SMALL BUSINESS LEGISLATIVE COUNCIL

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GOOD NEWS, BAD NEWS

This week Congress will pass a bill to extend the current temporary extension of unemployment benefits. Unemployed will get an additional 14 weeks of benefits. Individuals in states with an unemployment rate above 8.5 percent will be eligible for additional benefits.

The Senate will vote on cloture on Monday. If it receives the 60 votes necessary to preclude a filibuster, the Senate is expected to pass the bill quickly, perhaps even on Monday. While the House had previously approved a modest unemployment benefits bill, the House majority's leadership has indicated they will move to pass the Senate version, as is. As a result, the bill will likely be law by the end of the week.

The bill includes an extension and expansion of the temporary first time homebuyer's credit and an extension and expansion of the temporary Net Operating Loss (NOL) carryback relief.

The bill also extends a current "temporary" tax and adds a new tax penalty for some small businesses. It also postpones some tax relief for some larger companies and accelerates tax payments for some really big companies.

FUTA

Employers pay a Federal Unemployment Tax Act (FUTA) tax annually. Technically, employers are subject to a Federal unemployment insurance payroll tax equal to 6.2 percent of the total wages of each employee (up to $7,000) on covered employment. However, employers are eligible for a Federal credit equal to 5.4 percent for State unemployment taxes. As a result, the actual current effective FUTA tax rate is 0.8 percent. The tax rate is composed of a permanent tax rate of 0.6 percent and a temporary surtax rate of 0.2. The arithmetic translates into a $56 annual payment to the Federal government for each employee with at least $7,000 in wages - $42 for the permanent base tax rate and $14 for the surtax.

The surtax was passed in 1976 on a temporary basis to make up a deficit in the unemployment insurance trust fund. It was supposed to expire in 1987. Every time Congress needs some revenue, it extends the surtax. It has done so five times! The 0.2 surtax was set to expire again at the end of this year. To pay for the unemployment benefit extension, the surtax will be extended until June 30, 2011.

HOMEBUYER'S TAX CREDIT

The unemployment benefit bill will include provisions to extend and expand the first time homebuyer's tax credit that was set to expire at the end of November. Under the current temporary provision, the First-Time Homebuyer Tax Credit is a refundable tax credit available to an individual buying a principal residence for the first time. The current credit phases out for individuals with income between $75,000 and $95,000 and for joint filers with income between $150,000 and $170,000. For purchases made on or after January 1, 2009 and before December 1, 2009 the tax credit is equal to the lesser of $8,000 or 10 percent of the purchase price of the residence.

The pending bill will extend the availability of a homebuyer credit to homes under a binding contract before April 30, 2010, allowing 60 days to close. In addition, the credit will now phase out for individuals with income above $125,000 and for joint filers with income about $225,000. A $6,500 credit will be available to homebuyers who have been in their current residence for the last five years or more. The credits will be available only for the purchase of principal residences with a purchase price of $800,000 or less.

NET OPERATING LOSS

Earlier this year, the American Recovery and Reinvestment Act of 2009 extended the net operating loss carryback period from two to five years for tax years beginning in or ending in 2008 for small businesses with gross receipts of $15 million or less.

The pending unemployment benefit extension bill includes a provision to allow all businesses to carry back net operating losses for up to five years for losses incurred either in 2008 or 2009, but not both (at the election of the taxpayer). Businesses would be able to offset 50 percent of the available income from the fifth year and 100 percent of all income in the remaining four carryback years. However, the plus for small businesses is that small businesses that have already elected to carry back 2008 under the American Recovery and Reinvestment Act may also elect to carry back losses from 2009.

TAX RELIEF DELAYS, TAX PENALTIES, AND PAY SOONER

To pay for the NOL relief and homebuyer credit, Congress will delay the adoption of worldwide interest allocation rules. Do not ask me what that means but the companies that wanted it will not get it until 2017.

Once this bill passes, make sure you file your partnership or S Corporation tax return form. Starting in 2011, the failure to file penalty will increase from $89 to $195.

Finally, I am pretty sure this last pay-go provision is not of interest to small business. The bill would increase the required corporate estimated tax payments factor for corporations with assets of at least $1 billion for payments due in July, August, and September 2014 by 33 percentage points.

HEALTH CARE REFORM

The House majority's leadership released its latest version of a comprehensive health care reform measure. The House may vote on it later this week. The bill now includes the Form 1099 "pay-go" revenue offset upon which we have reported many times. This is the provision that would require all businesses to issue Forms 1099 to all of their vendors (corporate and non-corporate entities) that provide services or provide "property," if the business pays more than $600 annually for those services or property. The current Form 1099 law requires the issuance of Forms 1099 only to individuals that provide services.

The easy part (said sarcastically) may be issuing the forms. Obtaining the taxpayer identification number (TIN) from the vendor (you are allowed to withhold 28 percent of the payments until you receive the TIN) may be the messy part. The requirement would take effect in 2012. PS Businesses will not have to send a Form 1099 to their associations for the dues they pay. Internal Revenue Code Section 501 tax-exempt corporations would be excluded.

Senate Majority Leader Harry Reid (D-NV) has sent his version of comprehensive health care reform to the Congressional Budget Office for them to "score" how much it will cost. His version is almost certain to include the Form 1099 provision as well. The Form 1099 requirement is approaching "likely to be law" status.

The House majority's leadership did make improvements in the employer mandate and one of the other revenue offsets to mitigate some of the impact on small businesses. They doubled the "floor" for the "play or pay" penalty for not providing health care benefits to employees and dependents. In the "old" version, the penalties (a percentage of wages) began at $250,000 in total wages. Now, the penalties will kick in at $500,000 in total wages.

The House bill also includes a surtax on high incomes. Since it is part of the personal rate structure, it has an impact on sole proprietors, partners and S Corporation shareholders. Under the "old" House bill, the surtax kicked in at $280,000 in income for individuals and $350,000 for joint filers. The rate was gradually increased to 5.4 percent for higher income levels. The new version imposes the surtax beginning at $500,000 in income for individuals and $1 million for joint filers. The tax is now a flat 5.4 percent on those incomes.