Federal Income Tax Provisions for Material Participants

The Small Business and Work Opportunity Tax Act of 2007 (P.L. 110-28)

Economic Stimulus Act of 2008 (P.L. 110-185)

Federal Income Tax Provisions for Material Participants

- Two recent provisions will affect nonindustrial private forest owners who hold their forest as part of a trade or business:
  - ✓ Increases in the section 179 deduction
  - ✓ Family business tax simplification provision

Section 179 Deduction

- Permits active participants in a trade or business to deduct at least part of the cost of *qualifying property* acquired for the business instead of having to depreciate it
  - ✓ In general, qualifying property is depreciable tangible personal property, defined to include single-purpose agricultural or horticultural structures, but not most other buildings or components of buildings

Section 179 Deduction

- ✓ Not available to investors, or to trusts or estates

Section 179 Deduction

- Earlier tax acts increased the maximum amount of the deduction to $100,000, indexed for inflation, and extended the increase through 2009
  - ✓ The maximum deduction $108,000 for 2006
  - ✓ Deduction was reduced dollar-for-dollar for purchases over a phase-out limit, also indexed for inflation, equal to $430,000 for 2006

Section 179 Deduction

- Small Business and Work Opportunity Tax Act of 2007 increased the maximum deduction to $125,000, indexed for inflation, and extended it through 2010
  - ✓ Also increased the phase-out limit to $500,000, indexed for inflation
  - ✓ And extended the section 179 deduction provisions for GO Zone businesses through 2008

Section 179 Deduction

- Economic Stimulus Act 0f 2008 increased the maximum deduction to $250,000 and the phase-out limit to $800,000
  - ✓ Neither amount is indexed for inflation – apply to tax years beginning in 2008 only
  - ✓ For tax years beginning after 2008, return to Small Business and Work Opportunity Tax Act provisions

Section 179 Deduction

EXAMPLE 1: If you placed section179 property costing \$150,000 in service during 2008, you could deduct the entire \$150,000

EXAMPLE 2: If you placed section 179 property costing \$850,000 in service during 2008, your deduction would be reduced by the \$50,000 difference between the cost and the phase-out limit:

Deduction = \$800,000 – \$50,000 = <u>\$750,000</u>

Family Business Tax Provision

- Under previous law, a husband and wife who both qualified as material participants in an unincorporated business would ordinarily be considered a partnership
- Under the new provision, a married couple who form a qualifying joint venture can elect to be taxed as two sole proprietorships instead of a partnership

Family Business Tax Provision

- *To qualify:*
  - ✓ *The husband and wife must be the only members of the joint venture,*
  - ✓ *Each must qualify independently as an active participant in the trade or business, and*
  - ✓ *Both must elect to have the provision apply*

Family Business Tax Provision

- *All items of income, gain, loss, deduction, and credit are divided between the spouses according their respective interests in the venture*
  - ✓ Each files their own business and self-employment tax forms, and
  - ✓ Each receives credit for paying Social Security and Medicare taxes
- Effective for tax years beginning after 2006