Year-end Tax Planning

As we enter the latter part of the year, it's time to take a closer look at your business' financial situation and consider potential tax savings strategies. There are provisions in the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 and the Energy Improvement and Extension Act of 2008 that benefit 2009 taxpayers. In February, Congress also passed the American Recovery and Reinvestment Act of 2009 which offers savings opportunities for small businesses.

As you evaluate potential credits and tax-minimization opportunities, keep in mind that the application of various strategies may differ depending upon your business' unique situation and accounting methods. The cash method allows for deductions and income reported for the year they are paid and received, while the accrual method applies income and expenses in the year incurred. As always, you should consult with your tax attorney, preparer or advisor.

Some tax-saving tactics and strategies worth considering include:

- *Defer recognition of income*—If your cash flow permits, any payments your company can receive in January, as opposed to December, will reduce the current year tax burden. When using this strategy, the company's entity structure and annual profits and losses should be considered.
- *Contribute to a retirement plan*—Make payments to an existing plan, or set up a plan prior to year-end. Contribution limits vary depending upon the plan type. There are numerous retirement plan options to choose from; it is recommended that you choose the plan that best fits your business, number of employees and retirement goals.
- *Pay discretionary bonuses*—If you've had a good year—even in this tough economy—and want to reward employees (provided your accounting is done on an accrual basis), accrue year-end bonuses. Deductions may be allowed for accrued bonuses to employees as long as they are paid within two and a half months of year end (March 15 for businesses with a December 31 year-end).
  - For bonuses given to owners:
    - *S corporations* may deduct bonuses for shareholders or owners who have any percent ownership when bonuses are paid.
    - *C corporations* may only deduct bonuses for shareholders or owners who have 50% or more ownership when bonuses are paid in order to get the deduction.
    - *A note on cash basis accounting*—For those using cash method accounting, the bonus must be paid in that year to be deducted in the same year.
- *Make additional charitable contributions*—If possible, make contributions prior to the beginning of the next year, so they may be deducted in the current tax year. Be sure to retain receipts.
- *Incur expenses*—For cash-basis taxpayers—cash flow permitting—pay as many expenses as possible prior to year end to maximize deductions. Examples include:
  - utilities
  - printing new marketing collateral
  - office supply purchases
  - equipment purchases—In this case, you have multiple write-off options (Section 179 deduction discussion below). The equipment must be in your office and in use by year-end.
- *Write off uncollectible accounts (bad debts)*—The IRS allows deductions for actual write-offs, not those allowed for in your "allowance for doubtful accounts." If the item is truly a bad debt—meaning you're able to show you've tried to collect the debt and payment is unlikely—go ahead and write it off. Note: Only businesses using the accrual method of accounting can write off bad debts.
- *Write off obsolete inventory*—If you have inventory, update your records, write off any obsolete or damaged inventory.
- *Capitalize on potential estimated tax savings*—For small businesses, under the American Recovery and Reinvestment Act of 2009 enacted by Congress in February, a "qualified individual" can base annual payment of 2009 taxes on the lesser of: 90% of the tax shown on the individual's 2009 return, or 90% of the tax shown on the individual's 2008 return.
- *Deducting equipment and assets through Section 179 expense and Bonus Depreciation*—The American Recovery and Reinvestment Act of 2009 also set the Section 179 deduction limit at $250,000, with the qualifying property limit set at $800,000 for tax years beginning in 2009. Generally, assets have to be depreciated over statutory lives, but under Section 179, a business or self-employed

individual may be able to deduct the full amount of certain equipment or asset purchases in the year of purchase. New guidelines and considerations are as follows:

  - Certain types of tangible personal property are eligible, such as furniture and fixtures and machinery and equipment. The limit on first-year depreciation for certain types of passenger automobiles was raised by $8,000 under the American Recovery and Reinvestment Act. Real property and investment property are not eligible.
  - For tax years beginning in 2009, the maximum deduction is $250,000.
  - If your total qualifying property purchases exceed the $800,000 threshold, the maximum Section 179 deduction gets reduced.
  - Section 179 Expense Deductions can't be used to make business income go negative. Deductions that reduce income below zero can be carried forward for an unlimited number of years to a year when the business has positive income and can be applied to that year.
  - Businesses will be able to deduct an additional 50% of the cost of certain asset purchases in 2009. The American Recovery and Reinvestment Act of 2009 also provides for Bonus First Year Depreciation by allowing a bonus first year depreciation deduction of 50% of the adjusted basis of qualified property placed in service after December 31, 2008, or during 2010 if long production-period property.

- *Perform a cost-segregation study if you own real estate*—If you own real estate or build a building, consider taking advantage of a cost-segregation study, which can accelerate depreciation and increase cash flow. (To learn more, check out the IRS's "Cost Segregation Audit Techniques Guide.")
- *Qualified Leasehold Improvement and Qualified Restaurant Improvements*—For qualified leasehold improvement and qualified restaurant improvements placed in service in 2008 and 2009, you are allowed a 15-year straight-line recovery period.
- *Qualified Retail Improvement Property*—For qualified retail improvement property placed in service in 2009, you are allowed a 15-year straight-line recovery period.
- *Increase energy efficiency to receive tax incentives*—The Energy Improvement and Extension Act of 2008, enacted October 2008, supplements specific tax credits offered in the Energy Policy Act of 2005, and other previous acts. As in previous tax years, there are tax credits for buying hybrid vehicles, for building energy-efficient buildings and for improving the energy efficiency of commercial buildings. The Energy Improvement and Extension Act, though, also adds tax credits for small wind and geothermal energy generation. (For more information, see the U.S. Department of Energy's *"Tax Breaks for Businesses, Utilities, and Governments."*)
- *Manufacturers should explore Section 199 Domestic Production Activities Deduction opportunities*—Small businesses in the manufacturing sector should evaluate this "manufacturer's deduction." An overview of the deduction is as follows:

  - A business engaged in a "qualifying production activity" is eligible to take a tax deduction of 6% in years 2007-2009, and 9% in year 2010.
  - The deduction is limited to 50% of annual W-2 wages allocable to the domestic manufacturing activities.
  - Determining the deduction is based on determining qualified production activity income (QPAI).

- *Work Opportunity Tax Credit*—Under the Work Opportunity Tax Credit (WOTC), an employer can claim a tax credit for wages paid to members of certain "targeted" groups. Generally, the maximum credit is $2,400 per employee (or 40% of wages, whichever is less.) The WOTC now includes the following in "targeted" groups: unemployed veterans and disconnected youths.

Careful planning is the best way to capitalize on available opportunities. There are many other potential tax-optimization strategies that may apply to your business entity. Consult a qualified tax professional about your unique circumstances when evaluating the strategies that are best for your business.