H.R. 5486

"Small Business Jobs Tax Relief Act of 2010"

June 9, 2010

I. SMALL BUSINESS TAX INCENTIVES

General Provisions

100% Exclusion of small business capital gains. Under current law, Section 1202 provides a fifty-percent (50%) 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. This provision is limited to individual investments and not the investments of a 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 *American Reinvestment and Recovery Act* (the "Recovery Act") temporarily increased the Section 1202 exclusion to seventy-five percent (75%) for qualifying stock acquired in 2009 and 2010. The bill would temporarily increase the amount of the exclusion to one hundred percent (100%) for qualifying stock acquired after March 15, 2010 and before January 1, 2012. *This provision is estimated to cost $1.962 billion over 10 years.*

Limitations and Reporting on Certain Penalties

Small business penalty relief. Under current law, Section 6707A of the Internal Revenue Code 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 bill generally would make the penalty for failing to disclose reportable transactions (including listed transactions) proportionate to the underlying tax savings. *This provision is estimated to cost $176 million over 10 years.*

Annual reports on penalties and certain other enforcement actions. Under current law, the Internal Revenue Service is not required to report annually to the Congress on penalties assessed during the year. The bill would require the IRS Commissioner to report annually to the Ways and Means Committee and the Senate Finance Committee on penalties assessed, and enforcement actions taken, with respect to tax shelters. *This provision is estimated to have no revenue effect.*

Other Provisions

SBA non-recourse loans treated as at-risk. 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. *This provision is estimated to cost $942 million over 10 years.*

Increase deduction for start-up expenditures. 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. *This provision is estimated to cost $508 million over 10 years.*

Benefits under the Small Business Borrower Assistance Program are excluded from gross income. The bill would create a Small Business Borrower Assistance Program that would provide assistance to small businesses that are struggling to meet their obligations to creditors. The bill would exclude from gross income any amounts that are received under this program and, correspondingly, would also deny tax benefits associated with payments on loans that are attributable to amounts received under this program. *This provision is estimated to have no revenue effect.*

II. Offset Provisions

Require a minimum 10-year term for grantor retained annuity trusts ("GRATs"). Grantor retained annuity trusts ("GRATs") allow taxpayers to structure a transfer of assets to another individual in such a way that substantial gift taxes may be avoided. A GRAT is generally an irrevocable trust in which the grantor retains an annuity interest and transfers a remainder interest to another individual. For gift tax purposes, in valuing the gift of the remainder interest to the beneficiaries of such a trust, current law allows taxpayers to deduct the value of the retained annuity interest from the value of the transferred assets. The value of the retained annuity interest is determined by computing the present value of the annuity at a statutory growth rate. If the property transferred to the trust appreciates in value at a rate that is greater than the statutory growth rate, the excess appreciation will be transferred tax free to the trust beneficiaries. One significant risk to this type of tax planning is that, if the grantor dies during the trust term, the portion of the trust necessary to satisfy the annuity amount is included in the grantor's gross estate for estate tax purposes. This generally eliminates the benefit of using a GRAT. As a result, taxpayers have created short-term GRATs to maximize their gift tax planning while minimizing the chances that they might die during the trust term. The bill would include the President's 2011 Budget proposal to require a minimum 10-year term for GRATs to significantly limit this type of planning. In connection with requiring a minimum 10-year term, the bill would also require that the value of the remainder interest must be greater than zero and that the annuity must not decrease during the first 10 years of the GRAT term. As a result, the bill would require taxpayers to take on a greater risk that they might die during the GRAT term in order to take advantage of the gift tax benefits of using a GRAT. *This provision is estimated to raise $5.297 billion over 10 years.*

Crude tall oil ineligible for cellulosic biofuel producer credit. In 2008, Congress enacted a $1.01 per gallon tax credit for the production of biofuel from cellulosic feedstocks in order to encourage the development of new production capacity for biofuels that are not derived from food source materials. The House of Representatives has voted on numerous occasions to prevent unprocessed fuels (e.g., black liquor) from claiming this tax credit. Congress is aware that some taxpayers are seeking to claim the cellulosic biofuel tax credit for processed fuels that are highly corrosive, such as crude tall oil (another waste by-product of the paper manufacturing process). The bill would limit eligibility for the tax credit to fuels that are not highly corrosive (i.e., fuels that could be used in a car engine or in a home heating application). *This proposal is estimated to raise $1.849 billion over 10 years.*