RECOVERY GRANTS IN LOWER MANHATTAN:
THE FEDERAL GOVERNMENT ATTEMPTS TO GIVE WITH ONE HAND, AND TAKE WITH ANOTHER

Small Business Owners Report On the Fiscal Impacts of 9/11 and the Challenges of Unexpected Taxation on the Aid Grants that Followed

(Prepared by the Office of Congresswoman Carolyn B. Maloney, NY - April 2003)

SUMMARY

In September of 2002, reports surfaced that the Internal Revenue Service was considering taxation on September 11th related grants being provided to lower-Manhattan residents and businesses. The grants were provided to assist in the recovery and as an incentive for businesses and residents to stay or move to lower Manhattan.

On November 7, 2002, the IRS confirmed that it had decided to tax the grants for small businesses in lower-Manhattan. On November 14, 2002, the IRS confirmed its determination that a large portion of grants to residents in lower Manhattan would also be taxed.

After the initial reports of potential taxation on the grants, New York Members of Congress immediately urged the Commissioner of the IRS to reverse the decision and introduced legislation authored by Congresswoman Carolyn Maloney and Congressman Jerrold Nadler in the House, and by Senators Chuck Schumer and Hillary Clinton in the Senate, to direct the IRS not to tax the grants.

Efforts to make the grants free of taxation are supported by the Lower Manhattan Development Corporation and State and City economic development corporations – which are distributing the $281 million in housing grants and $772 million in small-business grants respectively.

Meyer Feig, the President of the World Trade Center Tenants Association and Co-Founder of the Downtown Business Network – also President of the Intera Corp. Inc. which was located in the World Trade Center – said, "Lower-Manhattan's small businesses are worried and astonished that these recovery grants, which only partially help to recoup enormous losses, will now be taxed significantly. These taxes create an extremely unfair burden on those who suffered the most, financially, due to the disaster. I wish to thank Congressmembers Maloney, Nadler and rest of the Congressional delegation for bringing this urgent matter to the attention of the House and Senate leadership."

The individual case reports that follow detail losses experienced by specific small businesses in lower Manhattan as a result of the September 11th terrorist attacks. The reports also document the amount of federal aid received through these grant programs by individual small businesses, and detail the difficulties businesses have experienced in grappling with unexpected taxation on the grants.

With near one billion dollars in aid grants potentially subject to taxation as income by the IRS, under anticipated tax liability for the companies of between 15% to 34%, it is reasonable to project $200 million dollars or more of the grants being returned to the federal government in taxes.

CASE REPORTS

Avalon Partners Inc.
Vincent Au, President

This financial services/brokerage firm reports losses of approximately $900,000 dollars as a result of the terrorist attacks and its aftermath, receiving approximately $120,000 in federal grants. Mr. Au reports that the company suffered an additional challenge in losses because it had relocated from an office of 1,100 square feet to an office of 5,500 square feet in August of 2001, and invested significantly in new office equipment. The question of whether the federal grants would be taxed seemed "always up in the air" says Mr. Au, who now anticipates having to return $40,000 to $50,000 of the grants to the IRS, even though the funds were already used.

Mr. Au states, "I don't understand how is this reasonable. If they looked the dictionary under red tape this would it."

Karoon Capital Management, Inc.
Kayvan Karoon, President

This financial services company reports losses of approximately $2.5 million as a result of the September 11th terrorist attacks, while receiving $33,000 in federal grants. Between five and six months after the disaster, Karoon Capital Management received $13,000 in grants, while an additional $20,000 was received more than a year later.

Mr. Karoon was not informed that the grants would be taxed until late November of 2002, near the end of the fiscal year. The tax avoidance strategies suggested by the IRS at that time came too late in the process for this company to adjust its expenditures and investments from the grants, and additional guidance from the IRS – made public on March 19, 2003 with less than a month left before the tax filing deadline of April 15, 2003 – was never received by this company.

Mr. Karoon states of the situation, "Taxing these grants seems unfair. My business suffered $2.5 million in losses from the disaster and we received a small but very appreciated federal grant of $33,000 to help. But to tax these grants just heaps on additional burdens that really defeat the whole purpose of the assistance. I fail to find the logic in the whole thing, not just the amount of the grants in relation to losses, but the aftermath of being taxed. If I ran my business like this I'd be out of business."

OM Beauty Concepts Inc.
Olga Diaz, Owner

Ms. Diaz's hair salon was located in the World Trade Center and lost approximately $300,000 as a result of the attacks, receiving $37,000 in federal grants. Ms. Diaz states that she learned about the taxation on the grants "after I invested it in rebuilding my business and now I am struggling to find ways to pay."

Ms. Diaz reports that she already faced the initial requirement to become eligible for the grant of finding and securing a new location for her business, which took months and delayed needed aid. Now, as she works to build her business, she is facing an unexpected tax on the federal grants that she says, "makes the whole process just extremely, almost impossibly, challenging."

The Hunter Realty Organization

Richard Selig, President

The Hunter Realty Organization suffered several million dollars in losses as a result of the September 11th disaster, receiving approximately $80,000 in federal grants. While Mr. Selig reports a relatively early awareness that the grants could be taxed, his business has been forced to wait for the actual grant award, because the State agency distributing the grants – the Empire State Development Corporation (ESDC) – approved payments totaling $49 million more than the amount allotted to the program.

As of late-March 2003, the ESDC reports that about 1,500 of the 14, 233 companies approved for the small-business recovery grants faced the same situation as the Hunter Realty Organization in having been approved for grants, but not yet receiving any money. Mr. Selig states, "The delays are frustrating, but beyond that, the taxation on the grants seems really to defeat the purpose of getting people to come back and stay in lower-Manhattan, and it adds to the challenge for businesses here to recover and grow."

Transition Networks LLC

Mary Olsen, President and CEO
Co-Founder of the Downtown Business Network

Transition Networks LLC reports estimated losses from the September 11th disaster of 66% of prior annual earnings. The company received $26,000 in grants through the ESDC and learned that the aid would be taxed in November of 2002, after the funds had been reinvested in the companies recovery.

Ms. Olsen says of the tax on the grants, "Although the money allocated to small businesses like mine was not exponentially balanced with the mega-sums provided to large businesses, I did appreciate the funds. I don't think it was legislators intention to tax this money, but if the IRS does this, they are reducing our ability to survive as a business. If we and other businesses can't survive, this tax has the effect of reducing New York's ability to recover more broadly, so in the end I really don't understand what are they thinking."

Serko & Simon LLP

Christopher M. Kane, Esq., Partner

Tenants of the World Trade Center for more than twenty years, Serko and Simon LLP suffered property losses from the September 11th disaster in excess of two million dollars, receiving $300,000 in grants through the ESDC.

Mr. Kane notes that, "At the time the grants were made, no statement was made as to their taxability. And, at the time of the receipt, we were not in a position to 'put aside' a portion of what was supposed to be 'disaster relief' in the possibility that the IRS was going to lay claim to what we had received."

Mr. Kane also states, "This federal grant, while certainly appreciated, did not offset our uninsured losses to any significant degree. Taxing the grants in addition means that we will lose in help that we were hoping to could help us recover our firm more quickly."

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