



O'Connor Davies Munns & Dobbins, llp
ACCOUNTANTS AND CONSULTANTS

Tax Facts

Small Business and Work Opportunity Tax Act of 2007

Dear Clients and Business Associates:

Congress recently passed a new package of tax incentives and this issue of *Tax Facts* summarizes the highlights of this new legislation. Many of the tax breaks are targeted to businesses and are especially beneficial for small businesses. The offsets, which are revenue raisers to pay for the tax cuts, primarily affect individuals. As always, we would be happy to help you craft a tax strategy that maximizes the benefits of the new law.

The *Small Business and Work Opportunity Tax Act of 2007*, which passed Congress on May 24 and was signed into law by President Bush on May 25, gives businesses nearly \$8 billion in tax cuts over a 10-year period. However, approximately \$5 billion of these cuts are front-loaded over the next five years.

All of the small business provisions are designed to help businesses absorb the cost of a higher federal minimum wage. The new law gradually raises the federal minimum wage from \$5.15 to \$7.25 an hour over the next two years. Unlike past tax cuts, this one is fully offset. Those are the revenue raisers mentioned earlier.

Business Tax Incentives:

The business tax incentives contained in the new legislation are not as generous as in past tax cuts, but with careful planning and maximum utilization, we can assist your business in attaining the greatest tax savings.

Small Business Expensing - Congress significantly extended and expanded small business expensing. The tax laws allow you to deduct some business expenses that would otherwise have to be capitalized and depreciated. Generally, up to \$112,000 can be deducted in qualifying expenditures for property placed in service in 2007 and there is a \$450,000 investment limitation. The new law raises the dollar limitation from \$112,000 to \$125,000 and the income limitation from \$450,000 to \$500,000, retroactive to the start of 2007. The amounts are also indexed for inflation.

If you have been debating whether to make a significant capital expenditure prior to the end of 2007, the increased expensing rules could make that purchase much more attractive.

Work Opportunity Tax Credit - The Work Opportunity Tax Credit (WOTC) is one of several tax incentives to encourage employers to hire challenged individuals. Some are challenged by physical disabilities and others are challenged economically. The new law extends the credit to cover more veterans and some other target groups. In return, employers that hire individuals from these targeted groups gain some generous tax savings.

FICA Tip Credit - The new law preserves the FICA Tip Credit based on the old minimum wage of \$5.15 per hour. Therefore, although the minimum wage has increased, the amount of the tip credit will not be reduced.

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Family Business Tax Simplification - The new law also allows married couples who operate a joint venture and who file a joint return to elect not to be treated as a partnership for federal tax purposes. Each spouse would take into account his or her share of income, gain, loss and other items as a sole proprietor.

S Corporations - Additionally, the new law includes a package of S corporation reforms. These provisions are both complex and narrow in their applicability and provide tax breaks previously unavailable. We will determine if the changes of this legislation apply to our existing S corporation clients in the normal course of year-end planning. However, if you run your business as an S corporation or own part of an S corporation, please feel free to contact us so we can review these changes in detail together.

Katrina Recovery Tax Incentives - One of the ways the federal government is helping Hurricane Katrina taxpayers is by offering them tax breaks to rebuild their homes and businesses. The new law extends and enhances incentives in the *Gulf Opportunity Zone Act of 2005* and the *Katrina Emergency Tax Relief Act of 2005*. The extension includes special expensing for qualified property, enhanced low-income housing credit as well as flexible tax-exempt bond financing rules.

Revenue Raisers:

Kiddie Tax - This is a significant change in the new law that could impact you if you have children. The "Kiddie Tax" rules have prevented most children under the age of 18 from using their low tax bracket to shelter significant amounts of investment income. Under those rules, investment income over a small amount is taxed at their parent's marginal tax rate, as if earned by the parent. The child is not allowed a personal exemption if he or she can be claimed as a dependent on his or her parents' tax return. However, the child can use up to \$850 for 2007, of his or her standard deduction to offset unearned income. As a result, only unearned income in excess of \$1,700 for 2007 is taxed at the parents' top marginal rate.

Until last year, the Kiddie Tax applied to children under the age of 14 with unearned income. In 2006, Congress raised the age to under 18. The new law raises it to under age 19 (under age 24 for full-time students). When Congress raised the age eligibility in 2006, it did so retroactively to January 1, 2006. This time, Congress makes the change prospective, beginning in 2008, and the difference is critical. Unlike in 2006, you have time to adjust your tax planning. This is especially important if you have a child starting college next year and you were planning to use appreciated investment assets to pay for tuition. Fortunately, we have time between now and the end of the year to revise your tax plans.

Additional Revenue Raisers - Congress granted the IRS permanent authority to charge user fees for determination letters, letter rulings and similar services. The IRS can also charge higher penalties for claims for erroneous refunds and for bad checks. The new law expands return preparer penalties to cover more types of returns and increases penalties. In addition, the new law eliminates the requirement that the IRS hold a collection due process hearing before issuing a levy on delinquent employment taxes.

As your trusted tax and business advisor, ODMD will review your specific facts and circumstances and seek tax saving opportunities, or revise existing tax planning strategies, in response to this new legislation. If you have any specific questions about the *Small Business and Work Opportunity Tax Act of 2007*, please contact your ODMD client service partner. We would be happy to meet with you to review the new law in detail and determine how it affects you.

Sincerely yours,

O'Connor Davies Munns & Dobbins, LLP

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