

The Small Business and Work Opportunity Act of 2007

After months of political wrangling, Congress has passed a small business tax incentives bill coupled with an increase in the federal minimum wage. The Small Business and Work Opportunity Tax Act of 2007 (2007 Small Business Tax Act) is part of a much larger and more controversial bill, H.R. 2206, U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability.

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.

Because of the extension of enhanced Section 179 expensing, taxpayers now have more certainty. The significantly more generous tax break is not only extended through 2010, it is also indexed for inflation. If Congress had not acted, the dollar limitation would have plummeted to \$25,000 and the investment limitation to \$200,000 after 2009. But since the deduction is completely phased out under the new levels for qualifying purchases above \$625,000, the deduction continues to be confined generally to the relatively small business.

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.

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.

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.

The new S corp provisions are designed to make it easier for small businesses to retain S corp status. In two cases—ESBT interest and E&P reduction—they also encourage use of the S corp business entity by effectively reducing the taxes owed by shareholders.

KIDDIE TAX

The 2007 Small Business Tax Act

extends the reach of the “kiddie tax” by raising the age limit 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.

College age students will no longer be able to sell off their appreciated investment accounts set up by the parents to cover current tuition. At a minimum, taking out student loans with interest until the year the student turns 24 will be necessary now to carry forward such a plan. However, the maximum tax on capital gains imposed on any stock sales might rise from 15 to 20 percent after 2010, adding another price tag to postponing income recognition.

The effective date for the new kiddie tax provision brings with it some good news and some bad news. For calendar year taxpayers, the higher age limit starts in 2008. The last hike in the kiddie tax, from age 14 through age 17, in TIPRA was made retroactive to the beginning of 2006. This time, the change is not retroactive and, for most taxpayers, does not take effect until next year. Parents have the option to sell quickly in 2007, while the old rule is still in effect.

For more information on these and other tax law changes, contact your Alpern Rosenthal representative.

