Supplement to J.K. Lasser’s Small Business Taxes 2011

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The tax law is not static, and there have been a number of changes affecting 2010 returns, as well as returns in 2011. Since publication of the 2011 edition of J.K. Lasser’s Small Business Taxes, Congress enacted the Small Business Jobs Act, and the Tax Relief, Unemployment Benefits Reauthorization, and Job Creation Act. The courts and the IRS have also made decisions and rulings on many tax items that can impact your 2010 return. Here are key developments, some of which can apply to your 2010 return. Also, factor in 2011 changes if they affect your quarterly estimated tax payments for 2011.

The changes presented in this Supplement are tied to the chapters in the book.

Introduction

Definition of “small business” in Table I.1. For purposes of the extended general business carryback explained in Chapter 23, “small business” includes any privately held corporation, partnership, or sole proprietorship with average annual group receipts in the 3 prior years not exceeding $50 million. For partnerships and S corporations, this gross receipts test must be met at both the entity and owner levels.

Also in the table, the first-year expensing election (Chapter 14) is $2 million (rather than $800,000).

Further, there is a therapeutic discovery tax credit for biomedical research in 2009 and 2010. It applies only to companies with no more than 250 employees.

The table entry for estimated tax relief should be eliminated. This break was not extended for 2010.

Chapter 1—Business Organization

Series LLCs. Eight states—Delaware, Illinois, Iowa, Nevada, Oklahoma, Tennessee, Utah, and Wisconsin (to a limited extent)—permit multiple LLCs (“units”) to operate under a single LLC umbrella called a “Series LLC.” Proposed regulations treat each series LLC unit as a separate entity for federal tax purposes. However, the IRS has yet to resolve a number of employment tax issues for series LLCs.

Filing deadlines. For sole proprietorships and partnerships reporting on a calendar year basis, the 2010 return (or a request for a filing extension) is due no later April 18, 2011. The extended due date is October 17, 2011.

Chapter 2—Tax Year and Accounting Methods

Chapter 3—Recordkeeping for Business Income and Deductions

Cellular phones. Cell phones have been “delisted,” which means they are no longer treated as listed property for purposes of depreciation. This eases the recordkeeping requirements for deducting the cost of buying cell phones and monthly service charges.

Recordkeeping for the general business credit. For small business credits arising in 2010, the carryback period is 5 years; the carryforward period remains at 20 years (see Chapter 23).

Chapter 4—Income or Loss from Business Operations

Income for service businesses—1099 income. Effective for services performed in 2011, not only businesses, but also landlords who are not in business must report services of $600 or more. This includes, for example, services of painters, plumbers, and accountants.

Gift cards. The IRS has issued guidance and a safe harbor for merchants who use the accrual method of accounting and issue gift cards to customers in exchange for returns of merchandise. For tax years ending on or after December 31, 2010, these merchants can treat the card as a payment of a cash refund and a sale of a gift card. This is treated as a change in accounting method for which automatic consent is provided (see Chapter 2). Effect: Merchants can defer the income to be received through the gift cards.

Real estate professionals. Individuals who can show that they are real estate professionals are not subject to the passive activity loss rules. In demonstrating material participation, hours “on call” do not count; only actual hours of participation are taken into account.

Chapter 5—Capital Gains and Losses

Sales of qualified business stock—excluding gain. There is a 100% exclusion for stock acquired after September 27, 2010, and before January 1, 2012. The stock must be held at least 5 years in order to qualify for zero capital gain tax on the sale. The 100% exclusion applies for both regular tax and the alternative minimum tax. The Administration announced that it would propose a permanent extension of the 100% exclusion in its fiscal 2012 budget.

Chapter 7—Employee Compensation

Employee use of company car. For purposes of valuing employee use of a company car in 2011, the IRS standard mileage rate is 51¢ per mile.

Empowerment Zone employment credit. The 20% credit for hiring certain workers, which expired at the end of 2009, has been extended through 2011. However, the Renewal Community employment credit, which also expired at the end of 2009, has not been extended.
Indian employment credit. The 20% credit for hiring certain employees, which had expired at the end of 2009, has been extended through 2011.

Employer wage credit for activated workers. The 20% credit for wage differential payments by small employers made to employees called to active duty, which had expired at the end of 2009, has been extended through 2011.

General business credit carryback. For credits arising in 2010 that exceed the general business credit limitation, there is a 5-year carryback for small businesses (see definition in the Introduction above).

Employment tax credits for all businesses—forms. In light of extension of these employment tax credits (with the exception of the Renewal Community employment credit), all of the forms continue to be in use for 2010.

Chapter 8—Travel and Entertainment Expenses

Business travel per diem rates. The maximum federal per diem rate for travel from October 1, 2010, through September 30, 2011, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $123 per day ($77 for lodging and $46 for M&IE)—up from $116 ($70 for lodging and $46 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 (click on “Per Diem Rates”).

The high-low substantiate rates for high-cost and all other areas within CONUS for the period October 1, 2010, through September 30, 2011, is $233 for travel to high-cost localities and $160 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 slightly lower 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 2011; it is 51¢ per mile.

Those who own their vehicles and use the standard mileage rate for 2011 must reduce the vehicle’s basis by 22¢ per mile.

Starting in 2011, the IRS standard mileage rate can be used for cars for hire.

Chapter 10—Repairs, Maintenance, and Energy Improvements

Environmental cleanup costs. The opportunity to expense rather than capitalize cleanup costs (so-called “brownfield” remediation costs), which had expired at the end of 2009, has been extended through 2011.
Chapter 12—Rents

Qualified leasehold improvements. Leasehold improvements qualify for bonus depreciation. Improvements made after September 8, 2010, and before January 1, 2012, qualify for 100% bonus depreciation. Qualified restaurant and retail improvements do not qualify for this bonus depreciation.

Qualified leasehold, restaurant, and retail improvements have a 15-year recovery period. Qualified leasehold improvements likely will be deducted in full using bonus depreciation. For the cost of restaurant and retail improvements, the $250,000 first-year expensing option will likely permit an immediate deduction, but if expensing is not elected or the improvements costs exceed $250,000, then the 15-year amortization rule will come into play.

Chapter 14—First-Year Expensing, Depreciation, Amortization, and Depletion

First-year expensing. The expensing limit for 2010 and 2011 is $500,000. The limit phases out when purchases for the year exceed $2 million. Thus, no expensing can be used if purchases for the year exceed $2.5 million.

Looking ahead, the expensing limit for 2012 is set to be $125,000 (adjusted for inflation). The phase-out starts when purchases for the year exceed $500,000. In 2013, the limit reverts to $25,000, with a phase-out beginning at $200,000, unless Congress again extends the law.

The additional first-year expensing for property in empowerment zones and the DC zone, which had expired at the end of 2009, has been extended through 2011.

The opportunity to expense film and television production costs, which had expired at the end of 2009, has been extended through 2011.

Recovery period for farming equipment and machinery. The 5-year recovery period that had applied through 2009 has not been extended. Farming equipment and machinery placed in service in 2010 falls within various recovery periods.

15-year amortization of qualified leasehold, restaurant, and retail improvements. The opportunity to amortize these costs over 15 years instead of depreciating them over 39 years expired at the end of 2009, but has been extended through 2011. However, up to $250,000 of these costs qualify for first-year expensing in 2010 and 2011. Also, qualified leasehold improvements are eligible for bonus depreciation. Thus, in many cases, all of the costs of improvements may be deductible in the year they are made.


Rebuilding incentives for certain disaster victims. No special tax breaks were created for victims of the BP oil spill disaster, or for any other disaster victims in 2010.
**Qualified disaster costs.** The opportunity to expense qualified disaster costs expired at the end of 2009 and was *not* extended for 2010.

**Form 4562.** The form for claiming depreciation and amortization does not reflect the latest tax changes. The form in the book was the draft form available at the time of publication; the form has not been updated.

**Chapter 16—Retirement Plans**

**Contribution limits.** Various limits have remained unchanged for 2011:

- 401(k) plan elective deferrals: $16,500 (plus $5,500 for those age 50 and older by December 31, 2011).
- Savings incentive match plan for employees (SIMPLE) elective deferrals: $11,500 (plus $2,500 for those age 50 and older by December 31, 2011)
- 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 2011 remain unchanged at $3,050 for self-only coverage and $6,150 for family coverage. Those age 55 or older by the end of 2011 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 2011, this means that the plan has a minimum deductible of $1,200 for self-only coverage and $2,400 for family coverage (the same deductible that applied for 2010).

**Debit cards for flexible spending accounts (FSAs) and health reimbursement accounts (HRAs).** Debit cards can continue to be used in 2011 for doctor-prescribed over-the-counter medications. Since over-the-counter medications that are not doctor prescribed do not qualify for reimbursement from FSAs and HRAs (as well as health savings accounts [HSAs]) starting in 2011, there had been some confusion about the use of debit cards; this has now been clarified.

**Health insurance premiums reduce self-employment tax.** See Chapter 29.

**Chapter 20—Deductions for Farmers**

**Depreciation.** The 5-year recovery period that had applied to farming equipment and machinery in 2009 expired. For equipment and machinery placed in service in 2010, various recovery periods apply.
Chapter 22—Miscellaneous Business Deductions

Personal education incentives. The American Opportunity tax credit, which expired at the end of 2010, has been extended through 2012.

The above-the-line deduction for tuition and fees, which expired at the end of 2009, has been extended through 2011.

Charitable contributions. Enhanced deductions for donations of food, books, and computer equipment, which had expired at the end of 2009; have been extended through 2011.

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 2000, but has been extended through 2011.

The enhanced deduction for conservation easements, which expired at the end of 2009, has been extended through 2011. This means farmers and ranchers can claim a charitable contribution deduction for conservation easements of 100% of their contribution basis.

Meal costs for day-care providers. For 2011, 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: $2.22
- Alaska: $3.60
- Hawaii: $2.60

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

Chapter 23—Roundup of Tax Credits

Employment-related credits:

- Work Opportunity credit. The credit had been set to run only through August 31, 2011; it has been extended through December 31, 2011. Two targeted groups that applied for 2009 and 2010—unemployed veterans and disconnected youth—have not been extended.
• **Empowerment Zone employment credit.** The credit expired at the end of 2009; it has been extended through 2011.

• **Indian employment credit.** The credit expired at the end of 2009; it has been extended through 2011.

• **Employer differential wage payment credit.** The credit expired at the end of 2009; it has been extended through 2011.

**Capital construction-related credits:**

• **New markets credit.** The credit expired at the end of 2009; it has been extended through 2011.

• **Energy-efficient home credit.** The credit expired at the end of 2009; it has been extended through 2011.

**Other tax credits:**

• **Research credit.** The 20% credit, which had expired at the end of 2009, has been extended through 2011.

  In addition, for 2009 and 2010 only, there is a 50% credit for biomedical research, called the therapeutic discovery tax credit. It applies to companies with no more than 250 employees. The credit is 50% of qualifying costs, up to a maximum credit of $5 million per company (with a $1 billion overall limit). No credit can be claimed if a grant is received for this research.

  A federal district court allowed Fed Ex to claim a research credit for the development of *internal use software* to make its operations run more smoothly. Regulations say that internal use software may be qualified research if the software is innovative in that the software is intended to result in a reduction in cost, improvement in speed, or other improvement, that is substantial and economically significant, and meets other tests.

**General business credit.** The carryback for the general business credit usually is 1 year. However, for credits of small businesses arising in 2010, the carryback period is 5 years. The carrybacks can offset both regular tax and the alternative minimum tax.

A “small business” for this purpose is a privately held corporation, partnership, or sole proprietorship with average gross receipts in the 3 prior years not exceeding $50 million.

**Note:** For partnerships and S corporations, the gross receipts test must be met at both the entity and owner levels.

**Table 23.1—Guide to Tax Credits.** All of the credits with an asterisk (*) have been extended.

**Chapter 27—Alternative Minimum Tax**

**Exemption amounts.** The alternative minimum tax (AMT) exemption amounts have again been “patched” for 2010:

- $72,450 for married filing jointly
$47,450 for single taxpayers and heads of households
$36,225 for married filing separately

For 2011, the “patch” in the exemption amounts:

$74,450 for married filing jointly
$48,450 for single taxpayers and heads of households
$37,225 for married filing separately

**Tax credit offsets.** Nonrefundable personal tax credits, such as the lifetime learning credit and the dependent care credit, can be used to offset not only regular income tax, but also the alternative minimum tax through 2011. After 2011, the only nonrefundable personal credits that can offset AMT will be the adoption credit, the child tax credit, and the retirement saver’s credit, unless Congress continues the current rule.

**Chapter 29—Other Taxes**

**Social Security and Medicare taxes.** The 2011 wage base for the Social Security tax portion of FICA and self-employment tax remains unchanged from 2010 at $106,800. There is a 2% reduction in the employee share of Social Security taxes in 2011. Thus, instead of withholding 6.2% from employees, the withholding is 4.2%. This reduction is reflected in new withholding tables (see IRS Publications 15 and 15-A).

**Payroll notices.** Congress did not extend the federal COBRA subsidy. Thus, the subsidy applies only to workers who were involuntarily terminated before June 1, 2010.

**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.

**Depositing employment taxes.** Starting January 1, 2011, employment taxes, with few exceptions, must be deposited electronically using EFTPS.gov. Forms 8109 and 8109-B, Federal Tax Deposit Coupon, cannot be used after December 31, 2010.

**Form W-2 reporting.** Employers were supposed to report the value of health care for employees in 2011, whether paid by the employer, employee, or a combination of both; the IRS has made this reporting voluntary for 2011. Mandatory reporting will begin in 2012.

**Self-employment tax.** Health insurance premiums paid by self-employed individuals in 2010 are subtracted from net earnings from self-employment in order to figure self-employment tax. In effect, there is no self-employment tax on these premiums. This rule is set to run only for 2010.

For 2011, self-employed individuals pay 13.3% because of the 2% reduction in the Social Security portion of the so-called employee share of self-employment tax. Self-employed
individuals should adjust their 2011 quarterly estimated tax payments to enjoy the 2% tax savings.

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

*Filing deadlines.* The due date for filing 2010 returns by individuals and partnerships reporting on a calendar basis is April 18, 2011. The extended due date for these returns is October 17, 2011.

*Fast Track Settlement Program.* The IRS’s Fast Track Settlement Program has been extended to the SB/SE, allowing small businesses and self-employed individuals to expedite the resolution of these cases within the SB/SE division. The program is restricted to taxpayers in these locations: Chicago; Houston; St. Paul, MN; Philadelphia; Central New Jersey; and San Diego, Laguna Nigel, and Riverside, CA.