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ANOTHER WEEK, ANOTHER SMALL BUSINESS JOBS AND TAX RELIEF BILL

This week the House is expected to consider H.R. 5486, the Small Business Jobs Tax Relief bill. The bill would provide for the temporary 100 percent exclusion of gains from the sale of certain small business stock from the capital gains tax, the easing of penalties for small businesses that inadvertently engaged in what are called listed transactions, and the temporary increase in the deductible amounts for small business start up expenditures.

If the bill sounds familiar, it is because those provisions can be found in H.R. 4849, the Small Business and Infrastructure Jobs Tax Act, which passed the House in March. The difference is that H.R. 4849 included several infrastructure items such as an extension of the Build America Bond program.

The House leadership has ditched the infrastructure items and as a result, some of the revenue offsets. (The offset to increase the penalties for failing to issue timely Form 1099s is the one that gave us heartburn, coming on the heels of the passage of the huge increase the

responsibility to issue Form 1099s that is now law.) We support the penalty relief for listed transactions and welcome any increase in start up deductions. The capital gains tax relief for gains from the sale of certain small business stock is way down on our priority list because it is so narrow. As far as I know, none of the remaining revenue offsets is a problem for the small business community.

Even with a scorecard, it is almost impossible to keep track of all of the “jobs” and “tax relief” bills pending. This current bill and its predecessor have nothing to do with the on-going extender bill debate in the Senate.

Speaking of extenders, Senators Olympia Snowe (R-ME) and Mike Enzi (R-WY) have offered an amendment to drop the “recharacterization of income of professional service S Corporations’ shareholders as wages” (I am thinking I need to create an acronym for this offset (PSSCSAW) if this debate continues) offset in the current extenders bill pending in the Senate. The Senate will continue to discuss the extenders bill this week. About the only thing I can say is that the Senate bill will not match up with the most recent House-

passed version so the merry go-round will take at least another turn.

NON-SBA SMALL BUSINESS LENDING

The House is expected to consider this week H.R. 5297, the Small Business Lending Fund (SBLF) Act. The bill will establish a \$30 billion fund to boost lending to small businesses. Under the proposal, the SBLF would support lending among community and smaller banks with assets under \$10 billion. The theory is the new program will provide an incentive for smaller banks to increase small business lending – as their lending increases, the dividend rate or interest rate payable to Treasury gets reduced, to as low as 1 percent for banks that increase lending by 10 percent from a baseline set in 2009.

REMIND ME AGAIN

Why is the 100 percent exclusion for capital gains on small business stock not high on our list of priorities?

This is a change to a very narrow specialized provision that has been the tax code for years; most small businesses do not utilize this

provision. Under long-standing law, individuals were able to exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years. The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax. A percentage of the excluded gain is an alternative minimum tax preference; the portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of 28 percent under the alternative minimum tax.

As a result of the enactment of the American Recovery and Reinvestment Act (ARRA) last year, the percentage exclusion for qualified small business stock sold by an individual was increased temporarily from 50 percent (60 percent for certain empowerment zone businesses) to 75 percent for 2009 and 2010. The bill would increase the exclusion to 100 percent.

This is not something the “average” small business owner can take advantage of. Think “venture capitalist.” The definition of what constitutes “qualified” small business stock is what takes all the fun out of this. The stock must meet all of the following tests.

1. It must be stock in a C corporation.
2. It must have been originally issued after August 10, 1993.
3. The corporation must have total gross assets of \$50 million or less at all times after August 9, 1993, and before it issued the stock. Its total gross assets immediately after it issued the stock must also be \$50 million or less. When figuring the corporation's total gross assets, you

must also count the assets of any predecessor of the corporation. In addition, you must treat all corporations that are members of the same parent-subsidiary controlled group as one corporation.

4. You must have acquired the stock at its original issue, directly or through an underwriter, in exchange for money or other property (not including stock), or as pay for services provided to the corporation (other than services performed as an underwriter of the stock). In certain cases, your stock may also meet this test if you acquired it from another person who met this test, or through a conversion or trade of qualified small business stock that you held.

5. The corporation must have met the active business test, defined next, and must have been a C corporation during substantially all the time you held the stock.

6. Within the period beginning 2 years before and ending 2 years after the stock was issued, the corporation cannot have bought more than a de minimis amount of its stock from you or a related party.

7. Within the period beginning 1 year before and ending 1 year after the stock was issued, the corporation cannot have bought more than a de minimis amount of its stock from anyone, unless the total value of the stock it bought is 5 percent or less of the total value of all its stock.

REMIND ME AGAIN

Why do we care about penalty relief for small business' inadvertent use of “listed transactions?”

In its never-ending quest to close tax shelters, Congress passed Section 6707A of the Internal Revenue Code in 2004, imposing a penalty of \$100,000 per individual and \$200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a “listed transaction” or “substantially similar” to a listed transaction. Basically, “listed transactions” are those the IRS views as designed for tax avoidance purposes and the idea was that if taxpayers had to disclose that they were utilizing the tax shelter device, they would be less likely to use them.

The significant feature of the 2004 law was a “no mercy” rule. The IRS has taken the view it has no discretion in assessing the penalty - it must do so in all cases. This means the penalty applies without regard to whether the small business or the small business owners have knowledge that the type of transaction has been “listed.” The penalty applies even if the small business and/or the small business owners derived no tax benefit from the transaction! The penalty also applies even if, on audit, the IRS accepts the derived tax benefit. You fail to disclose the transaction on the IRS list of those to be disclosed – penalty assessed – end of story.

Most small businesses probably would not seek to engage in a tax avoidance transaction and it is highly unlikely they have heard of the “listed transactions” rule. However, it is not out of the realm

of possibility. And some have. And the penalties assessed have been as described. What kind of transactions might small businesses trip over that are considered "listed transactions?" How about:

Adopting a certain type of defined benefit plan which called a 412(i) plan - this is a defined benefit plan funded with insurance products. Not all 412(i) plans are listed transactions but many are.

Insurance funded welfare plans. They were sold primarily as a vehicle for owners to be covered by insurance benefits and provided for discriminatory benefits between the owners and non-owners of the business.

Roth-IRA transactions - small business owners were told that they could run their businesses through a Roth IRA.

PICKING PRIORITIES

And yes, if you are wondering, while neither a qualified small business stock sale or the use of listed transactions are common events, a small business is more likely to stumble inadvertently into a listed transaction than be eligible for the small business stock sale exclusion. So while we would take both, the listed transactions fix is higher on our list than the small business stock exclusion.

"Eliminating small business capital gains" makes for a wonderful sound bite, but probably less than a couple of dozen folks on the Hill and in the Administration know what it really entails.

ENDANGERMENT

Last week we reported that the Senate would take a run at the Environmental Protection Agency's (EPA) "endangerment finding" regarding greenhouse gases under the Clean Air Act. Said the EPA, "After a thorough examination of the scientific evidence and careful consideration of public comments, the U.S. Environmental Protection Agency (EPA) announced that greenhouse gases (GHGs) threaten the public health and welfare of the American people. EPA also finds that GHG emissions from on-road vehicles contribute to that threat."

Some senators were trying to overrule the finding through the Congressional Review Act (CRA). The resolution of disapproval failed last week. Since the CRA has a time limit on its use, opponents of the EPA's finding will have to find another option.