



TAX ALERT

JUNE 8, 2007

PRESIDENT SIGNS SMALL BUSINESS AND WORK OPPORTUNITY TAX ACTS

After months of political infighting, Congress passes a small business tax incentives bill tied to an increase in the federal minimum wage. President Bush recently signed the bill into law.

The new law gives tax incentives to help small businesses pay the cost of the higher minimum wage. It raises the minimum hourly wage to \$7.25 over two years. The primary tax incentive is liberalizing the expensing of personal property used by businesses. Under the new law the base \$100,000 limit (\$112,000 as indexed for inflation in 2007) is increased to \$125,000 for tax years beginning in 2007 and ending in 2010. In order to limit the benefit to small businesses, the investment limitation for property placed in service in tax years beginning in 2007 was increased from \$450,000 to \$500,000. This limitation is also indexed for inflation.

Other Changes in the New Act

- Married couples who jointly operate an unincorporated business can elect not to file a partnership return. Each spouse would report their share of the income on a Schedule C of their joint return. In order for this provision to apply, the husband and wife must be the only members of the joint venture and both spouses must materially participate in the business.
- New S corporation provisions make it easier for S corporations that were formerly C

corporations to retain their S status. Specifically, capital gains from the sale of stocks or securities are no longer passive income (effective for tax years beginning after May 25, 2007).

The benefits arising from the new law will be paid for by certain revenue raising provisions. The primary provision extends the reach of the “kiddie tax” by raising the age limit to include:

1. all children under age 19 (previously under age 18), and
2. students under age 24.

Both of these changes are effective for tax years beginning after May 25, 2007.

The actual computation of the Kiddie tax remains the same. The net unearned income of the child (for 2007, generally unearned income over \$1,700) is taxed at the parents’ marginal tax rates, if the rates are higher than the child’s tax rates. Only last year, *TIPRA* raised the reach of the kiddie tax from under age 14 to under age 18.

The effective date for the new kiddie tax provision brings with it some good news and some bad news. For calendar year taxpayers, the higher age limit starts in 2008. The last hike in the kiddie tax, from age 14 through age 17, in *TIPRA* was made retroactive to the beginning of 2006. This time, the change is not retroactive and, for most taxpayers, does not take effect until next year. Parents have the option to sell quickly in 2007, while the old rule is still in effect.

However, because this provision is effective for tax years beginning after May 25, 2007, there is also some bad news. It is not until 2008 that capital gain for those in the 15 percent or lower tax brackets fall to zero rather than 10 percent. That zero no-tax rate remains through 2010. Many lawmakers earlier this year called for preventing dependents under age 24 from using the zero percent rate. The new law covers this “loophole” and more by expanding the kiddie tax.

The new age limit for the kiddie tax generally tracks the age test for a “qualifying child” under the uniform definition of child first put into place by the *Working Families Tax Relief Act of 2004*. At the end of the calendar year, a qualifying child under the uniform definition and for purposes of the new kiddie tax is an individual under the age of 19, or a student under age 24. Unlike the uniform definition, however, a child who is permanently and totally disabled will not be excluded from the age test for kiddie tax purposes.

If the earned income of a student over age 17 exceeds half of the student’s support, the kiddie tax no longer applies. Scholarships are not counted in the support test for this purpose.

ANOTHER E-MAIL TAX SCAM IN THE NAME OF THE IRS

The Internal Revenue Service has recently alerted taxpayers to the latest versions of an e-mail scam intended to fool people into believing they are under investigation by the agency’s Criminal Investigation Division.

The e-mail purporting to be from IRS Criminal Investigation falsely states that the person is under a criminal probe for submitting a false tax return to the California Franchise Board. The e-mail seeks to entice people to click on a link or open an attachment to learn more information about the complaint against them. The IRS warned people that the e-mail link and

attachment is a “Trojan Horse” that can take over the person’s computer hard drive and allow someone to have remote access to the computer.

The IRS urged people not to click the link in the e-mail or open the attachment.

Similar e-mail variations suggest a customer has filed a complaint against a company and the IRS can act as an arbitrator. The latest versions appear aimed at business taxpayers as well as individual taxpayers.

The IRS does not send out unsolicited e-mails or ask for detailed personal and financial information. Additionally, the IRS never asks people for the PIN numbers, passwords and similar secret access information for their credit card, bank or other financial accounts. “Everyone should beware of these scam artists,” said Kevin M. Brown, Acting IRS Commissioner. “Always exercise caution when you receive unsolicited e-mails or e-mails from senders you don’t know.”

Recipients of questionable e-mails claiming to come from the IRS should not open any attachments or click on any links contained in the e-mails. Instead, they should forward the e-mails to phishing@irs.gov (the instructions may be found on IRS.gov by entering the term “phishing” in the search box).

Other fraudulent e-mail scams try to entice taxpayers to click their way to a fake IRS Web site and ask for bank account numbers. Another widespread e-mail tells taxpayers the IRS is holding a refund (often \$63.80) for them and seeks financial account information. Still another e-mail claims the IRS’s ‘anti-fraud commission’ is investigating their tax returns.

More information is available on IRS.gov.

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