Small Business and Work Opportunity Tax Act of 2007

Kathleen Zhang
CERTIFIED PUBLIC ACCOUNTANT

Kathleen Zhang, CPA
124 Main Street. 844 Massachusetts Ave
Acton, MA 01720 Lexington, MA 02420
Tel: 978-263-4355 Fax: 978-264-9909 E-mail: kathy@kathleenzhangcpa.com

NEWSLETTER
NOVEMBER 2007

President Signs Small Business and Work Opportunity Tax Act: Triggers Retroactive and Immediate Changes

Congress passed the *Small Business & Work Opportunity Tax Act of 2007* tax incentives bill coupled with an increase in the federal minimum wage *(2007 Small Business Tax Act)* on May 24, 2007. President Bush signed the bill into law on May 25, 2007.

Revenue raising provisions totaling nearly $5 billion mean more taxes for certain taxpayers. One of them – an expansion of the kiddie tax to apply to children who are under age 19 or who are full-time students up to age 24 - will impact millions of families.

SMALL BUSINESS TAX INCENTIVES

The small business tax incentives are designed to help businesses absorb the cost of a higher federal minimum wage. The new law gradually raises the minimum wage to $7.25 over two years. Highlights of the small business tax incentives are:

(1) an extended and enhanced small business Code Sec. 179 expensing;
(2) a FICA tip credit calculation that ignores the new hike in the minimum wage; and
(3) an extended and enhanced Work Opportunity Tax Credit.

Small Business Expensing

Almost every new tax law over the past few years has tweaked small business expensing under Code Sec. 179 and the *2007 Small Business Tax Act* is no exception. The dollar and investment limitations are increased.

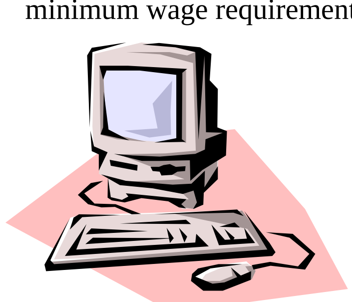
Dollar limitation. Under the new law, the base $100,000 limit ($112,000 as indexed for inflation for 2007) is increased to $125,000 for tax years beginning in 2007 through 2010.

Investment limitation. The maximum deduction is phased out by the amount by which all qualifying property placed in service during the tax year exceeds the investment limitation. The investment limitation for property placed in service in tax years beginning in 2007 was formerly $450,000, as indexed for inflation. The new law retroactively raises the investment limitation to $500,000 for tax years beginning in 2007 through 2010. The $500,000 amount is indexed for inflation in tax years beginning after 2007 and before 2011.

FICA Tip Credit

Under the *2007 Small Business Tax Act*, the FICA tip credit (also known as the Sec. 45B credit) will continue to be based on the old minimum wage of $5.15 per hour, rather than the new minimum wage, which will reach $7.25 over the next two years. As a result, even though the minimum wage has increased, the amount of the tip credit will not be reduced. The provision applies with respect to tips received for services performed after December 31, 2006.

An employer may claim a credit for FICA tax paid on tips received by employees for serving or delivering food or beverages consumed on the employer's premises if tipping is customary. Employers may claim the Code Sec. 45B credit even if employees do not report the tips. The credit equals the employer's FICA obligation (7.65 percent) attributable to tips that exceed those tips treated as wages for purposes of the minimum wage requirements of the Fair Labor Standards Act (FLSA).



AMT treatment. The new law treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the FICA tip credit. The FICA tip credit. The FICA tip credit may offset AMT liability.

Work Opportunity Tax Credit

The *2007 Small Business Tax Act* extends the Work Opportunity Tax Credit (WOTC) through August 31, 2011. It had been set to expire for employees hired after December 31, 2007. The new law also broadens the scope of the credit. The expanded WOTC is effective starting May 26, 2007.

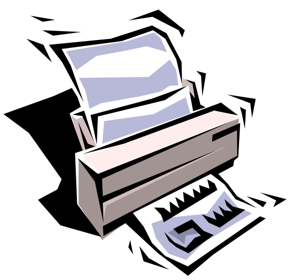
Small Business and Work Opportunity Tax Act of 2007

Kathleen Zhang, CPA
124 Main Street. Acton, MA 01720 Tel: 978-263-4355
844 Massachusetts Ave Lexington, MA 02420 Fax: 978-264-9909 E-mail: kathy@kathleenzhangcpa.com

NEWSLETTER
NOVEMBER 2007

(cont.)
The WOTC encourages employers to hire individuals from various economically-challenged populations. Traditionally the credit, which is a percentage of qualified wages paid during each of the first two years of employment, targeted individuals receiving public assistance high-risk youth, ex-felons, veterans, and others similarly situated.

The *2007 Small Business Tax Act* expands the targeted veterans' community. It now includes veterans with service-connected disabilities who have



been unemployed for six months or more during a one year period ending on the hire date (the six months does not have to be consecutive) and are hired within one year after having been discharged from the military or released from active duty. Additionally, the new law raises the qualified wage threshold for the expanded veterans' group (from $6,000 to $12,000)

The high-risk youth and vocational rehabilitation referral targeted groups have also been expanded.

AMT treatment. The new law treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the WOTC. The WOTC may offset AMT liability.

FAMILY BUSINESS TAX SIMPLIFICATION

Under the *2007 Small Business Tax Act*, a married couple who jointly operates an unincorporated business and who files a joint return can elect NOT to be treated as a partnership for federal tax purposes. This treatment is available for tax years beginning after December 31, 2006.

The husband and wife can be the only members of the joint venture. If there are other individuals in the enterprise, the provision does not apply. Additionally, both spouses must materially participate in the business.

If you have any questions, please don't hesitate to call. We are at your service.

S CORPORATIONS

The *2007 Small Business Tax Act* includes a package of S corp reforms. The changes impact the treatment of passive investment income, partial sale of qualified subchapter S subsidiaries (QSubs), interest deduction by electing small business trusts (ESBT), reduction of earnings and profits (E&P), and banks operating as S corps.

Passive Investment Income

The passive investment income test has long been a trap for S corps that convert from C corp status. The *2007 Small Business Tax Act* eliminates some of that worry and does an about-face by no longer treating capital gain from the sale or exchange *of stock or securities as an item of passive investment income.*

Reduction of E&P

Accounting methods. The new law allows an S corp to reduce its accumulated earnings and profits (E&P) by its pre-1983 accumulated E&P for which the corporation was an S corp. This benefit involving pre-1983 E&P had previously been available only to a corporation that was an S corp for its first taxable year after 1996. This provision takes effect for tax years beginning after May 25, 2007.

REVENUE RAISERS

Not all provisions in the 2007 Small Business Tax Act are pro-taxpayer. Some of the revenue raisers will hit a lot of taxpayers' wallets. The measures are expected to raise almost $5 billion over 10 years, making the new law fully offset.

Major "Kiddie Tax" Changes

The *2007 Small Business Tax Act* extends the reach of the "kiddie tax" by raising the age linit to include (1) all children under age 19 (previously under age 18) and (2) students under age 24. Both changes are effective for tax years beginning after May 25, 2007.

The actual computation of the kiddie tax remains the same. The net unearned income of the child (for 2007, generally unearned income over $1,700) is taxed at the parents' marginal tax rates, if the rates are higher than the child's tax rates. Only last year, TIPRA raised the reach of the kiddie tax from under age 14 to under age 18.