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RETURN TO WORK

Congress is back and has a full plate of issues from which to choose if they would like to take some action. The following is a review of some of the issues upon which SBLC is working.

HEALTH CARE REFORM

Issue

Fix the health care system. It is too complicated to get into the details.

One issue of interest is employer mandates. The House version requires employers to pay a tax if they do not provide health care coverage to employees and dependents. If the annual payroll of an employer for the preceding calendar year does not exceed \$500,000, the applicable percentage is 0 percent; if the payroll exceeds \$500,000, but does not exceed \$585,000, the percent is 2 percent; if payroll exceeds \$585,000, but does not exceed \$670,000, the percent is 4 percent; and if payroll exceeds \$670,000, but does not exceed \$750,000, the percent is 6 percent. If payroll is over \$750,000, the percent is 8 percent.

The Senate Health, Education, Labor, and Pension (HELP) Committee has a mandate for employers of more than 25 employees to provide coverage for employees or pay a flat fee to the government. The annual fee for not providing coverage would be equal to

\$750 for each full-time employee and \$375 for each part-time employee.

Status

The three principal House committees with jurisdiction over health care reform have finished their work on the House version of comprehensive reform, H.R. 3200. The Energy and Commerce Committee version contains many more pages than the Ways and Means and the Education and Labor Committees' versions, which are roughly the same. More significantly, it includes a series of amendments that resulted from negotiations between the leadership and the fiscally conservative "Blue Dog" Democrats. Over the August recess, the House Rules Committee was to develop a final version to be brought to the House floor.

The Senate Health, Education, Labor, and Pension Committee approved a version of comprehensive health care reform. The Senate Finance Committee was negotiating behind closed doors. A bipartisan "gang of six" was leading the efforts.

The budget resolution passed earlier this year includes a controversial procedural device known as "budget reconciliation instructions" to allow for health care reform consideration later in the year. The most significant feature of a reconciliation instruction is it can be passed with a simple majority. The various procedural obstacles that

would require 60 votes do not come into play. However, there are some technical aspects to a reconciliation bill that would severely limit the scope of the bill, in order to avoid a "point of order," which would put the 60 votes back in play.

In theory, the budget resolution provides that Congress has until October 15, 2009, to come up with a proposal, although Congress always seems to have a way of getting around deadlines

Outlook

The passionate nature of the town hall meetings held in August by members of Congress, expressing concern about the direction of the health care reform puts the initiative on a track towards "implosion." The passing of Senator Kennedy appears to have, at a minimum, neutralized the impact of the town halls. Given his career-long commitment to health care reform, there are senators in both parties who would like to finish the job in his honor. Senator Orrin Hatch (R-UT), who was close to Senator Kennedy, is probably a key barometer. Prior to the recess, he backed away from bipartisan talks. If he re-enters the discussions, it could have a significant impact on the outcome.

Congressional Democrats have the additional pressure of producing a win for the President, who has placed his credibility on the line in the debate. It

may come down to utilizing the budget reconciliation option at that point.

CARD CHECK

Issue

Under current law, individuals interested in organizing a union must file a petition with the National Labor Relations Board (NLRB). This petition must demonstrate that 30 percent of potential union members want to have a union organizing election. Generally, the potential union members sign an authorization card indicating their desire to join a union. Importantly, within 45 days of receiving the petition, the NLRB then will conduct a secret ballot election to let employees decide whether they want to join the union. The secret ballot election allows employees to choose in private whether or not they wish to join the union.

Instead of using a petition to force a union election, under the proposed legislation, if an organizing campaign can collect signed authorization cards or a petition from more than 50 percent of the employees (this is often referred to as the "50 plus one" rule, as the cards must be collected from 50 percent of the employees plus one more employee), an employer would be required to recognize the union. There would be no secret ballot election in such a case.

The legislation also provides for the mediation and binding arbitration of the initial collective bargaining agreement following any recognition of the union, if the parties cannot come to an agreement on their own within a certain time.

Status

Representative George Miller (D-CA), Chairman of the House Education and Labor Committee, introduced H.R. 1409, the Employee Free Choice Act. The late Senator Ted Kennedy, Chairman of the Senate Health, Education, Labor, and Pensions

Committee introduced S. 560, the companion bill in the Senate. President Obama made passage of this legislation one of his campaign promises.

While it seems like this legislation has been discussed forever, there have been no votes on it in this Congress. The House majority decided to wait until the Senate acted.

Outlook

The resolution of this debate has been all about the 60 votes necessary to end a filibuster. The Senate majority did not have the votes at the beginning of the Congress and still does not have them.

Earlier this year, before switching parties, Senator Arlen Specter (D-PA) indicated he would not vote for the bill in its original form. He reiterated his position after changing parties. After it became clear that Senate proponents would not have enough votes to overcome a filibuster, a group of Senators started working on a compromise. However, with the Minnesota vacancy and the illnesses of Senator Robert Byrd (D-WV) and Senator Kennedy, the majority has never had the leverage to move the legislation.

The expectation was that a compromise would be brought to the floor after the August recess. The question that both sides are probably weighing is whether to wait until the Massachusetts seat in the Senate is filled or to compromise now.

It does seem likely that any compromise would retain the requirement for a secret ballot election. The compromises are believed to focus on the process, such as giving organizers more access to the workplace; reducing employers' communication rights and/or increasing organizers' communication rights; speeding up the election cycle; or making it easier to cast the ballots.

FORMS 1099

Issue

Under current tax law, a business taxpayer making payments to a service provider (the "payee" in IRS language) aggregating to \$600 or more for services in the course of a trade or business in a calendar year is required to send an information return to the IRS (and to the service provider-payee) setting forth the amount, as well as the name and address of the recipient of the payment (generally on Form 1099). Under the law, the business taxpayer is not required to issue a Form 1099 to a corporation that provides services to it.

There is a belief that corporations may be underreporting their income and that third party information reporting increases income reporting, therefore, business taxpayers should be required to issue Forms 1099 to all their service-providing vendors, including corporations.

Status

In his Fiscal Year 2010 budget request, the President proposed that all business taxpayers issue Forms 1099 to all their service-providing vendors, including corporations.

Representative Jim McDermott (D-WA) has introduced H.R. 3408, The Taxpayer Responsibility, Accountability, and Consistency Act, a bill that deals primarily with independent contractor classifications. H.R. 3408 includes provisions to require business taxpayers to issue Forms 1099 to all service-providing vendors.

A proposal to require all business taxpayers to issue Forms 1099 to all of their vendors—providers of both goods and services—was under consideration at least at the staff level in the Senate Finance Committee, as a revenue-raising offset for the pending health care reform bill. It has never been discussed in a public forum.

To date, no stand-alone bill on the Forms 1099 change has been introduced.

Outlook

At some point, whether it is in conjunction with health care reform or some other tax-reducing initiative, the Forms 1099 proposal will resurface as a revenue outset.

CELL PHONES

Issue

To the extent that an employee uses his employer's cell phone for business purposes, the fair market value of such usage qualifies as a working condition fringe benefit excludable from the employee's gross income. As such, the cell phone expense is a deductible business expense for the employer, PROVIDED that the substantiation requirements of the Code are met. (The substantiation requirements are requirements that most small business owners are familiar with, since these are the same ones that apply for documenting business use of cars and computers.)

To the extent the employee uses the employer's cell phone for personal purposes (i.e., only a portion can be substantiated as business use), the fair market value of such personal use is includable in the employee's gross income.

The ramification for the employee is income tax liability on the imputed income as well as FICA tax (7.15 percent). The ramification for the business is the additional FICA tax (7.15 percent) on the amount of imputed income. In addition, the business will lose of a portion (or all, if no substantiation) of the deduction for the cost of the purchase of the telephone (probably a Section 179 direct expensing deduction for the full amount, but a depreciation deduction over ten years otherwise) and lose a portion (or all, if no substantiation) of the deduction for the on-going service

charges. Since some or all of those expenses will now be income to the employee, those expenses should still be deductible as wages, and the business exposure should be limited to the employer's FICA tax on imputed income equivalent of those costs.

For the self-employed, it basically means paying for the cell phone with after-tax dollars.

Status

While the requirement has been in the law for a long time, the issue has only begun to be raised in audits. Universities have been among the early targets.

Several bills have been introduced to eliminate the recordkeeping requirement. Representative Sam Johnson (R-TX) has introduced H.R. 690, the Modernize Our Bookkeeping in the Law for Employees' Cell Phone Act of 2009. In the Senate, Senators John Kerry (D-MA) and John Ensign (R-NV) have introduced S. 144.

Outlook

This should be an easy to fix issue, but it will require a revenue offset.

LIFO REPEAL

Issue

The Last In- Last Out (LIFO) inventory method assumes the items of inventory you purchased or produced last are the first items you sold, consumed, or otherwise disposed of. Items included in closing inventory are considered to be from the opening inventory in the order of acquisition and from those acquired during the tax year. Typically, a business carries a LIFO reserve on its books that reflects the amount of taxable income that has been "deferred" by using the method. This amount reflects the difference between what the dollar value of the inventory would have been under First In- First Out (FIFO) inventory value and the LIFO value.

If the LIFO method is repealed, the LIFO reserve is eliminated and the taxable income is increased immediately, but the taxes due usually can be paid over a four-year period under change of accounting rules.

Status

In his Fiscal Year 2010 proposed budget, President Obama has recommended that Congress repeal the LIFO inventory accounting method beginning in 2012.

No stand-alone legislation has been introduced.

Outlook

At some point, this Congress will need tax revenues to offset other tax relief it may want to enact. The LIFO repeal is a prime candidate to be used as an offset. In the past, discussions about LIFO repeal usually include some discussion of a longer transition rule to stretch out the period in which the business has to pay the accrued tax liability.

RESEARCH AND DEVELOPMENT CREDIT

Issue

Internal Revenue Code (IRC) Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year. There is also an alternative incremental credit and alternative simplified credit.

Public Law 110-343, the Emergency Economic Stabilization Act, extended the "regular" credit through 2009, extended the alternative simplified credit through 2009, and modified it for 2009.

The Tax Relief and Health Care Act of 2006 created an alternative simplified credit effective January 1, 2007, for qualified research expenses. The alternative simplified research is equal

to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to 6 percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years.

Public Law 110-343, the Emergency Economic Stabilization Act extended the “regular” credit through 2009. It also increased the alternative simplified credit from 12 percent to 14 percent for the 2009 tax year, and repealed the alternative incremental research credit for the 2009 tax year.

There is a lot to the story of the R&D Credit. It requires a lot of complicated bookkeeping for those businesses that utilize it. This has been one of the primary reasons most small businesses are not able to use it. It is also a credit based on incremental increases in research budgets, something most small businesses cannot achieve. The alternative “simplified” credit is not a simplified in terms of recordkeeping but has to do with simplifying the base measurement.

In the public policy process, the R&D credit has been on the brink of extinction several times, only to have Congress extend it on a temporary basis. During the last extension, the emphasis has switched to extending the alternative simplified credit and abandoning the original credit.

Status

In his Fiscal Year 2010 proposed budget, the President recommended that Congress make the credit permanent.

H.R. 422, introduced by Representatives Kendrick Meek (D-FL) and Kevin Brady (R-TX), and S. 1203, introduced by Senators Max Baucus (D-MT) and Orrin Hatch (R-UT), extends the “regular” R&D credit for one more year, makes the alternative simplified credit permanent, and increases it to 20 percent.

Outlook

Congress will at least extend the credit. There’s a “reasonable” chance the alternative simplified credit will be made permanent.

MANDATORY SICK LEAVE

Issue

Legislation has been introduced to require an employer to provide each employee with not less than 1 hour of accrued paid sick time for every 30 hours worked, up to a total of 56 hours of paid sick time in a calendar year.

The proposal includes part-time employees. If the normal workweek of such an employee is less than 40 hours, the employee shall earn paid sick time based upon that normal work week.

An employer is any “person” engaged in commerce or in any industry or activity affecting commerce who employs 15 or more employees for each working day during each of 20 or more calendar workweeks in the current or preceding calendar year.

Status

Representative Rose DeLauro (D-CT) introduced H.R. 2460, the Healthy Families Act. The late Senator Edward Kennedy (D-MA) introduced the companion bill, S. 1152, in the Senate.

Outlook

If health care reform implodes, perhaps this bill would garner some attention; otherwise, it is hard to imagine Congress doing both.

INDEPENDENT CONTRACTORS

Issue

As long as there have been employment taxes, tax administrators and taxpayers have been engaged in a dialogue to answer the question, “Who is an employee?”

The IRS, faced with the responsibility to make determinations of the status of individuals, uses a “facts and circumstances” approach appropriate with its statutory authority. Thus it has largely fallen to the courts to determine whether various facts and factors are relevant to the determination of “who is an employee.” Over time, that body of cases and rulings under our system of jurisprudence is what is referred to as the “common law.” In 1987, in Revenue Ruling 87-41, the IRS distilled the “common law” into 20 factors. The modern day context for the application of the common law test is often framed around whether the individual is an employee or an independent contractor. At issue are not only the various employment tax obligations, but income tax and employee benefit ramifications.

Section 530 of the Revenue Act of 1978 was the vehicle for one of the most significant changes in the common law-based process of determining the classification of an individual as employee or independent contractor. Originally, it was meant to be a temporary provision to provide Congress more time to sort through the options for the appropriate rules regarding classification. The section was made permanent in 1982. It was modified in 1986, 1996, and 2006.

Section 530 provided a “safe harbor” which is generally stated in the negative: “Section 530 allows a taxpayer to treat a worker as not being an employee for employment tax purposes (but not income tax purposes), regardless of the worker’s actual status under the common law test, unless the taxpayer has no reasonable basis for such treatment or fails to meet certain requirements.” One of the “reasonable bases” is a long-standing recognized practice in the industry.

Status

Representative Jim McDermott (D-WA) has introduced H.R. 3408, The Taxpayer Responsibility,

Accountability, and Consistency Act. H.R. 3408 makes several changes with respect to Section 530. It also changes various penalties related to the Forms 1099. It makes one significant change that will have an impact on ALL businesses.

With respect to independent contractor classifications and Section 530, H.R. 3408 would repeal section 530 and replace it with one new safe harbor. The industry practice safe harbor would be repealed. In order to qualify for the new safe harbor, taxpayers would need a written determination from the Department of Treasury that the individual (or individuals holding a substantially similar position) was not considered an employee. Taxpayers could also rely on the safe harbor if the IRS concluded an examination of the individual (or individual holding a substantially similar position) and did not determine that such individual was an employee. Taxpayers could rely on a letter ruling or an examination that was completed up to seven years prior to the tax period in question. It requires that taxpayers must have consistently treated workers as independent contractors in order to qualify for the safe harbor. The current-law section 530 safe harbor would remain in effect for up to one year after the date of enactment of the legislation.

The bill provides individuals (or a designated representative) the ability to petition the IRS for a review of their classification status. If an individual is reclassified as an employee, the IRS must report that fact to the Department of Labor. The bill also extends the requirement for issuing a Form 1099 to ALL service-providing vendors (see Forms 1099 story).

Outlook

With all that the Ways and Means Committee has on its plate, it is not clear this will garner much attention this year. But next year....

CLIMATE CHANGE

Issue

Congress is debating the merits of legislation to curb “global warming.” The primary focus has been on methods to control the emission of greenhouse gases (GHGs). While some manufacturers may incur direct costs, all will certainly bear some of the indirect costs because the two main sources of GHG emission are electricity generation and vehicles, and both are significant cost centers for any small businesses.

Electricity generation is the biggest source of emissions. Electricity generators consumed 36 percent of U.S. energy from fossil fuels and emitted 42 percent of the carbon dioxide (CO₂) from fossil fuel combustion in 2007. Transportation activities are number two on the list, accounting for 33 percent of CO₂ emissions from fossil fuel combustion in 2007.

Status

The House passed the American Clean Energy and Security (ACES) Act of 2009, H. R. 2454, on June 26, 2009, by a 219-212 vote. Under ACES, carbon emissions from large sources (25,000 tons of emissions annually) must be reduced by 17 percent below 2005 levels by 2020 and 83 percent below 2005 levels by 2050. To achieve these limits, ACES establishes a system of tradable permits called “emission allowances.” Under ACES, approximately 80 percent of allowances are distributed without charge during the early years of the program. This transition period starts to phase out after 2025. By 2031, about 70 percent of the allowances are auctioned.

The legislation converts various greenhouse gases into carbon dioxide equivalents for the purpose of measuring the amount of emissions.

Outlook

The Senate is expected to consider legislation in the fall. Recently, Senator Barbara Boxer (D-CA) indicated she would probably not have a draft bill ready until late September. The question is whether Congress can pass two major pieces of legislation, health care reform and climate change, in the same year. If Congress moves forward with health care reform, climate change legislation may be held over until next year.

ESTATE TAX

Issue

At the present time, the top estate tax rate stands at 45 percent—temporarily—and an individual’s heirs are allowed to exclude \$3.5 million from the estate before the tax is applied; this is also temporary. The estate tax will automatically be repealed at the end of this year. The repeal will last for one year; then in 2011 the estate tax system is restored to its pre-2001 form. The top rate reverts to 55 percent and the exemption shrinks to \$1 million.

Status

In his Fiscal Year 2010 proposed budget, the President recommended that Congress “freeze” the rate and exemption at 2009 levels.

Congress passed a budget resolution with a placeholder for a freeze at those levels. The problems are that the relief has to be offset with tax revenue elsewhere, and a relief bill would require 60 votes in the Senate to pass if there is a procedural challenge.

Outlook

This is a mess. There is increasing talk on Capitol Hill (mostly on the House side) about a one-year temporary freeze at 2009 levels instead of repeal for 2010. This allows Congress to actually pick up some tax revenue that could be used as a revenue offset for other

initiatives that might spend money or provide different tax relief.

SELF-EMPLOYED HEALTH CARE DEDUCTION

Issue

While the health care insurance premiums for the self-employed are deductible for income tax purposes, the premiums are not deductible for the purposes of the self-employment tax and, accordingly, sole proprietors, partners in partnerships, and S corporation owners pay self-employment tax (15.3 percent on self-employment income) on health insurance premiums.

Status

Representatives Ron Kind (D-WI) and Wally Herger (R-CA) introduced the Equity for Our Nation's Self-Employed Act to fix this anomaly. The bill number is H.R. 1470. Senators Jeff Bingaman (D-NM) and Orrin Hatch (R-UT) have introduced the companion bill, S. 725, in the Senate.

Outlook

On its own, this does not have much chance of passage, but perhaps Congress could fix it as part of the overall health care reform debate.

HOME OFFICE DEDUCTION

Issue

In 1976, Congress enacted Section 280A of the Internal Revenue Code, which as amended in 1997, provides the limited circumstances in which an individual or an S corporation may take a deduction for expenses related to an office in the home. Generally, deductions are limited to those parts of a home that are exclusively used on a regular basis as a principal place of business or to meet with patients, clients, or customers. It is not a simple process to calculate the deduction.

Status

Representatives John McHugh (R-NY) and Kurt Schrader (D-OR) introduced H.R. 1509, the Home Office Deduction Simplification Act.

The legislation would allow otherwise qualified taxpayers to use a standard home office deduction of \$1,500 rather than go through the calculations

Outlook

As with all things regarding tax relief, the problem is the congressional rule that requires revenue offsets.

CHIEF COUNSEL FOR ADVOCACY

Issue

In the mid-1970's, at the behest of the small business community, Congress created a government funded "lobbyist" for small business—the Chief Counsel for Advocacy, whose appointment requires Senate confirmation. The first Chief Counsel was Milton D. Stewart. The Office of Advocacy, which is housed within the Small Business Administration, conducts research, administers the Regulatory Flexibility Act and its offspring, and generally advocates on behalf of the small business community before Congress and federal agencies.

Status

President Obama nominated Winslow Sargeant as the next Chief Counsel. Mr. Sargeant has been a managing director in the technology practice at Venture Investors since 2006. From 2001 to 2005, he was the program manager for the Small Business Innovations Research (SBIR) Program in Electronics, a new office in the National Science Foundation's (NSF) Engineering Directorate.

The Senate Committee on Small Business has held a confirmation hearing.

Outlook

Sargeant should be approved by the Senate in September.

LISTED TRANSACTIONS

Issue

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 a tax shelter device they would be less likely to use it.

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." You failed to disclose the transaction on the IRS list of those to be disclosed – penalty assessed – end of story.

Status

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.

Outlook

We expect some relief to be provided for small businesses. Whether it happens by September 30th, is another matter. But we would not expect the IRS to suddenly ramp up activity after that date.