



Dear Clients and Friends:

The economic slowdown has made 2009 one of the most challenging years in recent memory for many businesses. Many employers are struggling to boost profits, retain customers and develop new products in a sluggish market. The Tax Code can provide some relief. Some year-end tax planning strategies may be able to reduce your tax burden as 2009 draws to a close.

Net operating losses

Due to recent tax law changes to jumpstart the economy, Congress has made year-end loss shifting as lucrative in many instances as income shifting has been in the past. Many small businesses experienced net losses in 2008 and may be preparing themselves for the same bottom line in 2009. The tax law's use of NOL carrybacks, however, can provide a silver lining that allows those losses to be carried back to profitable years and generate an instant tax refund. Congress earlier this year allowed 2008 NOLs from eligible small businesses (those with gross receipts of \$15 million or less) to be carried back up to five years to 2003, rather than the usual two years. Now, under the Worker, Homeownership and Business Assistance Act of 2009, signed into law on November 6, Congress extended modified NOL relief to all businesses and to either 2008 or 2009 NOLs, at the election of the taxpayer. Although not as generous in its fifth year carryback provision (only 50 percent of income may be offset), the latest law in effect offers many small businesses the opportunity to double dip: to claim refunds from 2008 NOLs under the earlier relief provision and to claim another round of refunds from 2009 NOLs under the new law that has just passed. In any case, 2009 NOLs are not set in stone until the end of the 2009 tax year. Many businesses that anticipate 2009 tax year losses should be taking steps before end year to accelerate deductions to maximize the size of their 2009 NOLs for a larger carryback refund.

Bonus depreciation

A related, and also temporary tax break, is 50 percent first-year bonus depreciation of the adjusted basis of qualifying property. The property must be (1) eligible for the modified accelerated cost recovery system (MACRS) with a depreciation period of 20 years or less; (2) water utility property; (3) computer software (off-the-shelf); or (4) qualified leasehold property. Only new property qualifies. In addition, it must be "placed in service" before January 1, 2010, with some exceptions for certain transportation property.

Code Sec. 179 expensing

For 2009, a business can immediately deduct up to \$250,000 for qualifying equipment purchases, including computers and software. The property must be used more than 50 percent for business. It can be used or new property but in all cases must be your business's first use of that property. To take the deduction for 2009, qualified equipment must be placed in use by December 31, 2009. Keep in mind that any unused Code Sec. 179 amount cannot be carried over into the next year. Please contact us if you are considering an equipment purchase or other qualifying purchase before year-end. You do not want to miss out on this valuable tax break, which is scheduled to end in 2010.



Research tax credit

Many small businesses mistakenly think the Code Sec. 41 research and experimentation credit is only for large businesses. The credit is complex but it rewards businesses for research activity regardless of size. The credit is generally 20 percent for qualified research and experimentation expenses above a base amount. There is also an alternative simplified credit of 14 percent. Currently, the research and experimentation credit is scheduled to expire after December 31, 2009.

Manufacturing deduction

Another valuable deduction that is often overlooked by small businesses is the Code Sec. 199 deduction for qualifying domestic production activities benefits. For 2009, the deduction equals six percent of the lesser of (1) qualified production activities income for the tax year, or (2) taxable income that does not take the deduction into account for the tax year. The deduction cannot exceed 50 percent of W-2 wages allocable to domestic gross receipts. The deduction applies for both regular and alternative minimum tax (AMT) liability.

Leasehold improvements

Generally, business owners must capitalize the cost of property used in their trade or business and recover the cost over time through annual deductions for depreciation or amortization. In 2008, Congress temporarily reduced the recovery period for qualified leasehold improvement property, qualified retail improvement property and qualified restaurant property to 15 years. If you are considering an improvement to your business, please contact our office.

Charitable contributions

Businesses, like individuals, may deduct contributions to charitable organizations within certain limits. Corporations, but not other business entities, enjoy an enhanced deduction for contributions of computer technology and equipment for educational purposes. This enhanced deduction will expire after December 31, 2009. All businesses regardless of how they are organized can claim an enhanced deduction for donations of food. However, the deduction for donations of food will expire after December 31, 2009.

Business vehicles

Many small businesses depend on vehicles owned or leased either by the company or by the proprietor. The standard mileage rate for business use of vehicles is 55 cents per mile for 2009. The IRS is expected to announce the rate for 2010 before the end of 2009. Because inflation has been low and gas prices relatively stable, it is unlikely that the rate will increase dramatically as it has in past years; it may even go down. Alternatively, you may use the actual cost method. Under that method, you may take deductions for depreciation, lease payments, registration fees, licenses, gas, insurance, oil, repairs, garage rent, tolls, tires and parking fees. If you have not compared the two methods recently, please contact our office. Regardless of the method you use, if your vehicle is used for personal as well as business purposes, only expenses or mileage attributable to the percentage of business use are deductible. There are separate considerations involved in leasing a car for business.



Employee benefits

Establishing employee benefit plans, qualified retirement plans and medical or health reimbursement plans can provide tax savings to employees and your business. Recently, the Obama administration and the IRS unveiled a new initiative encourage small businesses to offer retirement savings plans. The initiatives expand opportunities for automatic enrollment in retirement plans; show how employees can save payments they would receive for unused vacation or other similar leave in their retirement plan; and help employees and employers understand their tax-favored rollover and other savings options. Our team can help you choose or refine a retirement savings plan that best fits your business.

Accounting methods

The accounting method used by a business determines when income must be recognized and expenses are deductible for tax purposes. Cash based businesses can shift income to next year by delaying billing notices for services or products so that payment is not received until 2010. Accrual based businesses can defer income by delaying the shipment of products or provision of services until the 2010 tax year.

Income shifting

Businesses, like individuals, can benefit from the classic strategy of shifting taxable income and accelerating or deferring deductions between 2009 and 2010 by controlling the receipt of income and payment of expenses. Businesses expecting to be in the same or lower tax bracket in 2010 should consider deferring income until next year and accelerating deductible expenses in 2009. Alternatively, if a substantial increase in income is anticipated in 2010 (propelling the business into a higher tax bracket), income should be accelerated in 2010 and deductions deferred until next year.

Other provisions that may offer opportunities that should be evaluated as part of your year-end tax planning include:

- *Deferral of discharge of indebtedness income resulting from reacquisition of business debt.* At the election of the taxpayer, income from the discharge of debt in connection with the reacquisition before January 1, 2011, of business debt instrument is includable in gross income ratably over a five tax years.
- *Work Opportunity Tax Credit.* The work opportunity tax credit was designed to provide an incentive for employers to hire individuals from disadvantaged groups that have a particularly high unemployment rate. The credit is equal to 40% of the first \$6,000 of wages paid to the individual during the first year of employment.
- *Reduced recognition period for S corporation built-in gains tax.* For tax years beginning in 2009 and 2010, no tax is imposed on an S corporation's net unrecognized built-in gains if the seventh tax year in the corporation's 10-year recognition period preceded its 2009 or 2010 tax year.



- *Book inventory contributions.* For C corporations only, an enhanced deduction for donations of book inventory is allowed when made to public schools, or a qualified charity or private operating foundation for use in the care of the ill, the needy or infants before January 1, 2010.
- *15-year MACRS recovery period for restaurant improvements and buildings.* The 15-year recovery period for improvements to a restaurant building is extended to apply to restaurant buildings placed in service in 2009.
- *Energy efficient commercial buildings deduction.* A deduction is available for certain energy efficiency improvements installed before January 1, 2014 on, or in, a depreciable building located in the United States. This deduction applies to property installed as part of a building's interior lighting systems; heating, cooling, ventilation, and hot water systems; or envelope, as part of a plan to reduce total energy and power costs of the system as least 50 percent. The deduction is limited to \$1.80 times the total square footage of the building.
- *Alternative minimum tax.* The alternative minimum tax (AMT) is not a challenge reserved solely for individual taxpayers. A corporation that is not a "small corporation" may be required to pay AMT if the corporation claims tax preference items or certain credits.

Overall, a key element of tax planning is a careful review of these incentives and provisions, and how best to take advantage of them in the current tax year.

There have been proposals to increase the income and capital gains tax on single individuals with income of more than \$200,000, and married couples with income exceeding \$250,000. Therefore, following the traditional year-end planning maxim of deferring income into next year may not be a positive strategy. Deferring too much income into 2010 could result in income taxed at a higher rate.

Regardless of your tax entity, your state's treatment of these and many other provisions may be a more significant issue this year than in prior years. Although a state may wish to boost its economy by adopting some of the 2009 Recovery Act provisions, they cannot afford to create deeper revenue shortfalls. Therefore, what may be treated as a deduction for federal purposes may be an adjustment to income as computed by the state. This is especially true regarding a state's treatment of bonus depreciation and the increased section 179 deduction, which also impacts a decision to accelerate AMT and investment credits.

Business tax planning involves not only planning for the current year, but also making wise tax decisions that will benefit your business for years to come. A further review of your options now could identify what you can do during the next couple months to save money on your 2009 tax bill and plan for the future. Please call us to arrange an appointment at your convenience.