RECAP OF SIGNIFICANT DEVELOPMENTS THAT OCCURRED IN THE SECOND QUARTER 2007

Although the Small Business and Work Opportunity Tax Act of 2007 (2007 Small Business Act) dominated the tax news in the second quarter of 2007, there were other important tax developments which may affect you, your family and your livelihood. The new law changes and other key developments are summarized below.

- **2007 Small Business Act.**

  On May 25th, the President signed into law new legislation to increase the minimum wage and provide relief to small businesses. However, some other rules were toughened in order to generate revenue to pay for the relief. Key provisions in the Act include:

  - Starting in 2008, the kiddie tax will reach a child age 18 or age 19-23 if a full time student. This could cause the investment income of such a child to be taxed at the parent's higher tax bracket but there may be a way to completely avoid this result if the child has enough earned income.

  - Several S corporation rules have been liberalized with various effective dates. For example, for tax years beginning after 2006, an electing small business trust (a trust than can hold S stock for a beneficiary) may deduct interest expense it incurs when it borrows funds to purchase S stock.

  - The work opportunity tax credit is extended for 44 months with liberalized rules for hiring disabled veterans and workers in rural renewal counties.

  - Expensing - the option to currently deduct the cost of business machinery and equipment - is extended and enhanced. For tax years beginning in 2007, the limit is increased to $125,000 and the investment-based phaseout is increased to $500,000, and the enhanced expensing provision is extended through 2010.

  - Starting next year, a husband and wife operating a partnership and meeting certain conditions may instead choose to file as sole proprietors. Choosing this new option would ensure each spouse receives credit for paying Social Security and Medicare taxes.

  - The law was changed so next year's increase in the Federal minimum wage won't cause a reduction in the FICA tip credit for restaurants.

  - IRS generally must suspend interest and penalties if it doesn't notify an individual about his tax liability within 18 months of the later of the date he filed or date the return was due. For notices provided after November 25, 2007, the 18-month period will be increased to 36 months.

- There's a new penalty for refund claims filed after May 25, 2007, without any reasonable basis.

- Various tax incentives for the GO Zone (encompassing areas hard hit by hurricanes in 2005) are enhanced and/or extended.

- **Final regulations on nonqualified deferred compensation plan rules.**

  The IRS issued final regs clarifying the nonqualified deferred compensation plan rules. They cover key definitions, deferral elections, permissible payments and the application of the effective date. The regulations apply for tax years beginning after 2007, but taxpayers may rely on them for tax years beginning before 2008.

- **Final regulations on distributions from designated Roth accounts.**

  A 401(k) plan may include a feature allowing plan participants to elect to have all or part of their elective deferrals treated as Roth contributions - that is, to make designated Roth contributions. Designated Roth contributions are currently includible in income, but qualified distributions are tax-free. The IRS has issued final regulations providing comprehensive guidance on the taxation of distributions from designated Roth accounts and on the reporting requirements for these accounts. The regulations generally apply for tax years beginning after 2006.

- **Guidance on passthrough entities and statistical sampling for the domestic production deduction.**

  The IRS explains which partnerships and S corporations may calculate domestic production gross receipts and W-2 wages at the entity level for purposes of the Code Section 199 domestic production activities deduction. The guidance also details how qualified production activities income and W-2 wages are to be allocated to partners and shareholders for Code Section 199 purposes. Separate guidance explains when statistical sampling may be used for various Code Section 199 allocation purposes and details acceptable statistical methodologies.

- **Consequences of nonqualified plans for highly compensated executives.**

  The IRS has provided a comprehensive explanation of the tax consequences of a nonqualified funded employees' trust for all the parties involved - the employees who are trust beneficiaries, the employer who contributes to the trust and the trust itself. A participant includes in gross income as compensation his vested accrued benefit (other than his investment in the contract) as of the end of the tax year of the trust ending with or within the participant's tax year. The trust is the employer for wage withholding purposes with respect to the nonqualified plan for these highly compensated employees, regardless of whether contributions made for the benefit of the employee are vested at the time of contribution. The employer's contributions to a nonexempt employees' trust on behalf of a highly compensated employee is subject to FICA and FUTA tax when the amounts (and any earnings on them) are vested. If the contribution isn't vested at the time of contribution, the trust is considered the employer liable for the payment of the

FICA and FUTA tax.

- **The IRS will no longer treat trade discounts as includible in income.**

  IRS will treat cash advances by a wholesaler to a retailer in exchange for a volume purchase commitment (i.e., an advance trade discount) as not includible in gross income if the retailer adopts the "Advance Trade Discount Method" of accounting. Under this method, an advance trade discount isn't recognized as gross income on receipt, but instead generally is taken into account for Federal income tax purposes in the amount and manner the retailer accounts for the discount in its applicable financial statements.

- **Deduction limits liberalized for entertainment use of planes by key personnel.**

  The IRS has issued proposed regulations, on which taxpayers may rely, explaining how an employer calculates its restricted deduction for the entertainment, amusement, or recreational use of employer-owned aircraft by "specified individuals" (e.g., officers, directors). Generally, the employer's deduction for the cost of providing an aircraft for entertainment use by a specified individual is disallowed, except to the extent the cost of providing the aircraft is treated as compensation to that individual. The regulations have liberalized rules relating to which expenses must be allocated, the methods that may be used and travel that's exempt from the deduction limit.

- **Full credit for Ford, GM and Nissan qualifying hybrids through September of 2007.**

  Taxpayers who purchase new qualified hybrid motor vehicles may claim a tax credit which varies in amount with the car model, but the credit begins to phase out after the manufacturer sells a fixed number of hybrid vehicles. Based on manufacturer sales figures, the IRS has announced the full hybrid credit remains available through at least Sept. 30, 2007, for qualified hybrid vehicles manufactured by Ford, GM and Nissan.

- **Mazda joins the hybrid club.**

  The IRS has announced Mazda's 2008-model-year Tribute hybrids qualify for the alternative motor vehicle credit. The two-wheel Tribute hybrid credit amount is $3,000; it's $2,200 for the four-wheel drive version).