



FOR LEASE

Real Estate Industry Tax Savings Opportunities 2010-2011

The recently enacted 2010 Small Business Jobs Act includes a wide range of tax breaks and incentives for the real estate industry. Included below is a brief overview of some of the tax breaks and incentives in the new law. Please contact Aronson & Company's Real Estate Industry Services Group at 301.231.6200 with any questions related to these opportunities and other tax planning opportunities for 2010 and 2011.

TAX BREAKS & INCENTIVES

The provisions most beneficial to the real estate industry include Section 179 expensing, the expansion of Section 179 expensing to certain real property, 50% bonus depreciation, and increased start-up expense opportunities. These tax breaks and incentives are explained below.

Enhanced Small Business Expensing (Section 179 Expensing)

In order to help small businesses quickly recover the cost of certain capital expenses, small business taxpayers can elect to write off the cost of these expenditures in the year of acquisition in lieu of recovering these costs over time through depreciation. Under pre-2010 Small Business Jobs Act law, taxpayers could expense up to \$250,000 of qualifying property—generally, machinery, equipment and certain software—placed in service in tax years beginning in 2010. This annual expensing limit was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service in tax years beginning in 2010 exceeded \$800,000 (the investment ceiling). Under the new law, **for tax years beginning in 2010 and 2011, the \$250,000 limit is increased to \$500,000 and the investment ceiling to \$2,000,000.**

Section 179 Expensing to Certain Real Property for the First Time

The new law also makes certain real property eligible for expensing. For property placed in service in any tax year beginning in 2010 or 2011, **the up-to-\$500,000 of property expensed can include up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).** As the rules of determining what property is “qualifying”, please contact us if

you have constructed or plan to construct new improvements for tenants (or for yourself as a tenant), improvements for restaurants or for retail businesses.

Extension of 50% Bonus 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 or 2009 (2010 for certain property), by permitting the first-year write-off of 50% of the cost. **The new law extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (2011 for certain property).**

Boosted Deduction for Start-Up Expenditures

The new law allows taxpayers to **deduct up to \$10,000 in trade or business start-up expenditures** for 2010. The amount that a business can deduct is reduced by the amount by which startup expenditures exceed \$60,000. Previously, the limit of these deductions was capped at \$5,000, subject to a \$50,000 phase-out threshold.

OTHER TAX INCENTIVES

Other key provisions that may be beneficial include the following:

S Corporation Built-in Gain Recognition Period

Generally, a C corporation converting to an S corporation must hold onto any appreciated assets for ten (10) years following its conversion or face a business-level tax imposed on the built-in gain at the highest corporate rate of 35%. This holding period is reduced where the seventh tax year in the holding period preceded the tax year beginning in 2009 or 2010. The 2010 Small Business Jobs Act temporarily shortens the holding period of assets subject to the built-in gains tax to five (5) years if the fifth tax year in the holding period precedes the tax year beginning in 2011; applies to election in 2006 or earlier. **This change is effective only for 2011 so planning to take advantage of this opportunity should be considered immediately.**



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Deductibility of Health Insurance for the Purpose of Calculating Self-Employment Tax

The new law allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

100% Exclusion of Gain from the Sale of Small Business Stock for Qualifying Stock

Before the 2009 Recovery Act, individuals could exclude 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, QSBS must meet a number of conditions (e.g., it must be stock of a corporation that has gross assets that don't exceed \$50 million, and the corporation must meet active business requirements). Under the 2009 Recovery Act, the percentage exclusion for gain on QSBS sold by an individual was increased to 75% for stock acquired after Feb. 17, 2009 and before Jan. 1, 2011. Under the new law, the amount of the exclusion is temporarily increased yet again, to 100% of the gain from the sale of qualifying small business stock that is acquired in 2010 after date of enactment (September 27th) and held for more than five years. In addition, the new law eliminates the alternative minimum tax (AMT) preference item attributable for that sale.

REVENUE RAISERS

The costs of these incentives are expected to be paid for through a number of revenue raising provisions which include some that are tax friendly and others that are not so friendly. These include the following:

Information Reporting Required for Rental Property Expense Payments

For payments made after Dec. 31, 2010, the new law requires persons receiving rental income from real property to file information returns with IRS and service providers reporting payments of \$600 or more during the tax year for rental property expenses. Exceptions are provided for individuals renting their principal residences on a temporary basis (including active members of the military), taxpayers whose rental income doesn't

exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regulations). **As this reporting requirement will begin with payments made starting January 1st, lessors should start preparing for this now.** Failure to do so may make the taxpayer subject to the significantly increased penalties discussed below.

Increased Information Return Penalties (effective for information returns required to be filed after Dec. 31, 2010)

For information returns required to be filed after Dec. 31, 2010, the penalties for failure to timely file information returns to the IRS would be increased. The first-tier penalty would go from \$15 to \$30 per unreported form, and the calendar year maximum from \$75,000 to \$250,000. The second-tier penalty would be increased from \$30 to \$60, and the calendar year maximum from \$150,000 to \$500,000. The third-tier penalty would be increased from \$50 to \$100, and the calendar year maximum from \$250,000 to \$1,500,000. For small business filers, the calendar year maximum would go from \$25,000 to \$75,000 for the first-tier penalty, from \$50,000 to \$200,000 for the second-tier penalty, and from \$100,000 to \$500,000 for the third-tier penalty. The minimum penalty for each failure due to intentional disregard would be increased from \$100 to \$250.

First tier penalties are for self-corrected forms filed within 30 days of the due date of the form. Second tier penalties are for self-corrected forms filed by August 1st. Third tier penalties are for any other unreported or underreported payments.

Guarantee Fees

Amounts received directly or indirectly for guarantees of indebtedness of a U.S. payer issued after the date of enactment are sourced, like interest, in the U.S. As a result, amounts paid by U.S. taxpayers to foreign persons will generally be subject to U.S. withholding tax.