



July 12, 2010

SMALL BUSINESS TAX AND LENDING RELIEF

Congress is back. The Senate will try again to lock down a version of a small business lending and tax relief bill. 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 - H.R. 5297 but with a new title, the Small Business Jobs and Credit Act of 2010.

Whatever the Senate passes will go back to the House. We're fairly sure that something will get to the President's desk by the August recess. (After all, it is an election year and there is plenty of campaigning to do during the break.) We are making a push to get estate tax certainty into the bill (this will be tough to accomplish) and trying to get the provision that doubles penalties for inadvertent mistakes in filing tax information reports (1099s), out of the bill (this should be easier to accomplish). [As to the 1099 issue, at least some folks in Congress and in the administration are finally having a "duh" moment that they just exponentially expanded the reporting requirement in the health care bill and it is going to look pretty bad to double the penalties even before the new requirement is in force.] Some believe that this is the only tax bill that will get through this year.

H.R. 5297 would establish a \$30 billion fund to boost lending to small businesses. Under the proposal, the Small Business Lending Fund (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 2009 baseline.

The bill would also create 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, author of the SBBAP idea. 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. The bill would exclude from gross income any amounts that are received under the SBBAP.

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 no latitude to mitigate penalties and must assess the full penalty for inadvertent violations. **The bill would make the penalty for failing to disclose reportable transactions (including listed transactions) proportionate to the underlying tax savings. The SBCA has been working hard to fix the unconscionable 6707A penalties. We are aware of owners across the country who are literally facing financial ruin because of this penalty (some penalties are in excess of \$1 million) for entering into plans that they thought were legitimate. This provision does not do all that we want but compared to existing law it is a huge improvement.**

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, the bill 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.

The bill provides some additional tax reductions for owners of a special type of 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. The bill would temporarily increase the amount of the exclusion to 100 percent for qualifying stock acquired after March 15, 2010 and before January 1, 2012. *Even though this sounds like a great provision as we've reported in the past it will not be of any use to most small business owners. See below if you want more details.*

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). The bill 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.

At this point we are fairly certain that there will be an amendment adding bonus depreciation to the bill. Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Charles Grassley (R-IA) introduced S. 3513, The Bonus Depreciation Extension to Create Jobs Act. The bill would extend the 50 percent bonus depreciation through 2010. The most recent version of bonus depreciation was enacted as part of the 2008 economic stimulus efforts. The American Reinvestment and Recovery Act extended bonus depreciation, but the provision expired at the end of 2009. The word is that this bill will be in the manager's amendment.

FORM 1099

The Internal Revenue Service (IRS) has issued Notice 2010-51 asking for comments on how to implement the send-everybody-a-1099 requirement. Our view is there are no good ideas out there to mitigate the impact. It is possible that even the IRS would welcome plenty of comments saying it is a bad idea. They have no choice in the matter, they cannot ignore the law, but a huge record of objections might help make the case for repeal. You can go to www.irs.gov to find out how to file comments electronically. The National Taxpayer Advocate, with whom we have worked over the years has put out an excellent statement on the problems of implementing the Form 1099 requirement. You can find that on the IRS site too. Attached is the SBCA's one pager on this issue.

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-subsidary 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.