



SMALL BUSINESS
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AUDIT LETTERS

The first two thousand letters out of an eventual total of six thousand over three years will be sent to some very unfortunate small businesses by the Internal Revenue Service (IRS) next week. The reason businesses will be getting these letters is because their business rhymes with “random.” The IRS is conducting what it calls a National Research Program (NRP). The purpose is to determine whether businesses are properly classifying individuals as employees or independent contractors. If you are thinking, I do not need to read further because I do not have independent contractors, SORRY, you have to read on. First, this is supposedly a scientific sample. Businesses are not selected based on the likelihood of having an issue with classifications but because they are unlucky. Every business that gets the letter will be put through an audit, regardless. In addition to the classification issue the examiners will also be looking at executive and officer compensation (see SBLC Issue Paper on Reasonable Compensation) and whether fringe benefits are being properly reported as taxable or nontaxable income. (The IRS has a publication at

www.irs.gov that is a pretty good primer on fringe benefits, Publication 15-B, Employer's Tax Guide to Fringe Benefits.)

The bottom line is that the audit is not going to be a cakewalk just because you do not have independent contractors.

CREDITWORTHY

On Friday, the federal financial institutions regulatory agencies (i.e. the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the National Credit Union Administration) and the state supervisors issued an “Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers” to restate and elaborate their supervisory views on prudent lending to creditworthy small business borrowers.

In part the regulators, said, “As a general principle, examiners will not adversely classify loans solely due to a decline in the collateral value below the loan balance, provided the borrower has the willingness and ability to repay the

loan according to reasonable terms. In addition, examiners will not classify loans due solely to the borrower’s association with a particular industry or geographic location that is experiencing financial difficulties.”

We will see if it helps. If you are curious, the entire statement can be found at http://www.federalreserve.gov/news_events/press/bcreg/bcreg20100205.pdf

THREE TOES IN THE DOOR

Congress has passed legislation to increase the Federal debt ceiling. (Every time I type those words, I shake my head, thinking wouldn’t it be nice to decrease the debt instead?) The President will sign it. The law creates a statutory pay-as-you-go regime that requires Congress and the Administration to maintain balanced budgets – if you do not count all the exceptions ☺ such as Social Security, veterans’ disability and other benefits, and major low-income entitlements, such as Supplemental Security Income and Medicaid.

In addition to the exceptions, as I have been reporting, the bill includes four waivers from the

offset requirement, if Congress were to pass legislation to address specific issues. The three of interest to us are estate tax relief, Alternative Minimum Tax Relief (AMT) and an increase in the Section 179 Direct Expensing Allowance. The estate tax relief and AMT relief permitted under the bill are for two years in duration. The increase in the Direct Expensing Allowance can be a permanent increase.

The estate tax “waiver” is for an amount of tax revenue “lost” if a two-year freeze, based on the 2009 top rate of 45 percent and exemption of \$3.5 million, is instituted. Congress could devise any variation on the rate and exemption as long as it fits within the revenue lost number. The issue of whether a freeze would be retroactive to the beginning of the year is a matter that would have to be resolved during the legislative debate.

The AMT income levels for 2010 have reverted to their old levels. The 2009 AMT exemptions of \$70,950 for married couples and \$46,700 for unmarried filers have reverted in 2010 to the pre-2001 levels of \$45,000 and \$33,750, respectively. The waiver would allow Congress to push the levels back up to the 2009 levels with indexing for two years.

When the Direct Expensing Allowance (often referred to by its Internal Revenue Code Section - 179) was originally enacted, it allowed businesses to write off \$25,000 of capital asset purchases in the year of purchase. However, if you spent more than \$200,000 on such things as equipment in the year, the Direct Expensing Allowance phased out and you had to use depreciation.

Over the years, we have been able to secure temporary increases in both the allowance and the investment cap. In 2007, the limits were increased to \$125,000 and \$500,000, respectively, for taxable years beginning in 2007 through 2010. In 2008, the amounts were increased for taxable years beginning in 2008 to \$250,000 and \$800,000, respectively.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act. It extended the temporary increases of 2008 through 2009. In 2010, the amounts have returned to the 2007 levels of \$125,000 and \$500,000 indexed. In 2011, the amounts revert to pre-2003 levels of \$25,000 and \$200,000. Enactment of the debt ceiling increase law gives us the opportunity to at least set the permanent baseline amounts at the 2007 levels rather than the pre-2003 levels – if we can convince Congress to do so.

(Because of the indexing, the amounts one reads in accounts are the actual amounts for a year. For example, in 2008, the actual allowance was \$128,000. For policy purposes, the baseline amounts are used.)

SENATE JOBS BILL

The Senate is scheduled to consider a “jobs” bill this week. Infrastructure spending and a jobs tax credit are the big items of interest to us. Since the details are still fluid, I am still reluctant to provide an analysis.