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SMALL BUSINESS JOBS TAX RELIEF ACT

The House passed H.R. 5486, the Small Business Jobs Tax Relief Act of 2010, on June 15, 2010, by a 247-170 margin. The bill has been combined with a small business lending bill, H.R. 5297, that has also been approved by the House, and the new combined bill has been sent to the Senate. Senate Majority Leader Harry Reid (D-NV) has said he hopes to bring the bill to the floor as soon as possible. The new bill will travel to the Senate as H.R. 5297 but with a new title, the Small Business Jobs and Credit Act of 2010.

The following are provisions of H.R. 5486:

Small Business Stock

Under current law, Internal Revenue Code (IRC) Section 1202 provides a 50 percent exclusion for gain from the sale of “certain” small business stock that is held for more than five years. The amount of gain eligible for the Section 1202 exclusion is limited to the greater of 10 times the taxpayer’s basis in the stock, or \$10 million gain from stock in that small business corporation. The non-excluded

portion of section 1202 gain is taxed at the lesser of ordinary income rates or 28 percent, instead of the lower capital gains rates for individuals. The term “certain” is based on the fact there are several specific conditions related to the nature of the stock that severely limit eligibility.

The American Reinvestment and Recovery Act temporarily increased the Section 1202 exclusion to 75 percent for qualifying stock acquired in 2009 and 2010.

H.R. 5486 would temporarily increase the amount of the exclusion to 100 percent for qualifying stock acquired after March 15, 2010 and before January 1, 2012.

Small Business Penalty Relief

Under current law, IRC Section 6707A imposes a penalty on the failure to disclose a “reportable transaction” on any tax return or information statement. There are six categories of reportable transactions, one of which is a “listed transaction.” A “listed transaction” is a type of transaction identified by the IRS through guidance as a tax avoidance transaction. The penalty for failure

to disclose a reportable transaction (other than a listed transaction) on a return is \$10,000 in the case of individuals and \$50,000 in any other case. For listed transactions, the penalty is \$100,000 in the case of individuals and \$200,000 in any other case. The Internal Revenue Service has taken the position it has no latitude to mitigate penalties and must assess the full penalty for inadvertent violations.

H.R. 5486 would make the penalty for failing to disclose reportable transactions (including listed transactions) proportionate to the underlying tax savings.

SBA Non-recourse Loans Treated as At-risk

Under current law, business expenditures are deductible against related business income even if they are financed with non-recourse debt. However, in order to prevent taxpayers from engaging in certain types of tax shelters, Congress enacted the “at-risk” rules to prevent taxpayers from using expenses financed with non-recourse debt to shelter unrelated income. There are exceptions to the at-risk rules in situations where Congress believed that, even though a project was financed with non-

recourse debt, that it is likely that the financing will be repaid and that the purchaser will have real equity in property financed with the non-recourse debt (e.g., real estate).

H.R. 5486 would provide an exception to the “at-risk” rules for non-recourse loans that are guaranteed by the Small Business Administration (SBA). The passive activity loss rules would still apply to these expenses to prevent taxpayers from engaging in tax shelter transactions.

Increase Deduction for Start-up Expenditures

Under current law, taxpayers may deduct up to \$5,000 in trade or business start-up expenditures. The amount that a business may deduct is reduced by the amount by which start-up expenditures exceed \$50,000. Start-up expenditures are defined as expenses paid or incurred in connection with investigating the creation of a business, and do not include expenses that would otherwise be allowed to be expensed (i.e., capital or equipment investments).

For taxable years beginning in 2010 or 2011, H.R. 5486 would increase the limit on the tax deduction for trade or business start-up expenditures from \$5,000 to \$20,000, and increase threshold amount for reducing such limit to \$75,000.

Small Business Borrower Assistance Program

H.R. 5486 would exclude from gross income any amounts that are received under the Small Business Borrower Assistance Program (SBBAP).

The SBBAP, however, does not exist yet. It is to be created by another bill, H.R. 5297, which the House has also passed. The SBBAP would provide assistance to small businesses that are struggling to meet their obligations to creditors.

SMALL BUSINESS LENDING FUND

The House passed H.R. 5297, the Small Business Lending Fund (SBLF) Act of 2010, on June 17, 2010 by a 241-182 margin. The bill has been combined with a small business tax relief bill, H.R. 5486, which the House has also passed. Senate Majority Leader Harry Reid (D-NV) has said he hopes to bring the combined bill to the floor as soon as possible. The new bill will travel to the Senate as H.R. 5297 but with a new title, the Small Business Jobs and Credit Act of 2010.

H.R. 5297 would 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 bill would allow eligible institutions with assets of \$1 billion or less to apply for a capital investment from the Fund of up to 5 percent of risk-weighted assets. It would allow eligible institutions with assets of between \$1 billion and \$10 billion to apply for a capital investment from the Fund of up to 3 percent of risk-weighted assets. The new program would 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.

Small Business Borrower Assistance Program

The House approved an amendment to H.R. 5297, offered by Representative Kurt Schrader (D-OR), creating a Small Business Borrower Assistance Program (SBBAP). Under the SBBAP, small businesses that obtain a SBA 7(a) loan (except revolving credit line loans) in the amount of \$300,000 or less will receive a reserve equal to 6 percent of their small business loan principal “to help them make payments through the ups and downs of a cash flow cycle.” according to Representative Schrader. Small businesses will automatically be enrolled in the SBBAP if eligible, unless the business specifically requests otherwise. In order to qualify, borrowers must obtain a qualifying loan within one year after the SBA issues final regulations for the program.

The borrower would request payments to be made as needed and the payments made by the SBA under the program shall only be made to the lender or servicer of a qualifying small business loan to be applied against outstanding principal or interest, and may not be made to the borrower.

As noted above, H.R. 5486, as passed by the House, would mitigate the tax consequences of receiving such assistance. And, as also noted, H.R. 5486 has now been rolled into H.R. 5297.