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The Small Business and Work Opportunity Tax Act of 2007

On May 25, 2007, President Bush signed into law the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007.

One component of this legislation was the Small Business and Work Opportunity Tax Act of 2007 (the Act). Provisions of this Act include an expansion of the "kiddie tax" rules, modification of both the work opportunity tax credit and the tax credit for FICA taxes on tips, and increased Section 179 expensing limits.

"Kiddie tax" rules

Special rules (generally referred to as the "kiddie tax" rules) apply to the net unearned income of children. Generally, the kiddie tax rules apply if a child has unearned income exceeding $1,700 (2007 figure). In this case, the child's excess unearned income (that portion of the child's unearned income exceeding $1,700 for 2007) is taxed at the child's parents' marginal tax rate, assuming the parents' tax rate is greater than the child's.

Prior to the Act, the kiddie tax rules applied to children under age 18. The Act, however, expands the kiddie tax rules to apply to children who are 18 years old or who are full-time students over age 18 but under age 24. The expanded kiddie tax rules apply only to children whose earned income does not exceed one-half of the amount of their support. This provision is effective for the 2008 tax year (for calendar year taxpayers).

Deja vu

This is the second time in two years that the kiddie tax rules have been expanded. Last year's Tax Increase Prevention and Reconciliation Act of 2005 raised the applicable kiddie tax age from under age 14 to under age 18.

Work opportunity tax credit

The Act:

- Extends the work opportunity tax credit for 44 months (for qualified individuals who begin work for an employer after December 31, 2007, and before September 1, 2011)
- Expands the qualified veterans' targeted group and the definition of qualified first-year wages for individuals who qualify under the new rules
- Expands the scope of the high-risk youth targeted group and the vocational rehabilitation referral targeted group
- Allows the work opportunity tax credit to offset any alternative minimum tax (AMT) liability

The provisions expanding the targeted groups are effective for individuals who begin work for an employer after May 25, 2007. The provision allowing the credit to offset AMT liability applies to credits determined in taxable years beginning after December 31, 2006.

Tax credit for FICA taxes on tips

Employers are allowed to claim a business tax credit equal to the employer's FICA taxes paid on tips in excess of those treated as wages for purposes of meeting minimum wage requirements. Prior to this Act, the tax credit was based on a federal minimum wage of $5.15. Other provisions in the appropriations act increase the federal minimum wage, however (the federal minimum wage is gradually increased to $7.25). An increase in the federal minimum wage effectively means a reduction in the tax credit described above.

In light of this, the Act provides that the amount of the tip credit is based on the amount of tips in excess of those treated as wages for purposes of the federal minimum wage as in effect on January 1, 2007. So, under this provision, the tip credit is determined based on a minimum wage of $5.15 per hour. The Act also allows the credit to be used to offset any AMT liability.

This provision is effective with respect to tips received for services performed after December 31, 2006. The provision allowing the credit to offset AMT liability applies to credits determined in taxable years beginning after December 31, 2006.

Section 179 expensing for small businesses

Prior to the Act, the maximum amount a taxpayer could expense under Section 179 (for taxable years beginning in 2003 through 2009) was $100,000 of the cost of qualifying property placed in service for the taxable year. The $100,000 amount was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeded $400,000. The $100,000 and $400,000 amounts were indexed for inflation for taxable years beginning

after 2003 and before 2010. (For 2007, the inflation-adjusted amounts were $112,000 and $450,000, respectively.) The $100,000 and $400,000 figures were scheduled to return to pre-2003 limits ($25,000 and $200,000, respectively) beginning in 2010.

The Act:

- *Increases Section 179 limits*--The $100,000 and $400,000 amounts described above are increased to $125,000 and $500,000 respectively, for tax years beginning in 2007 through 2010. These amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.
- *Extends existing provisions one year*--Changes to Section 179 rules effective for taxable years beginning before 2010 (e.g., off-the-shelf computer software treated as qualifying property) are extended for an additional year; amended rules originally introduced by the Jobs and Growth Tax Relief Reconciliation Act of 2003, the American Jobs Creation Act of 2004, and the Tax Increase Prevention and Reconciliation Act of 2005 now apply to taxable years beginning after 2009 and before 2011.
- *Extends increased Gulf Opportunity Zone limits*--The Act extends the increased expensing amount established by the Gulf Opportunity Zone Act of 2005 for property substantially all of the use of which is in one or more specified portions of the Gulf Opportunity (GO) Zone to property placed in service by the taxpayer on or before December 31, 2008.

These provisions are effective for taxable years beginning after December 31, 2006. The provision relating to the extension of Gulf Opportunity Zone limits is effective for taxable years beginning after May 25, 2007.

Qualified joint ventures for husbands and wives

A partnership is treated as a pass-through entity, and income earned by the partnership, whether distributed or not, is taxed to the partners. The income of a partnership and its partners is determined under subchapter K of the Internal Revenue Code.

The Act allows a husband and wife in a qualified joint venture to opt out of partnership tax treatment for federal tax purposes. A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect to have the provision apply.

Husbands and wives in a qualified joint venture who make this election would divide all items of income, gain, loss, deduction, and credit in accordance with their respective interests in the venture, with each spouse taking into account his or her respective share of these items as a sole proprietor.

This provision is effective for taxable years beginning after December 31, 2006.

Other provisions

Other Act provisions include:

- Specific changes to the rules governing subchapter S corporations
- Changes to the low-income housing credit rules for buildings in the Gulf Opportunity Zone
- An increase in the amount and scope of tax return preparer penalties
- Changes to the suspension period for IRS penalties and interest when proper IRS notification is not sent
- Modification of collection due process procedures for employment tax liabilities
- Permanent extension of IRS user fees
- An increase in the minimum penalty for bad checks and money orders
- An increase in the penalty for filing erroneous refund claims
- Additional frontloading of corporate estimated tax payments

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