

# THE SMALL BUSINESS AND WORK OPPORTUNITY TAX ACT OF 2007

## Overview of Tax Changes

Congress recently passed the 2007 “Small Business Act” on May 24, and it was signed into law by the President on May 25, 2007. This new legislation, designed ostensibly to soothe the burden on small business of an increase in the minimum wage, contains an assortment of tax relief and revenue raising provisions. Here are the main tax provisions under the new law.

## Tax Relief Provisions

- ***Extend and liberalize the work opportunity tax credit.*** The credit is extended for 3.5 years with liberalized rules for hiring disabled veterans and workers in rural renewal counties.
- ***Extend and enhance Section 179 small business expensing.*** The (Code Sec. 179) expensing limit is increased to \$125,000 and the investment-based expensing phaseout is increased to \$500,000, effective for tax years beginning after 2006, and the enhanced expensing provision is extended for another year (through 2010).
- ***Extend and enhance certain GO Zone tax incentives.*** The small business expensing rules allowed for GO Zone businesses (i.e., \$100,000 higher expensing limit and \$600,000 higher phaseout point) are extended for one year (through 2008) for small businesses in the hardest hit area of the GO Zone. Also, the low-income housing credit rules for buildings in the GO Zones are extended and expanded, and the bond financing rules for repairs and reconstructions of residences in the GO Zones are modified.
- ***Enhance the tip credit for certain small businesses.*** The Federal minimum wage level for purposes of calculating the tip credit is frozen, thereby allowing restaurants to continue claiming the full tip credit despite an increase in the Federal minimum wage.
- ***Simplify family business tax.*** An unincorporated business that is jointly owned by a married couple in a common law state is permitted to file as a sole proprietorship (under prior law, unless the married couple was located in a community property state, both the married couple and the business were subject to penalties for failing to file as a partnership). The new law also ensures that both spouses receive credit for paying Social Security and Medicare taxes.
- ***Waive individual and corporate AMT limitations on work opportunity tax credits and tip credits.*** Prior law limited a small business' ability to claim the work opportunity tax credit and the tip credit by imposing a limitation that such credits could not be used to

offset taxes that would be imposed under the alternative minimum tax (AMT). The new law provides a permanent waiver of the individual and corporate AMT limitations for the work opportunity tax credit and the tip credit.

- ***Liberalize several S corporation rules.*** The new law contains several provisions beneficial to S corporations, including measures that:
  - Redefine “passive investment income” for purposes of S corporation revocation rules to exclude gains from the sale or exchange of stock or securities as an item of passive investment income.
  - Exclude restricted bank director stock from treatment as S corporation stock.
  - Set forth a special accounting rule for banks that become S corporations and that change from the reserve method of accounting for bad debts.
  - Revise the tax treatment of sales of stock of wholly-owned subsidiaries of S corporations.
  - Eliminate pre-1983 earnings and profits arising during an S corporation year, regardless of whether the corporation was an S corporation in its first taxable year beginning after December 31, 1996.
  - Permit an electing small business trust (ESBT) to deduct interest expense it incurs when it borrows funds to purchase S corporation stock.

### **Revenue Provisions (Offsets)**

... Raising the kiddie tax age from under-18 to under-19 (under-24 if a student).

... Modifying the rule that IRS must stop charging interest and filing related penalties if it fails to notify the taxpayer about a deficiency within 18 months after the taxpayer filed the return-the time limit is extended to 36 months.

... Eliminating the requirement that IRS hold a collection due process hearing before issuing a levy on delinquent employment taxes.

... Expanding preparer penalties to all types of tax returns (e.g., employment, excise, exempt orgs., estate and gift tax) and increasing the penalty amounts.

... Creating a new penalty on claims for refund that are filed without any reasonable basis.

... Increasing the penalty for bad checks and money orders.

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.