SMALL BUSINESS LEGISLATIVE COUNCIL

SBLC WEEKLY

Via E-mail
July 13, 2009

Volume XI, Issue 25

LISTED TRANSACTIONS

You probably have read the Internal Revenue Service (IRS) has said it will delay collecting some penalties on small businesses. Will it have an impact on you? Probably not. If it does, boy are you glad they have decided to hold off. Here's the story.

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 failed 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 highly unlike 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.

What action did the IRS take that has made the news? In a letter to the Hill, IRS Commissioner Doug Shulman said, "We will not undertake any collection enforcement action through September 30, 2009, on cases where the annual tax benefit from the transaction is less than $100,000 for individuals or $200,000 for other taxpayers per year. Because the penalty determination is related to the underlying transaction, and we can only determine the amount of tax benefit through examination, we will continue our examination on these cases. This practice will allow us to identify cases meeting the collection suspension threshold and will not delay the information gathering and review process."

Paula Calimafde, the Chair-Elect of SBLC, and her group, the Small Business Council of America (SBCA) (not to be confused with us ☺) were among the first to identify the potential unintended consequences for small businesses and they have been working diligently (with SBLC's support) to mitigate the impact. The IRS action is only a delay; SBCA and SBLC are working on a legislative solution. We will give Commissioner Shulman an "attaboy" for buying us some time.

We also need to give an "attagirl" to Taxpayer Advocate Nina Olson. She highlighted the problem in her 2008 annual report. Among the observations she noted was how quickly the penalties can add up: "Thus, an individual who does business through a wholly owned S corporation may enter into a ten-year transaction that he does not believe is improper and that produces little or no tax savings – only to end up owing a penalty of $3 million (i.e., a penalty of $200,000 on the S corporation and a penalty of $100,000 on the individual taxpayer for each of the ten years."

ELIGIBLE TO WORK

Last week, I had reported that Immigration and Customs Enforcement (ICE) agency had announced that it was increasing its I-9 compliance enforcement efforts. The I-9 form is the eligibility-for-employment form that requires verification of certain documents. The story probably triggered some vague memories in the back of your mind about E-Verify and No Match. In the past week, the Administration and Congress have taken some steps that will require you to move those thoughts up to the front of your mind.

1100 H Street N.W., Suite 540 Washington, DC 20005 / (202) 639-8500 / Fax: (202) 296-5333 / www.sblc.org

E-Verify is the controversial electronic eligible to work verification system the Department of Homeland Security (DHS) operates. It started out as a temporary voluntary pilot program. Since the funding for the temporary program runs out from time to time, the value (and the future) of the E-Verify system has been subject of congressional debate and caught up in comprehensive immigration reform discussions. In the last Congress, some Members of Congress proposed the creation of alternative systems.

One of the problems with the E-Verify system itself is the lag time. It is not “instant” verification. Under the program, employers enter the I-9 information into a computer program and submit the information to the federal government. Once the information is submitted, it is compared with information on both the Social Security Administration (SSA) and the Department of Homeland Security (DHS) databases. If SSA records confirm a legal work-authorization status, the employer is notified that the employee is verified. If the SSA cannot confirm the eligibility, the employer is notified that the employee has received a tentative non-confirmation finding. The employer is required to notify the employee of this finding. The employee can dispute the finding within a specified period of time, usually 10 days. During this time, employers are not allowed to take any adverse action against their employee based on the non-confirmation finding. However, the employer must terminate the employee if he or she does not wish to dispute the finding, the employee is found not to be work-authorized, or the employee receives a final non-confirmation findings.

The Bush Administration issued an Executive Order in June 2008 requiring federal contractors to use the E-verify system. Earlier this year, the Obama Administration delayed implementation.

“No match” refers to another even more controversial project proposed by the Bush Administration. Under the “no match” program employers who receive letters from the Social Security Administration, noting multiple errors with the social security numbers filed with W-2s (a long-standing initiative), would also receive a letter from the DHS at the same time, warning the employer that they need to fix the errors or risk liability for “knowingly” hiring illegal aliens.

DHS issued a No-Match Rule which detailed steps employers may take when they receive a "no match" letter and said ICE would consider employers who follow those steps to have acted reasonably. If an employer follows the "safe harbor" procedures in good faith, ICE said it would not use the employer's receipt of a no-match letter as evidence to find that the employer violated the employment provisions of the Immigration and Nationality Act by knowingly employing unauthorized workers.

A variety of employer and employee groups went to court to stop implementation of the program. The program was stayed by the court. The DHS then reissued basically the same rule but with new justifications to overcome the concerns of the court. The court, however, had not yet lifted its stay, and the no match rule had not been implemented as of last week.

So What Happened This Past Week?

On July 9, regarding the E-Verify program, DHS Secretary Janet Napolitano announced: “After a careful review, the Administration will push ahead with full implementation of the rule, which will apply to federal solicitations and contract awards Government-wide starting on September 8, 2009.”

In the same announcement, Secretary Napolitano said this about the No Match Rule: “It is DHS's intention to rescind the Social Security No-Match Rule, which has never been implemented and has been blocked by court order, in favor of the more modern and effective E-Verify system.”

End of Story?

Nope. This week the Senate finished up work on its versions of the Homeland Security Appropriations bill, H.R. 2892. Before approving the bill, the Senate adopted amendments to make the E-Verify System permanent, to require Federal contractors to use it AND to block DHS from rescinding the No Match Rule.

So Now What?

The House had passed its version of the Homeland Security Appropriations in June. It did not include any of the eligibility for employment verification amendments. The Senate bill also includes a provision to allow employers to use E-Verify to check the status of current employees, currently it can only be used for new hires.

So the bill heads to a conference committee. At this point, there is no indication when a conference committee will be convened. Also, at this point, it is not clear what the House thinks about the Senate’s actions.

LISTENING?

As you know, since mid May, SBLC has been making some noise about the shifting impact of the credit/bank situation. We have been emphasizing the changes in banks’ attitudes towards lines of credit.

A line of credit is the cash flow lifeline of many operating small businesses. Earlier this year the reports started crossing my desk about the fact lines of credit were being reduced, collateral re-valued and lines of credit converted to term loans.

There were reports in several major newspapers this week-end that the Administration is considering programs to help specifically with operational credit needs. Hopefully it adds up to good news. My main concern is will the help come soon enough?

What is the trend line? All along we have said the community banks continue to be the best friends of small business but even they are finding it more difficult to make available the kind of credit that small businesses need to operate on a daily basis.

The result is I am hearing about increasing pressure on “trade” credit, the unofficial traditional financing that is done within the sales and distribution channel within an industry. Trade credit practices vary greatly from industry to industry so it is hard to generalize. The most common is the adjustment in aging tolerances for receivables.