

Business and Corporate Changes

The new legislation contains an assortment of business and corporate tax breaks, as well as some revenue raisers affecting business taxpayers. I am writing to provide you with a quick overview of the provisions in the new law that directly impact business.

Extension of increased expensing for small business.

A taxpayer, other than an estate, trust, and certain noncorporate lessors, may elect under Code Sec. 179 to deduct as an expense, rather than to depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year in his trade or business. The maximum dollar amount that may be deducted annually is \$100,000 (\$108,000 for 2006, as adjusted for inflation). Under pre-Act law, this amount was to drop to \$25,000 for property placed in service in tax years beginning after 2007.

The taxpayer's maximum annual Code Sec. 179 expensing amount is reduced dollar-for-dollar by the amount of qualified expensing-eligible property that he places in service during the tax year in excess of a phaseout amount. This amount is \$400,000 (\$430,000 for 2006, as adjusted for inflation). Under pre-Act law, this amount was to drop to \$200,000 for property placed in service in tax years beginning after 2007.

Off-the-shelf computer software qualifies as "section 179 property" eligible for the Code Sec. 179 expense election, but under pre-Act law, could not qualify in tax years beginning in 2008 and later.

A Code Sec. 179 election or a revocation may be made, without IRS's consent, on an amended federal tax return for the tax year to which the election or revocation applies, but under pre-Act law, could not be so made in tax years beginning after 2007.

The new law extends the \$100,000 expense election limit and the \$400,000 phaseout ceiling (as inflation adjusted), the inclusion of off-the-shelf computer software in eligible "section 179 property," and the right to amend or revoke an expense election without IRS's consent for two years, to tax years beginning before 2010.

50% W-2 wage limit on the Code Sec. 199 domestic production deduction modified.

The domestic production deduction is limited to 50% of the W-2 wages paid by the taxpayer. Under the new law, the W-2 wages taken into account for purposes of this limitation must be properly allocable to domestic production gross receipts - that is, the gross receipts from the activities that give rise to the deduction. In addition, the new law repeals the special limitation on the amount of W-2 wages that may be taken into account by partners and S corporation shareholders. The changes are effective for tax years beginning after May 17, 2006.

Controlled foreign corporations (CFCs).

The new law makes two changes regarding controlled foreign corporations. First, it provides a two-year extension of the “active financing exemption,” due to expire at the end of this year and important to the financial-services industry. The exemption, which dates back to 1997, says that U.S. companies shouldn't be taxed on the active business income earned abroad by their foreign subsidiaries until the income is returned to the American parent. Second, regarding look-through treatment of payments between related CFCs under the foreign personal holding company income rules, the Act adds a new temporary exception from subpart F for dividends, interest, rents and royalties received by one CFC from a related CFC to the extent attributable to non-subpart F income of the payor. This provision is effective for tax years beginning after Dec. 31, 2005 and before Jan. 1, 2009.

Modified rules for distributions of controlled corporations.

The new law simplifies the active business test for tax-free corporate spin-offs by looking at all corporations in the distributing corporation's and the spun-off subsidiary's respective affiliated group to determine if the active business test is satisfied. This change applies for distributions after May 17, 2006 and before 2011.

Amortization of expenses paid for musical works and copyrights.

The new law allows taxpayers to elect to amortize over five years expenses paid or incurred in creating or acquiring certain musical works and copyrights. This five-year amortization method is an alternative to the income forecast method of accounting for these expenses.

Revenue offsets.

The new law pays for the extended and new tax breaks highlighted above with a number of revenue-raising provisions, including the following:

... Corporations with assets of at least \$1 billion face a modified schedule of estimated tax payments. Those payments due in July, Aug., or Sept. of 2006 will be increased to 105% of the payment otherwise due, and the next required payment will be reduced accordingly. Payments due in July, Aug., or Sept. of 2012, will be increased to 106.25% of the payment otherwise due, and the next required payment will be reduced accordingly. Finally, payments due in July, Aug., or Sept. of 2013, will be increased to 100.75% of the payment otherwise due, and the next required payment will be reduced accordingly.

... In another estimated tax change, with respect to corporate estimated tax payments due on Sept. 15, 2010, 20.5% won't be due until Oct. 1, 2010, and for Sept. 15, 2011, 27.5% won't be due until Oct. 1, 2011.

... Information reporting will be required for tax-exempt interest paid on tax-exempt bonds after Dec. 31, 2005.

... Taxpayers will be required to make partial payments to the IRS with any offer in compromise. For lump-sum offers (which include single payments, as well as payments made in 5 or fewer installments), taxpayers will have to make a down payment of 20% of the amount of the offer with any application. Any periodic payment offer in compromise will have to be accompanied by the payment of the amount of the first proposed installment. User fees will be applied against tax, interest or penalties due under the offer in compromise.

... The new law codifies proposed regs that provide that, for purposes of applying the earnings-stripping rules to a corporation that owns, directly or indirectly, an interest in a partnership, the corporation's share of partnership liabilities, interest income, and interest expense will be treated as those of the corporation. This provision is effective for tax years beginning on or after May 17, 2006.

... The new law denies tax-free treatment to certain spin-offs where either the distributing corporation or the controlled corporation is a “disqualified investment corporation.”

... The new law requires amortization of geological and geophysical (G&G) costs over five years (instead of the more favorable 24 months) for certain major integrated oil companies, effective for amounts paid or incurred after May 17, 2006. The five year amortization rule for G&G costs will apply only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the tax year, gross receipts in excess of \$1 billion in the last tax year ending during calendar year 2005, and an ownership interest in a crude oil refiner of 15% or more.

Please keep in mind that we have described only the highlights of the most important changes in the new law. Give us a call at your earliest convenience for more details on how you may be affected by this important tax legislation.