

July 2007

TAX BULLETIN

SMALL BUSINESS AND WORK OPPORTUNITY ACT OF 2007

\$8 Billion in Tax Cuts

The *Small Business and Work Opportunity Act of 2007*, which passed Congress on May 24 and was signed into law by President Bush on May 25, gives businesses nearly \$5 billion in tax cuts over a 10-year period. Through the Congressional budget rules, however, the tax advantages to small business over the next five years are even more generous: over \$8 billion.

All of the small business provisions are designed to help businesses absorb the cost of a higher federal minimum wage. The new law gradually raises the federal minimum wage from \$5.15 an hour to \$7.25 an hour over the next two years. Unlike past tax cuts, this one is fully offset by certain revenue raisers, which are expected to bring in \$5 billion to pay for business tax cuts.

Business Tax Incentives

Small business expensing. In very good news, Congress significantly extended and expanded small business expensing. The tax laws allow you to deduct some business expenses that would otherwise have to be depreciated. Generally, you can deduct up to \$112,000 in qualifying expenditures for property placed in service in 2007. There is a \$450,000 investment limitation. The new law raises the dollar limitation from \$112,000 to \$125,000 and the income limitation from \$450,000 to \$500,000, retroactive to the start of 2007. The amounts are also indexed for inflation.

Work Opportunity Tax Credit. The Work Opportunity Tax Credit (WOTC) is one of several tax incentives to encourage employers to hire challenged individuals. The new law extends the credit to cover more veterans and some other target groups, like workers in rural renewal counties. In return, employers that hire individuals from these targeted groups get some generous tax savings under the new law. This credit will be available for AMT purposes as well.

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. This credit will also now be available for AMT purposes.

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. The new law also ensures that both spouses receive credit for paying Social Security and Medicare taxes.

Liberalize several S corporation rules. The new law also 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.

Katrina Recovery

One of the ways the federal government is helping Hurricane Katrina taxpayers is by offering them tax breaks to rebuild their homes and businesses. The new law expands some housing tax incentives and small business expensing opportunities.

Revenue Raisers

The 2007 Small Business Act pays for the above benefits by:

- Raising the kiddie tax age from under-18 to under-19 (under-24 if a student), effective January 1, 2008.
- Extending – from 18 to 36 months – the period in which IRS must notify a taxpayer of the taxpayer's liability with respect to a tax return before IRS must suspend the accrual of interest and penalties relating to that liability.
- 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 organizations, 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. If you have any questions or would like to discuss how you may be affected by this important tax legislation, please contact your Wolf Financial Group representative.