S CORPORATION ASSOCIATION

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S-Corp Modernization Bill Introduced in the House

Good news! Last week, *S-CORP* Champion Congressman Ron Kind (D-WI) introduced the "S Corporation Modernization Act of 2009." Joining Congressman Kind in sponsoring the legislation were fellow Ways & Means Committee Members Wally Herger (R-CA), Allyson Schwartz (D-PA) and Dave Reichert (R-WA).

The legislation is the companion bill to legislation (S.996) introduced in the Senate earlier this year, and represents the priorities of the S Corporation Association for the 111th Congress, including a provision to make permanent the built-in gains reform enacted as part of the larger economic stimulus package adopted earlier this year.

In a statement accompanying the legislation, Congressman Kind noted, "This bill is a commonsense tax code change that will have huge returns in terms of growth and investment for S corporations. Especially in this tough economic time, my goal is to look out for the small and family-owned businesses which drive our economy. This bill speaks to that, reducing a penalty on S corporations, and thus encouraging them to reinvest the savings into growing their business and creating jobs."

"At a time when small, family and closely-held businesses are struggling to survive, it is encouraging to see that these Members of Congress are dedicated to ensuring the long term viability of S corporations," said *S-CORP* Chairman Dick Roderick. "*S-CORP* would like to congratulate our champions on the timely introduction of this legislation, and express our gratitude for their commitment to the nearly 4.5 million S corporations across the country."

With legislation now introduced in both the House and Senate, your *S-CORP* team will be working hard to garner additional support for the legislation. Reforming the rules governing S corporations will allow countless S corporations to reinvest in their businesses and create jobs – something the economy desperately needs at this moment.

S-CORP wishes to thank Representatives Kind, Herger, Schwartz and Reichert for their commitment to closely-held businesses and looks forward to working with these advocates to move this legislation forward this Congress.

How to Pay for Health Care

Chairman Max Baucus today announced he now has a plan to cover the cost of reforming health care. Past options to cover the cost put forward by the President, the Senate Finance Committee, and the House Ways and Means Committee include:

- A value-added tax
- A rate increase on upper-income families
- A rate increase on Medicare payroll taxes
- Capping employer-provided health insurance benefits
- Capping itemized deductions
- A sin tax on alcohol and soda

None of these options is particularly attractive and, given the challenge of raising this much money, our expectation was that the overall scope of the House and Senate reforms would get smaller as the debate moves into July.

It appears that whittling down process is underway. According to his comments, the Finance Chairman now has in mind a $1 trillion expansion of health insurance coverage (down from previous drafts) to be paid for through an even split of spending cuts and tax increases, including a slimmed down version of capping the employer-provided health care exclusion.

"We are much closer on the scores for a health care reform package than we were at this point last week. We have options the Congressional Budget Office tells us would cost under $1 trillion and are fully paid for," said Baucus. "Based on these developments, I'm even more confident in our ability to move forward. And as I've said before, we will not put out a mark until we are sure we have it right. I'll continue to work with Senator Grassley and Senators on both sides of [the] aisle to turn these options into a package that can pass the Senate and become law this year."

The reforms themselves seek to widen health insurance coverage by expanding Medicare and Medicaid while creating a new health insurance exchange for employers and families. The exchange would include both private insurance options as well as some sort of public alternative, and there would be carrots to encourage small employers and low-income families to participate as well as sticks for those who don't.

The overall cost of these proposals is in the $100 to $200 billion range and would be added on to the $750 billion the federal government already spends on health care programs annually.

But even if Senator Baucus succeeds in offsetting half that cost through spending cuts elsewhere, there is simply no way to efficiently raise $50 billion a year by focusing on individuals making more than $250,000. To raise that kind of money, you need to reach down to the middle class, which is why options like capping the employer-provided health care exclusion are now part of the discussion.

For S corporations, the concern is that the new taxes (whatever form they take) are going to come on top of likely tax increases on income, capital gains and dividends, and estates. These taxes are already scheduled to go up, and with Congress operating at a deficit several times larger than average, they are unlikely to get pared back before they take effect in 2011. Congress simply can't afford it. Whether Congress (and taxpayers) can afford an expensive expansion of health coverage too is certain to be part of the debate.

Obama LIFO Proposal and S Corps

Speaking of tax increases, the S Corporation Association has been fighting LIFO repeal ever since the issue first emerged as part of a 2006 bill to protect consumers from rising energy prices.

Over the years, we've made the case that LIFO is a perfectly legitimate inventory accounting method that can provide the IRS with a more accurate picture of a firm's income, especially in an environment where prices are rising. (Has anybody looked at long-term Treasuries recently?)

And over the past three years, Ways and Means, Finance, the Joint Committee on Taxation, FASB, and the SEC have all taken positions that, to one degree or another, would undermine the ability of firms to use LIFO in the future.

The most recent shot in the LIFO wars was included in President Obama's FY 2010 budget. The Obama proposal would repeal LIFO for tax purposes effective in 2012. This change would adversely affect LIFO firms in two respects. First, firms would no longer be able to use LIFO moving forward, likely resulting in higher reported income and higher taxes.

Second, firms would need to pay taxes on their so-called LIFO reserves -- an accounting entry that doesn't reflect real wealth or income. As we've observed, for firms that have been on LIFO for any significant period of time, their LIFO reserves are going to be substantial. The Obama proposal recognizes this double hit by allowing LIFO firms to pay tax on their reserves over an eight year period.

Firms will still be hit with a double tax increase for the privilege of switching to FIFO, but at least the second tax will be spread out over eight years. Of course, they'll also be paying for health care reform and shouldering the 2011 tax increase and paying down record federal deficit…