



Small Business and Work Opportunity Tax Act of 2007

Introduction

We have a new tax law in the United States! In a two day time period, both houses of Congress and the President enacted a new tax law. The Small Business and Work Opportunity Tax Act of 2007 contains approximately \$5 billion in tax incentives principally to small businesses, but the law also offsets the tax cut by \$5 billion. The Tax Act also contains tax incentives to help those recovering from Hurricane Katrina. This publication will address the incentives and impact of the Small Business and Work Opportunity Tax Act of 2007 on businesses. The incentives and impact on individuals will be addressed in a later publication.

The purported small business tax incentives are designed to help businesses absorb the impact of the higher federal minimum wage. While minimum wage, the federal minimum

wage. While many states have their own minimum wages that are currently higher than the federal minimum wage, the federal minimum wage gradually rises to \$7.25 an hour over the next two years. Of major importance in the new tax act are extended and enhanced Code Section 179 expensing, family business tax simplification, changes in S Corporation rules, and an extended Work Opportunity Tax Credit.

Section 179

Many businesses have benefited from the enhanced allowable deductions under Code Sec. 179. Over the past 7 years, the fully deductible amount has been increased from a mere \$25,000 to over \$100,000. This deduction is important, because not only is it a

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A CASE STUDY

A new revenue procedure now permits most pass through entities to calculate partner or shareholder Qualified Production Activities Income (QPAI) at the entity level. QPAI is generally, the total revenue from any lease, rental, service, sale, exchange or disposition of any tangible property grown, produced, or extracted or construction substantially performed in The United States. The American Jobs Creation

Creation Act of 2004 created the "Domestic Production Activities Deduction" (also known as the Section 199 Deduction which applies to much business activity in the United States). The deduction in 2007 is currently at 6% and grows to 9% in 2009. The calculation in the new procedure is substantially identical to calculations made for separately stated items on K-1 forms for shareholders.

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significant deduction for small businesses, it also has been instrumental in jump starting the economy of this country that was impacted heavily by the events of September 11, 2001. The new base for the 179 deduction has been increased to \$125,000 up from what was slated to be \$112,000 for 2007. The investment limitation has also been increased to \$500,000 up from \$450,000 as it was slated to be for 2007.

Family Business Tax Simplification

Couples legally married under federal laws, who operate businesses are now eligible to file as sole proprietors (Schedule C, Form 1040) and are no longer obligated to file taxes as partnerships (Schedule 1065). First, this new rule simplifies tax compliance. Second, the new law makes it easier for both, the husband and wife to receive credit for Social Security benefits. However, it must be remembered that both husband and wife must be active in the business.

S Corporations

Subchapter S Corporations also benefit from the bill. The passive income test has long been a peril for S Corporations. In previous years, gross receipts from passive activities totaling 25% or more would cause the S Corporation to be taxed at the corporate level. If this persisted for 3 years consecutively, the S Corporation would lose S status and be transformed into a C Corporation. The result was double taxation of profits. Under the new law, capital gains from the sale or exchange of stock or securities are no longer treated as an item of passive investment income allowing the S Corporation its special tax status.

Work Opportunity Tax Credit (WOTC)

The new tax act extends the Work Opportunity Tax Credit through August 31, 2011. It had been set to expire December 31, 2007. The WOTC encourages employers to hire employees who are economically challenged. They include individuals receiving public assistance, high-risk youths, ex-felons, veterans, and others in similar positions.



The new tax act expands the WOTC to include veterans with service related disabilities, who have been unemployed for 6 months or longer. This is expected to be a boom to veterans as well as a good source of manpower for small businesses.

Conclusion

The Small Business and Work Opportunity Tax Act of 2007 is not the same as the tax law changes in the past. The new act is specifically calibrated to increase business investment, encourage employment of those economically challenged, and solve a few other issues. If you are in the process of tax planning, the new act is worth exploring and analyzing. Contact The Center if you have any questions. Next time, we will look at changes affecting individuals and how the new law is supposed to be revenue neutral.

Points of Interest

- **The Small Business and Work Opportunity Tax Act of 2007 contains approximately \$5 billion in tax incentives**
- **The new base for the 179 deduction has been increased to \$125,000**
- **Under the new law, capital gains from the sale or exchange of stock or securities are no longer treated as an item of passive investment income**

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The entities that are eligible for this new procedure treatment are partnerships, widely-held pass through entities, and Subchapter S Corporations.

Editor's Comment:

This is a significant development in the tax rules for 2007. Many taxpayers involved in closely-held entities perceived the Domestic Production Activities Deduction as too difficult to calculate (or even conclude if they were eligible) and asked the IRS for simplification. The IRS responded with this procedure for the very purpose of simplification for many taxpayers. Instead of the taxpayer going through a complex analysis of tax law and a complex calculation, the taxpayer will now be handed the amount of the deduction simply laid out on a form.

This is also a good reminder that the Domestic Production Activities Deduction is in place for most businesses in the United States. Our research has concluded that many businesses, even those not traditionally associated as manufacturers, are eligible to use this deduction. If you have questions as to whether your business qualifies for this deduction or whether you would like to engage in other aspects of tax and business planning, be sure to call The Center



KEY FACTORS TO CONSIDER IN PREPARING YOUR BUSINESS FOR SALE – PART TWO

In last month's article we discussed two key factors in preparing your business for sale:

- How indispensable is the founder/ owner?
- General condition of equipment & facilities

This month we'll explore other key factors, including the extent to which a seller can improve his/her net proceeds from the business sale by reducing the amount of debt and working capital required to operate the business. Buyers will generally not pay much, if anything, for obsolete or dated inventory. A seller is almost always better off to convert as much of these items to cash before the sale.

Similarly, most buyers will not pay 100 cents on the dollar for Accounts Receivable over 90 days past due. These accounts tend to be even more difficult to collect after there's been a change in ownership. Here again, the seller is usually better off stepping up his/her collection efforts prior to the sale.

While it might seem like having large amounts of current inventory and accounts receivable which will convey on sale would be a good thing, in reality the leaner the current owner can successfully run the business, the greater his cash flow and the higher the purchase price.

Finally, it usually pays the seller to clean up as much corporate debt as possible prior to closing if only because it reduces the amount that must be paid off at closing from the sale proceeds before the owner can rightfully claim the remainder.

Of course, every seller's situation is different, and you would be well advised to consult your personal tax advisor as well as your personal financial planner before making any final decisions in this regard.

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free consultation with us, have them contact me, or any of the M&A professionals at www.bradwaygroup.com

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Frequently Asked Questions...



Q1: What form is the manufacturing deduction calculated on?

A1: IRS Form 8903 is the appropriate form to calculate and report the manufacturing deduction.

Q2: Can the section 179 expenses be carried forward into future years if all of the deduction cannot be used in the current year.

A2: Yes, 179 expenses can be carried forward if enough income is not present to be use din the current year.

Q3: How broadly does the Domestic Productions Activity Deduction apply?

A3: The Domestic Productions Activity Deduction is intended to be liberally interpreted. Activities not traditionally associated with manufacturing qualify for usage of the deduction. With this deduction, if you are in doubt as to whether the deduction applies or not, you are ahead in attempting to take the deduction if it can be reasonably justified.

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