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Small Business Act: Taxpayer Provisions

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We all know that April showers bring May flowers. This year, however, May not only saw flowers, it also saw the arrival of new tax powers. On May 25, 2007, President Bush signed The Small Business and Work Opportunity Tax Act of 2007 (P.L. 110-28, Small Business Act) into law. This law was passed in conjunction with legislation to continue funding the war in Iraq and

to raise the federal minimum wage from \$5.15 to \$7.25 an hour.

The intent of the new legislation is to provide almost \$5 billion in small business tax relief provisions. As with all new tax acts, it also includes new revenue-raising provisions. Someone has to pay for the “tax cuts,” after all. This article examines the key tax relief provisions for taxpayers.

The Work Opportunity Credit

Current tax law provides a work opportunity tax credit (WOC) for employers who hire individuals from one or more of nine targeted groups, such as veterans, ex-felons, high-risk youth, and food stamp and supplemental security income recipients. As noted in the Staff of

the Joint Committee on Taxation report (JCX 29-07, p. 2), the amount of the credit available to an employer is determined by the amount of qualified wages that employer pays. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period starting on the first day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category). The WOC was retroactively extended by the Tax Relief and Health Care Act of 2006 for employers who hire individuals by December 31, 2007. The good news for employers is that the Small Business Act extended the WOC for 44 months to include

qualified individuals who begin work for an employer after December 31, 2007, and before September 1, 2011.

Business Tax Credits and AMT

Under present law, business tax credits such as the WOC generally may not exceed the excess of the taxpayer's income tax liability over the tentative minimum tax (or, if greater, 25% of the regular tax liability in excess of \$25,000). If a business has credits in excess of the limitation, it may carry those credits back one year and forward for up to 20 years. To understand this fully, we need to define tentative minimum tax. The tentative minimum tax is an amount equal to specified rates of tax imposed on the excess of alternative minimum taxable income over an exemption amount. To the extent the tentative minimum tax exceeds the regular tax, a taxpayer is subject to the alternative minimum tax. Thus, business tax credits generally can't offset the alternative minimum tax liability.

How does the Small Business Act help? Starting in 2007, the provision treats the tentative minimum tax as being zero when determining the tax

liability limitation with respect to the WOC (and the credit for taxes paid with respect to employee cash tips). For employers, this means that the WOC may now offset the alternative minimum tax liability!

Small Business Expensing

Under IRC §179, a taxpayer may elect to fully expense capital investments in lieu of depreciation expense. As noted in the Staff of the Joint Committee on Taxation report (JCX 29-07, p. 7), present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2003 through 2009 is \$100,000 of the cost of qualifying property placed in service for that taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for active use in a trade or business. The \$100,000 is reduced (but not below zero) by the amount that the cost of qualifying property placed in service during the taxable year exceeds \$400,000. The \$100,000 and \$400,000 are indexed for inflation for taxable years beginning after 2003 and before 2010. For taxable years beginning in 2007, the inflation-adjusted amounts are \$112,000 and \$450,000, respectively. For taxable years beginning in 2010 and thereafter, a taxpayer can deduct up to \$25,000 of the cost of qualifying property placed in service for that taxable year. Additionally, the \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property exceeds \$200,000. The \$25,000 and \$200,000 amounts are not indexed for inflation.

The provision increases the \$100,000 and \$400,000 amounts to \$125,000 and \$500,000, respectively, for taxable years beginning in 2007

through 2010. And, yes, these amounts are indexed for inflation.

Subchapter S Provision

In general, an S corporation isn't subject to corporate-level income tax on its items of income and loss. Instead, an S corporation's income and losses are passed through to its shareholders. If the corporation has excess net passive income, however, that is subject to corporate-level tax at the highest corporate tax rate if (1) the corporation has accumulated earnings and profits at the close of the taxable year, and (2) more than 25% of its gross receipts are passive investment income.

Excess net passive income is the net passive income for the taxable year multiplied by a fraction: The numerator is the amount of passive investment income that exceeds 25% of gross receipts, and the denominator is the passive investment income for the year. Net passive income is the passive investment income reduced by the allowable deductions that are directly connected with the production of that income. Passive investment income generally means gross receipts derived from royalties, rents, dividends, interest, and gains from the sale or exchange of stocks or securities. In addition, an S corporation election is terminated whenever the S corporation has accumulated earnings and profits at the close of each of the three consecutive taxable years and more than 25% of its gross receipts for each of those years are passive investment income.

How does the new tax legislation help? For taxable years beginning after the date of enactment (May 25, 2007), capital gain income (gains from the sale or exchange of stock or securities) is no longer treated as

passive investment income for S corporations. That is to say, S corporations that were previously subject to having their S-election revoked for passive income due to capital gains not only save the S-election, but they also save tax!

The interesting aspect to all of the tax relief provisions, in case you didn't notice, is that all of the provisions extend through 2011 (when the sunset provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 kicks in).

Another appealing taxpayer provision is the increase of the federal minimum wage. Pursuant to Act §8102, the federal minimum wage of \$5.15 is raised to \$5.85 an hour starting July 24, 2007. It rises to \$6.55 an hour on July 24, 2008, and then goes to \$7.25 an hour beginning July 24, 2009.

This provision isn't exactly appealing to business owners, but a provision is provided to reduce the sting: The FICA tip credit calculation will be based on the minimum wage figure of \$5.15 and not the new number. The tip credit is equal to an employer's FICA taxes paid on tips in excess of those tip amounts that are treated as wages for meeting the minimum wage amount. Instead of using the prevailing minimum wage figure for this calculation, an employer can continue to use the \$5.15 figure. Hence, the tip credit isn't reduced by the higher minimum wage figure.

In a future article, we will continue with our discussion of the Small Business Act by exploring the revenue-raising provisions, including the age increase for the "kiddie" tax, permanent extension of IRS user fees, increase in penalties for bad checks and tax return preparer

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understatement of taxpayer's liabilities, and the imposition of penalties for filing erroneous refund claims. ■

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