BREAKS

The Act extended many important energy-related tax breaks for businesses, including the following:

1. the 30% alternative fuel vehicle refueling property credit was retroactively extended for two years through 2013, subject to certain limitations;
2. the credit for two- and three-wheeled electric vehicles was modified and retroactively extended for two years through 2013;
3. the cellulosic biofuel producer credit was modified, retroactively restored, and extended for one year through 2013;
4. the income and excise tax credits for biodiesel and renewable diesel were retroactively extended for two years through 2013;



5. the credit for facilities that produce energy from certain renewable resources was modified to apply to wind facilities placed into service before 2014 and to certain modifications to qualified facilities that are underway before 2014;
6. the credit for energy-efficient new homes was retroactively extended for two years through 2013;
7. the credit for energy-efficient appliances was retroactively extended for two years through 2013;
8. the additional depreciation deduction for cellulosic biofuel plant property was modified and extended for one year;
9. the excise tax credits for sale or use of alternative fuels and alternative fuel mixtures were retroactively extended for two years through 2013; and
10. the nonbusiness energy property credit for certain energy-efficient property installed in existing homes was retroactively extended for two years through 2013.

If you have questions regarding the many tax changes made by the Act, please contact Joel C. Farrar at (517) 371-8305 or by email.