The tax law is not static and there have been a number of changes affecting 2009 returns, as well as returns in 2010. Since publication of the 2010 edition of *J.K. Lasser’s Small Business Taxes*, Congress enacted the *Worker, Homeownership, and Business Assistance Act of 2009*, *Military Spouses Residency Relief Act*, and *Department of Defense Appropriations, 2010*. The courts and the IRS have also spoken to many tax items that can impact your 2009 return. Here are key developments, some of which can apply to your 2009 return. Also, factor in 2010 changes if they affect your quarterly estimated tax payments for 2010. Watch for the extension of a number of provisions that expired in 2010, taxes imposed by a health care act, and other new law changes that can impact 2010 taxes.

**Chapter 4—Income or Loss from Business Operations**

**Income to retired attorney.** Guaranteed payments to a retired attorney are ordinary income, not capital gains, because the firm had intended the payments to be a form of retirement income. The fact that the firm failed to report the payments to the IRS or taxpayer does not affect the tax treatment of the payments.

**ARC loans.** The America’s Recovery Capital Loan Program (ARC) provides interest-free loans to viable businesses that need short-term cash. The IRS has made it clear that a small business that receives an ARC loan does not have to include the interest paid by the Small Business Administration to the lender in gross income; no interest deduction is allowed.

**Sales of livestock because of drought.** The IRS has given an extension of the replacement period for livestock sold on account of drought in specified areas (affected counties are listed in Notice 2009-81). The replacement period is extended until the end of the first taxable year ending after the first drought-free year for the applicable region.

**Cancellation of debt income for S corporations.** When corporate debt is forgiven and the corporation opts not to report the cancellation of debt income but rather to reduce tax attributes, special rules apply.

Final regulations have been issued on the reduction of the net operating loss (NOL) attribute of S corporations. Any disallowed losses or deduction, including those of a shareholder who transferred all stock during the year, are included in an S corporation’s deemed NOL (it is “deemed” because technically NOLs are reported only at the shareholder level, but adjustments to the NOL are made at the corporate level). If the deemed NOL exceeds the discharged cancellation of debt income, the excess deemed NOL is allowed to the shareholders as disallowed losses and deduction that shareholders can later take into account.
The character of the excess deemed NOL that is allocated to shareholders will consist of a proportionate amount of each item of the shareholder’s loss or deduction that is disallowed for the year of the debt discharge. The corporations are required to provide information to shareholders regarding these suspended losses.

**LLC members not automatically subject to passive loss limits.** Under the passive activity loss rules, limited partners are automatically barred from deducting losses in passive activities. By definition, limited partners are barred from participating in the day-to-day operations of the business in which they invested. However, some courts have now held that members of limited liability companies are not treated as limited partners for purposes of the passive activity loss rules. Under the law, they can participate in daily operations and should be allowed to demonstrate their material participation in order to escape the loss limitations.

**Net operating losses.** For such losses arising in 2009, small business taxpayers can opt for a longer carryback period. The usual carryback period is 2 years; for 2009 losses, a taxpayer can choose a 3-, 4-, or 5-year carryback. For the fifth carryback year, however, only half of the income can be offset in that year.

The 90% NOL limitation that usually applies for alternative minimum tax purposes is waived for any carrybacks.

Businesses with average gross receipts of $15 million or less that used a 5-year NOL carryback in 2008 can do so again in 2009 if they so elect.

Eligible taxpayers can file amended returns for prior years or apply for a quick refund on Form 1045 for individuals (e.g., sole proprietors and owners of pass-through entities) or Form 1139 for C corporations.

**Guidance on NOL elections.** A business that elected to forgo a carryback for a loss for a taxable year ending before November 6, 2009, may revoke the election before the due date (including extensions) for filing the return for the business’s last taxable year beginning in 2009. An election can be made by attaching a statement to the return for the year in which the NOL arises; the statement must say “Under Rev. Proc. 2009-52.” The 50% offset for the fifth taxable year preceding the year of the loss does not eliminate the other 50% of the NOL; the remaining 50% can be carried to succeeding years.

**Chapter 5—Capital Gains and Losses**

**Qualified small business stock.** President Obama has suggested a 100% exclusion for qualified small business stock; this has yet to be enacted.

**Chapter 7—Employee Compensation**

**COBRA coverage for the unemployed.** The federal government will continue to pay 65% of insurance premiums for eligible individuals for up to 15 months (increased from the former 9-month period). Eligible individuals include those involuntarily terminated in January and February 2010 (instead of through the end of 2009). As an employer, you’ll have to implement this change, including:
• **Sending notices to affected employees and former employees.** The special notices for individuals must be given to those who were eligible for the subsidy on or after October 31, 2009, or who experienced a termination of employment (whether involuntary or voluntary) on or after October 31, 2009, and in either case before December 19, 2009. The notices must be distributed by February 17, 2010. In addition, your general COBRA notice for new terminations through February 28, 2010, should be updated to reflect the extension.

• **Giving refunds to individuals who “overpaid” premiums.** Those who lost eligibility at the end of November 2009 and paid a full December 2009 premium can receive a refund of the 65% subsidy portion. As the employer, you make the refund.

• **Preparing for the longer subsidy period.** For workers involuntarily terminated in February 2010, the subsidy period will run through May 2011.

**Chapter 8—Travel and Entertainment Expenses**

**Business travel per diem rates.** The maximum federal per diem rate for travel from October 1, 2009, through September 30, 2010, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $116 per day ($70 for lodging and $46 for M&IE)—up from $109 ($70 for lodging and $39 for M&IE) that had applied to the prior 12-month period. A number of the rates to certain areas have changed. These rates can be found at [www.gsa.gov](http://www.gsa.gov) (click on “Per Diem Rates”).

The high-low substantiate rates for high-cost and all other areas within CONUS for the period October 1, 2009, through September 30, 2010, is $258 for travel to high-cost localities and $2,163 for travel to all other areas with CONUS. Of these rates, the meal portion is $65 for high-cost areas and $52 for all other areas within CONUS. These rates are higher than the rates for the prior 12-month period.

**Chapter 9—Car Expenses**

**Standard mileage rate.** The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for 2010; it is 50¢ per mile.

Those who own their vehicles and use the standard mileage rate for 2010 must reduce the vehicle’s basis by 23¢ per mile.

**Chapter 10—Repairs, Maintenance, and Energy Improvements**

**Environmental cleanup costs.** The opportunity to expense rather than capitalize cleanup costs (so-called “Brownfield” remediation costs) expired at the end of 2009; look for an extension.
Chapter 14—First-Year Expensing, Depreciation, Amortization, and Depletion

First-year expensing. The expensing limit for 2010 is set to be $134,000. Look for a possible increase retroactive to the start of 2010; it is part of the administration’s budget proposals for fiscal year 2011.

15-year amortization of qualified leasehold and restaurant improvements. The opportunity to amortize these costs over 15 years instead of depreciating them over 39 years expired at the end of 2009. Look for an extension; it is part of the administration’s budget proposals for fiscal year 2011.

Chapter 16—Retirement Plans

Contribution limits. Various limits have remained unchanged for 2010:

- 401(k) plan elective deferrals: $16,500 (plus $5,500 for those age 50 and older by December 31, 2010).
- Savings incentive match plan for employees (SIMPLE) elective deferrals: $11,500 (plus $2,500 for those age 50 and older by December 31, 2010)
- Defined contribution plans (profit-sharing plans and simplified employee pension plans [SEPs]): up to $49,000
- Defined benefit (pension) plans: up to $195,000
- Compensation taken into account in figuring contributions and benefits: $245,000

Chapter 19—Medical Expenses

Health savings accounts. The contribution limits for 2010 have increased to $3,050 for self-only coverage and $6,150 for family coverage. Those age 55 or older by the end of 2010 can add another $1,000 for the year.

To contribute to a health savings account, the person must be covered by a high-deductible health plan. For 2010, this means that the plan has a minimum deductible of $1,200 for self-only coverage and $2,400 for family coverage.

Chapter 22—Miscellaneous Business Deductions

Charitable contributions. Enhanced deductions for donations of food, books, and computer equipment expired at the end of 2009; look for an extension.

In 2009, S corporation shareholders could take into account their prorated share of corporate donations, even if they exceed the shareholders’ basis in their S corporation stock. This break expired at the end of 2009; look for an extension.

Deduction for education costs. An itemized deduction for the cost of obtaining an MBA is allowed where the degree does not qualify the recipient for a new trade or business. For example, a nurse-administrator who obtained an MBA was allowed to deduct the cost
since she was not qualified for any additional licensing positions after completing the education.

**Office supplies.** Usually, you must have receipts or other proof of the office supplies you purchased in order to deduct the cost. However, the Tax Court has used the so-called *Cohan* rule to allow a business owner to deduct some office supplies even though he lacked substantiation. The *Cohan* rule is explained in Chapter 3.

**Meal costs for day-care providers.** For 2010, the deduction for standard meals and snack rates have been increased slightly:

Breakfast:
- States other than Alaska and Hawaii: $1.19
- Alaska: $1.89
- Hawaii: $1.38

Lunch and dinner:
- States other than Alaska and Hawaii: $2.21
- Alaska: $3.59
- Hawaii: $2.59

Snacks:
- States other than Alaska and Hawaii: $0.66
- Alaska: $1.07
- Hawaii: $0.77

**Chapter 23—Roundup of Tax Credits**

**Research credit.** The 20% credit had expired at the end of 2009; look for an extension. One court case held that for companies doing business overseas, the research credit’s base amount cannot exclude foreign receipts.

**Work opportunity credit.** For 2009 and 2010, the credit can be claimed for hiring “disconnected youth.” This is someone who lacks the education and skills for a job. Technically, it means someone who is not readily employable because the individual has a certificate of graduation or GED certificate awarded no less than 6 months before the hiring date and has not held a job (other than occasionally) or been admitted to a technical school or postsecondary school since receiving the certificate.

**Chapter 27—Alternative Minimum Tax**

**Exemption amounts.** The old alternative minimum tax (AMT) exemption amounts expired at the end of 2009. The exemption amounts for 2009 had been:
- $70,950 for married filing jointly
• $46,700 for single taxpayers and heads of households
• $35,475 for married filing separately

With no extension or increase for 2010, the exemption amounts are set to be:
• $45,000 for married filing jointly
• $35,475 for single taxpayers and heads of households
• $22,250 for married filing separately

Expect to see some “patch” for 2010 to keep one in five individual filers from owing AMT.

**Tax credit offsets.** Nonrefundable personal tax credits, such as education credits and the dependent care credit, were allowed to be used to offset both regular tax and the AMT in 2009. This rule expired, but look for an extension. If there is no extension, then the only nonrefundable personal credits that can offset AMT will be the adoption credit, the child tax credit, and the retirement saver’s credit.

**Chapter 28—Other Taxes**

**Social Security and Medicare taxes.** The 2010 wage base for the Social Security tax portion of FICA and self-employment tax remains unchanged from 2009 at $106,800.

**Federal Unemployment Tax Act (FUTA).** The “temporary” hike in the FUTA tax rate was originally added in 1976 and was set to expire at the end of 2009. The Worker, Homeownership, and Business Assistance Act of 2009 retained the additional 0.2% FUTA surtax through June 30, 2011. This continues the FUTA tax rate at 6.2%.

**Chapter 29—Other Taxes**

**Reporting stock options.** Final regulations tell corporate employers how to report employee stock options. Look for new Form 3921, Exercise of an Incentive Stock Option under Section 422(b), and Form 3922, Transfer of Stock Acquired through an Employee Stock Purchase Plan under Section 423(c); using these forms will satisfy the requirements under these regulation. Technically, the regulations are effective as of January 1, 2007, but employers are not required to comply with them for options issued in 2007, 2008, or 2009.

**Employment tax audits.** Starting in February 2010, the IRS will conduct random employment tax audits under the National Research Program. About 2,000 businesses will be randomly selected each year (2010, 2011, and 2012) to help the IRS gather information so they can better police employment taxes in the future. Companies from all industries and of all sizes may be selected. The IRS notes that this random audit program will be similar to the one they conducted for S corporations a few years ago.

**Opting out of Form 944 reporting.** Small employers (those expecting to report no more than $1,000 in employment taxes, which typically amounts to about $4,000 in compensation) can file an annual employer return rather than quarterly returns. However,
small employers can choose to file quarterly. The IRS has provided guidance in Revenue Procedure 2009-51 on how to opt out of Form 944 reporting.

**Chapter 30—Filing Income Tax Returns and Paying Taxes**

*Failure-to-file penalty.* The penalty for partnerships and S corporations that fail to file returns is $195 per owner (up from $89 per owner). This applies to returns due after December 31, 2009.