

December 17, 2010

Dear Client,

In addition to extending the Bush tax cuts, providing relief from the AMT, and cutting the payroll tax by two percentage points, the recently enacted "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (Tax Relief Act) extends a host of other important tax breaks for businesses. I'm writing to give you an overview of these key tax breaks that were extended by the new law. Please call our office for details of how the new changes may affect you or your business.

Business tax relief.

Here are selected business tax breaks which expired at the end of 2009 that have been retroactively reinstated and extended through 2011 by the Tax Relief Act:

- The research and development credit.
- 15-year write-offs for qualified leasehold improvements, and restaurant buildings (and certain improvements to such restaurant buildings).
- 7-year write-offs for certain motorsports racetrack property.
- The employer wage credit for activated military reservists.
- The special expensing rules for certain film and television productions.
- Expensing of environmental remediation costs.
- The deduction allowable for domestic production activities in Puerto Rico.
- The enhanced deduction for contributions of food and book inventories, and computer equipment for educational purposes.
- A liberal rule for S corporations making charitable donations.
- The special rules for interest, rents, royalties and annuities received by a tax-exempt entity from a controlled entity.

In addition, the new law extends for an additional year (i.e., through 2011) the temporary exclusion of 100% of gain on the sale of certain small business stock.

Energy provisions

The following energy provisions were extended by the Act (through 2011):

- The credit for manufacturers of energy-efficient new homes.
- Incentives for biodiesel and renewable diesel.
- The credit for refined coal facilities.

- Excise tax credits and outlay payments for alternative fuel and alternative fuel mixtures.
- The special rule to implement FERCs and State electric restructuring policy.
- Suspension of the limitation on percentage depletion for oil and gas from marginal wells.
- Grants for specified energy property in lieu of tax credits.
- Provisions related to alcohol used as fuel.
- The energy efficient appliance credit.
- The credit for energy-efficient improvements to existing homes.
- The 30% investment tax credit for alternative vehicle refueling property.

In addition, two of the most significant changes provide incentives for businesses to invest in machinery and equipment by allowing for faster cost recovery of business property. Here are the details.

Expansion and extension of additional first-year depreciation. Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, placed in service in 2008, 2009, or 2010 (2011 for certain property), by permitting the first-year write-off of 50% of the cost. The new law extends and temporarily increases this additional first-year depreciation provision for investment in new business equipment. For investments placed in service after September 8, 2010 and through December 31, 2011 (through December 31, 2012 for certain longer-lived and transportation property), the new law provides for 100% additional first-year depreciation. In other words, the entire cost of qualifying property placed in service during that time frame can be written off, without limit. Note that even though the legislation did not take shape in Congress until mid-December of 2010, the effective date of this provision was made retroactive, to include qualifying property placed in service after September 8, 2010.

Fifty percent additional first-year depreciation will apply again in 2012.

The Act extends through 2012 the election to accelerate the AMT credit instead of claiming additional first-year depreciation.

The new law leaves in place the existing rules as to what kinds of property qualify for additional first-year depreciation. Generally, the property must be (1) depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified leasehold improvements. Also the original use of the property must commence with the taxpayer – used machinery doesn't qualify.

Enhanced small business expensing (Section 179 expensing). Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is "capitalized" and depreciation deductions are allowed for most property (other than land), but are spread out over a period of years. However, to help small businesses quickly recover the cost of capital outlays for qualifying personal property, small business taxpayers can elect to write off these expenditures in

the year of acquisition instead of recovering the costs over time through depreciation. The expense election is made available, on a tax year by tax year basis, under Section 179 of the Internal Revenue Code, and is often referred to as the “Section 179 election” or the “Code Section 179 election.” The new law makes three important changes to the Code Section 179 expense election.

First, the new law provides that for tax years beginning in 2012, a small business taxpayer will be allowed to write off up to \$125,000 (indexed for inflation) of capital expenditures subject to a phase-out (i.e., gradual reduction) once capital expenditures exceed \$500,000 (indexed for inflation). The new maximum expensing amount and phase-out level for tax years beginning in 2012 is actually lower than the levels in effect for tax years beginning in 2010 or 2011 (maximum expensing amount of \$500,000, and a phase-out level of \$2,000,000). For tax years beginning after 2012, the maximum expensing amount will drop to \$25,000 and the phase-out level will drop to \$200,000.

Second, the rule which treats off-the-shelf computer software as qualifying property is extended through 2012.

Finally, the new law extends, through 2012, the provision permitting a taxpayer to amend or irrevocably revoke a Code Sec. 179 expense election for a tax year without IRS's consent.

I hope this information is helpful. If you would like more details about these changes or any other aspect of the new law, please do not hesitate to call.

Sincerely,

Watson & Associates, PA, CPAs