2009

YEAR-END INCOME TAX PLANNING FOR CORPORATE AND NON-CORPORATE BUISNESSES

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INTRODUCTION

As the end of 2009 approaches, it's time to evaluate year-end tax planning for corporations and other businesses. Over the past year, Congress, the IRS, and the courts have flooded us with significant tax developments. These changes make year-end tax planning for 2009 exceedingly important! Most recently, Congress passed the ***American Recovery and Reinvestment Tax Act of 2009,*** which includes corporate and business tax benefits that: provide a longer carryback period for 2008 net operating losses; expand the Work Opportunity Tax Credit for hiring certain disadvantaged employees; extend through 2009 accelerated business asset write-offs including the higher $250,000 179 deduction, the 50% bonus depreciation, and a 15-year (instead of 39-year) write-off of certain leasehold improvements, restaurant properties, and retail properties; offer a new income deferral election for businesses that experience cancellation of debt income; and temporarily shorten the time (from 10 years to 7 years) that an S corporation which used to be a regular C corporation is exposed to the corporate built-in gains tax.

We are sending you this letter to bring you up-to-date on these and other *new* tax planning opportunities for corporate and non-corporate businesses.

> **Caution!** Several of the most significant new tax breaks **expire in 2009** (and others in 2010). Therefore, it is extremely important that you be proactive and act timely to obtain maximum benefits! This letter also contains *traditional* year-end tax planning strategies **1)** to help ensure that your business income is taxed at the lowest possible rate, and **2)** to postpone taxes by deferring taxable income and accelerating deductions.

To help you locate items of interest, we have divided the planning ideas into the following categories:

- **Highlights Of Recent Legislation Impacting Year-End Planning**
- **Don't Overlook Other Expiring Business Tax Breaks**
- **Planning With Other Recent Tax Changes**
- **Traditional Planning For C Coprporations**
- **Traditional Planning For S Corporations**
- **Traditional General Business Planning**

> **Planning Alert!** Although this letter contains many planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. You should also consider any state income tax consequences of a particular planning strategy. We recommend that **you call our firm before implementing any tax planning technique** discussed in this letter, or if you need more information.

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***HIGHLIGHTS* OF RECENT LEGISLATION IMPACTING YEAR-END PLANNING**

Earlier this year, President Obama signed the *American Recovery and Reinvestment Tax Act of 2009* (the "2009 Act") providing approximately $275 billion of temporary tax breaks and incentives impacting virtually every business taxpayer. The following are *selected* provisions from this tax legislation that we believe will have the greatest impact on 2009 year-end planning for corporations and businesses.

Planning Alert! As you read the following highlights, please keep in mind that there are several tax breaks available **only in 2009**, and others expire after 2010! Due to mounting concerns about expanding budget deficits, it is unclear whether Congress will extend these temporary business tax benefits. Consequently, pay careful attention to the **effective date** and **expiration date** (if applicable) for each new provision, which we ***highlight prominently*** in each segment.

Tax Tip. The recent legislation contains a host of accelerated depreciation write-offs for qualifying equipment, vehicles, buildings, software, and capital improvements *placed in service* generally **no later than December 31, 2009.** If your business plans to take advantage of any of these increased write-offs for 2009, make sure that you order, purchase, acquire, or construct the property early enough so that your business can actually *place it in service* **no later than December 31, 2009!**

Fiscal Year Corporations May Still Have Opportunity To Elect *Temporary* 5-Year Carry Back Of Net Operating Losses. If a taxpayer has a net operating loss (NOL) for a tax year, the NOL may generally be carried back and offset taxable income reported in the 2 tax years before the year of the loss (the "carry back period"). Any remaining unused NOL can then be carried forward to each of the following 20 years until the NOL is used up. Under the *2009 Act*, for NOLs generated in a **tax year ending in 2008** by an **"eligible small business** (a business with average gross receipts of no more than $15 million), taxpayers may "elect" an extended NOL carry back period from 2 years to up to 5 years.

Planning Alert! This law has been modified and extended. Please see our complete analysis of **The Worker, Home Ownership and Business Assistance Act of 2009**which was signed into law on November 6, 2009.

Tax Tip. *Fiscal-year* taxpayers may still elect the extended carryback period of up to 5 years for the tax year *beginning* in 2008 if the extended carryback period was not elected for the tax year *ending* in 2008. If you own a fiscal-year eligible small business that has a net operating loss for the tax year **beginning in 2008** that still qualifies for this election (typically a fiscal year, regular C corporation having average gross receipts not exceeding $15 million), please call our office. We will help you determine whether or not you should consider electing an extended carryback period.

Please Note! As we complete this letter, there are proposals in Congress to extend this expanded NOL carryback period to certain NOLs generated after 2008.

Increased $250,000 Section 179 Deduction Extended Through 2009. Last year, Congress increased the maximum 179 deduction for the cost of qualifying new or used depreciable business property (e.g., machinery and equipment) from $128,000 to $250,000 for property placed-in-service in tax years beginning in 2008. The *2009 Act* has now extended this $250,000 cap for an additional year, to **property placed-in-service in tax years beginning in 2009.** However, the $250,000 deduction is reduced by the amount by which the cost of qualifying 179 property placed-in-service during the 2009 tax year exceeds $800,000.

Tax Tip. If your business is a *calendar-year* taxpayer, the increased 179 deduction will be available for qualified property placed-in-service **by December 31, 2009.** To be safe, your qualified property should be set up and tested **before 2010.**

Planning Alert! If your business purchases more than 40% of its machinery, equipment, etc. in the last 3 months of its tax year, it may only take 1 2 months of depreciation (instead of 6 months of depreciation) for the property acquired in the last 3 months. This is commonly referred to as the Amid-quarter convention. If you elect the 179 deduction for property purchased in the last three months of the tax year, that portion of the cost of the property will be excluded from the 40% test. This may allow you to avoid the mid-quarter depreciation convention and use the half-year convention instead.

Caution! For **tax years beginning after 2009**, the 179 deduction is scheduled to drop back to $134,000. If you are considering a significant equipment or business vehicle purchase, please call our office. We will help you develop a purchase strategy that gives you maximum depreciation deductions.

- **Pass-Through Entities.** If you have a pass-through business entity (e.g., S Corporation, LLC, Partnership), you must apply the $250,000/$800,000 limitations twice; once at the entity level and again to the owners (i.e., to the S Corporation Shareholders, LLC Members, and Partners). In certain situations with fiscal-year pass-through entities, the $250,000/$800,000 limitations may be reduced. The rules for applying the $250,000 179 limit to fiscal-year, pass-through entities are tricky. Please call us if you need more information.

- **Don't Forget Taxable Income Limitation.** The 179 deduction generally is not allowed to exceed the taxpayer's business taxable income (as determined without the 179 deduction). Thus, the 179 deduction generally cannot create a taxable loss (or NOL). For pass-through entities, this so-called *taxable income limitation* is applied at both the entity level, and again at the owner level. However, if wages are paid to S Corporation shareholders or guaranteed payments are paid to owners of a partnership, the S Corporation's or Partnership's 179 deduction can actually exceed the pass-through entity's *taxable income*, and create a pass-through loss. If you own an interest in a pass-through entity and plan to take advantage of these temporary increases in the 179 deduction limitations, please call our firm. We will help you maximize your section 179 deduction.

The 50% Bonus Depreciation Also Extended Through 2009. Last year, *Congress* reinstated the 50% bonus depreciation deduction for calendar-year 2008 property acquisitions. The *2009 Act* extends the 50% bonus depreciation for one more year. Therefore, the 50% bonus depreciation deduction is available for **new** qualifying property **acquired and placed-in-service during calendar years 2008 and 2009.** Generally, *qualifying property* includes property that has a depreciable life for tax purposes of *20 years or less* (e.g., machinery and equipment, furniture and fixtures, cars and light general purpose trucks, sidewalks, roads, landscaping, depreciable computer software**,** farm buildings, qualified leasehold improvements, and qualified motor fuels facilities).

Caution! Whether your business uses a fiscal or calendar tax year, the 50% bonus depreciation is allowed only if qualified property is acquired and placed-in-service **during calendar years 2008 or 2009.** To meet the placed-in-service requirement for 2009, property must be ready and available for use **by December 31, 2009.** **Passenger Automobiles.** The maximum first-year depreciation deduction (including the maximum 179 deduction) for most *business automobiles* is generally capped at $2,960 **for 2009** ($3,060 for trucks and vans not weighing over 6,000 lbs). However, the *2009 Act* increased the first-year depreciation cap by $8,000 for autos qualifying for the 50% bonus depreciation in 2009.

Planning Alert! The dollar limits must be reduced proportionately if your business use of a vehicle is less than 100%. For example, assume you are self-employed and you buy a new $30,000 passenger vehicle which you use 60% for business and 40% for personal driving in the first year. Your first year depreciation dollar limit for 2009 would be $6,576 ($10,960 x 60%).

Tax Tip. If you wait until early 2010 to purchase the same vehicle and the first year cap is the same for 2010 as for 2009, your first year limit would be only $1,776 ($2,960 x 60%). If you purchase the passenger vehicle late in 2009, be sure to use it as much as possible for business through **December 31, 2009**, and keep your personal use to a minimum. This will maximize your business percentage for 2009, and could dramatically increase your 2009 depreciation deduction.

Caution! If you take an additional $8,000 first year depreciation deduction on your passenger vehicle purchased in 2009, and your business use percentage later drops to 50% or below, you may be required to bring into income a significant portion of the depreciation taken. Therefore, it is imperative that the business use of the vehicle exceeds 50% for subsequent years. **Trucks And SUVs Over 6,000 Lbs.** Trucks and SUVs with loaded vehicle weights over 6,000 lbs are generally exempt from the passenger auto annual depreciation caps discussed above. However, the 179 deduction for an **SUV is limited to $25,000** (instead of $250,000). On the other hand, **pickup trucks** with loaded vehicle weights over 6,000 lbs **are *not* subject to the $25,000 limit** imposed on SUVs, if the truck bed is at least six feet long.

New Incentives To Hire Unemployed Veterans And Disconnected Youth. If your businesses employs workers who are members of certain targeted groups (e.g., certain low income employees, welfare recipients, ex-felons, summer youth employees), you may qualify for the *Work Opportunity Tax Credit* (WOTC*).* The credit is 40% of the first $6,000 of qualifying wages (up to $2,400 per employee). **For employees who begin work in 2009 or 2010,** the *2009 Act* created two new categories of individuals qualifying an employer for the 40% WOTC: **1)** *unemployed veterans*, and **2)** *disconnected youth*.

Planning Alert! A business must properly certify the employee in order to qualify for the WOTC. You can generally satisfy this certification requirement by having the employee complete a *pre-screening notice* (**IRS Form 8850**) before the employee begins working. Also, no later than 28 days after the employee begins working, you must submit the properly executed notice to the appropriate state employment security agency for certification.

Tax Tip. Be sure to use the most recent **Form 8850** and the related instructions which contain information on the two new categories of qualifying employees (*unemployed veterans* and *disconnected youth*) as well as the other targeted groups qualifying for the WOTC. Form 8850 and the related instructions are available at www.IRS.gov.

Deferral Of Income Recognition From Cancellation Of Business Debt in 2009 Or 2010. Generally, a business has *cancellation of debt* (COD) income where the debt of the business is cancelled or where the business reacquires its debt for an amount less than its face amount. However, under the *2009 Act*, a business may elect to defer its COD income resulting from the cancellation or the reacquisition of a debt instrument that was issued by the business **if the forgiveness or reacquisition takes place in 2009 or 2010**. If the election is made, qualified COD income that would otherwise be recognized in **2009 or 2010** will be **deferred until 2014**, and then included ratably in income over the next 5 tax years (i.e., from 2014 through 2018).

Tax Tip. The IRS has recently released detailed guidance on the technical application of these rules, and the procedures for making the election. These rules are quite detailed, please call our firm if you need additional information.

DON'T OVERLOOK OTHER EXPIRING BUSINESS TAX BREAKS

Even before the *2009 Act*, discussed above, Congress had previously given us an ever expanding list of temporary business tax breaks that expire after a certain date. Some of the more popular tax benefits that are currently scheduled to **expire at the end of 2009** include the: **1)** 15-Year (instead of 39-Year) Depreciation Period for Qualified Leasehold Improvements; **2)** 15-Year (instead of 39-Year) Depreciation Period for "Qualified Restaurant Improvement Property;" **3)** 15-Year (instead of 39-Year) Depreciation Period for "Qualified Retail Improvement Property; **4)** 5-Year (instead of 7 year) Depreciation Period for Certain Farming Business Machinery and Equipment; **5)** Research and Development Credit; **6)** Employer Differential Wage Credit for Payments to Military Personnel; **7)** Various Tax Incentives for Investing in the District of Columbia; **8)** Favorable S Corporation Charitable Contribution Provisions; **9)** Enhanced Charitable Contribution Rules for Qualifying Business Entities Contributing Computer Equipment, and Book and Food Inventory; and **10)** Extension of Increased Rehabilitation Credit for Structures in the Gulf Opportunity Zone.

> **Planning Alert!** In the past, many of these tax breaks have been extended before they actually terminated. However, given the current political environment of rising deficits, there is uncertainty as to which provisions Congress will extend beyond 2009. Therefore, if you wish to take advantage of these tax benefits, the property should be placed in service, or the expenditures should be made before the provision expires.

PLANNING WITH OTHER RECENT TAX CHANGES

***Temporary* 15-Year Write-Off For Improvements To Qualifying Buildings (2009 Only).** Last year, Congress enacted a *temporary* 15-year depreciation recovery period (instead of 39 years) for the following two new categories of depreciable realty *placed in service* **after 2008, and before 2010**: **1)** qualified retail improvement property, and **2)** qualified restaurant property. **Qualified Retail Improvement Property** generally includes improvements made to the interior portion of a **commercial building** (i.e., nonresidential real property), that are placed in service **more than 3 years after** the building was **first** placed in service, and that are made to a building, the interior portion of which is open to the general public **for the sale of tangible personal property.** The following capital expenditures will not qualify: improvements that enlarge the building; any elevator or escalator; any structural component benefitting a common area; and any cost relating to the internal structural framework of the building. **Qualified Restaurant Property** generally includes any building or improvement to a building, if more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals.

> **Tax Tip.** If a newly-constructed or newly-acquired qualifying restaurant building is **placed into service in 2009,** the *entire* cost of the building will qualify for the 15-year write off.

> **Planning Alert!** If you are currently making capital improvements that might constitute *qualified* retail improvement property or restaurant property, or you are purchasing a restaurant building, and you want to use the 15-year write-off, you must place the building in service **by December 31, 2009!** This will allow you to write off these capital improvements over 15 years (rather than 39 years). A certificate of occupancy will generally constitute placing the building in service.

> **Caution!** The rules dealing with improvements to leased commercial buildings, buildings used for retail, and buildings used as restaurants are extremely tricky and time sensitive. Furthermore, the depreciation rules become even more complicated if you are planning to do a cost segregation study where you break out nonstructural components of a building for depreciation purposes. Please call our firm if you are incurring capital expenditures for buildings (including acquiring or constructing a building), and we will help you devise a strategy that will provide for optimum depreciation.

TRADITIONAL PLANNING FOR C CORPORATIONS

Recession May Favor Closely-Held Corporations Paying Dividends Over Year-End Bonuses. Since your corporation can generally deduct a bonus, and cannot deduct a dividend, the advisability of paying a shareholder/employee a dividend in lieu of a year-end bonus is based largely on the tax brackets of both the corporation and the shareholder. If your corporation is feeling the effects of the recession and would receive little or no tax benefit from a bonus deduction (e.g., it is incurring current losses and/or has net operating loss carryovers to the current year), then a dividend taxed at a maximum rate of 15% will generally save taxes. On the other hand, if your corporation has significant income and is currently in a high tax bracket, then a bonus would likely save taxes.

> **Planning Alert!** If your corporation pays compensation to a shareholder/employee that is considered unreasonably high, the IRS may attempt to re-classify the payment as a dividend payment. Therefore, the corporation should document the reasonableness of compensation paid to shareholder/employees.

> **Caution!** Paying dividends to shareholders of Personal Service Regular C Corporations (in lieu of compensation) will generally not save you taxes. Personal Service Corporations generally are required to pay a flat 35% corporate tax rate on all taxable income (as discussed below).

Year-End Planning For Personal Service Corporations. If you own a C corporation that is a personal service corporation (PSC), all income retained in that corporation is taxed at a flat rate of 35%. Your C corporation is a PSC if its business is primarily in the areas of health, law, accounting, engineering, actuarial sciences, performing arts, or consulting. Furthermore, in order to be classified as a PSC, substantially all of your corporation's stock must be held by employees who are performing those services.

> **Tax Tip.** Generally, it is preferable from a tax standpoint to leave as little taxable income in a PSC as possible. This may be accomplished by paying reasonable salaries and compensation to the stockholders/employees **by year-end.**

Be Wary Of Passive Loss Trap When Leasing Property To Your Closely-Held Corporation. Owners of a closely-held C corporation frequently own the business's office building, warehouse, etc. individually (or through a partnership or LLC), and lease the facility to their corporation. However, a recent Tax Court case reminds us that this leasing arrangement can also create a passive loss trap. In this case, the Tax Court concluded that any rental loss generated from the shareholders' leasing property to their controlled C corporation, will generally be classified as a passive loss. Therefore, the shareholders must suspend the loss, and will not be able to deduct the rental loss on their current returns unless they have other passive income.

> **Tax Tip.** To avoid this trap, the shareholders should set the lease payments at a level (assuming the lease amount is reasonable) so that the rental property does not generate a tax loss.

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TRADITIONAL PLANNING FOR S CORPORATIONS

Check Your Stock And Debt Basis Before Year End. If your S corporation is anticipating a taxable loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless you have adequate basis in your S corporation. You will have basis to the extent of the amounts paid for your stock (adjusted for net pass-through items and distributions) plus any amounts you have personally loaned to your S corporation. If you do not have sufficient stock basis for the pass-through loss, a mere guarantee of a third-party loan made to your S corporation will not give you basis.

> **Tax Tip.** It may be possible to restructure an outside loan to your corporation in a way that will give you adequate basis. However, this restructuring must occur **before the end of the tax year.**

> **Planning Alert!** The rules for restructuring loans to an S corporation are complicated. **Please do not attempt to restructure your loans without contacting us first.**

Pay Careful Attention To Payments On S Corporation Shareholder Loans. If a shareholder has loaned funds to an S corporation, and all or a portion of the loan is paid back after the loan's basis has been reduced by previous pass-through losses, the shareholder will recognize a gain on the repayment. The amount, character, and timing of the gain is dependent on several factors.

> **Planning Alert!** The IRS has recently issued exhaustive final regulations establishing detailed rules for the tax treatment of payments on S shareholder loans that have a tax basis less than the face amount of the debt. The regulations create several tax traps as well as planning opportunities.

> **Tax Tip.** Please consult with us before you make any payments on your shareholder loans. We will help you structure the loans and any loan repayments to your maximum tax advantage.

Salaries For S Corporation Stockholders/Employees. The combined employer and employee FICA tax rate is 15.3% of your wages up to $106,800 for 2009. The combined rate drops to 2.9% for wages in excess of $106,800.

> **Tax Tip.** If you are a stockholder/employee of an S corporation, you may wish to take no more than a reasonable salary from your corporation to minimize your FICA tax. Other income that passes through to you or is distributed to you as a distribution on your stock is not subject to FICA tax.

> **Planning Alert!** Determining reasonable salaries for S corporation stockholders/employees is a hot audit issue. Also, minimizing your FICA tax could also reduce your Social Security benefits when you retire, and may reduce the amount of contributions that can be made to your retirement plan where the contributions to the plan are based upon your Awages.

TRADITIONAL GENERAL BUSINESS PLANNING

Self-Employed Business Income. If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2010.

> **Planning Alert!** If you have already received the check in 2009, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

> **Caution!** If your 2010 tax rates are higher than your 2009 tax rates, deferring income may not be a good option.

Year-End Accruals To Employees. Generally, if an accrual-basis business accrues year-end compensation to its rank-in-file employees (nonshareholder employees), the accrual must be paid no later than the 15th day of the third month after year-end to be deductible for the year of the accrual. Otherwise, the accrual is not deductible until paid.

> **Planning Alert!** These rules also apply to accrued vacation pay, and to accruals for services provided by independent contractors (e.g., accountants, attorneys, etc.).

Accruals To Related Parties. Year-end accruals to certain cash-basis recipients must satisfy various time-sensitive rules in order for an accrual-basis business to deduct the accruals.

Regular C Corporations. If your regular C corporation accrues an expense (e.g., compensation, interest, etc.) to a cash basis stockholder owning more than 50% (directly or indirectly) of the company's stock, the accrual is not deductible by the corporation until the **day** it is includable in the stockholder's income.

> **Tax Tip.** If the corporation's tax rate for 2009 is significantly greater than the more-than-50% stockholder's individual rate for 2009, the accrued amount should be paid by the **end of 2009.**

S Corporations And Personal Service Corporations. If your S corporation or personal service C corporation accrues an expense to any shareholder (regardless of the amount of stock owned), the accrual is not deductible until the day it is includable in the shareholder's income.

Partnerships, LLCs, LLPs. If your business is taxed as a partnership, its accrual of an expense to **any owner** will not be deductible until the day it is includable in the owner's income.

Other Related Entities. Generally, an expense accrued by one related partnership or corporation to another **cash-basis** related partnership or corporation is not deductible until the day it is includable in the cash-basis entity's income.

Establishing A New Retirement Plan For 2009. Calendar-year taxpayers wishing to establish a qualified retirement plan for 2009 (e.g. profit-sharing, 401(k), or defined benefit plan) *generally* must adopt the plan **no later than December 31, 2009**. However, an SEP may be established by the due date of the tax return (including extensions), and a SIMPLE plan must be established no later than October 1, 2009.

Recent Tax Law Changes Further Encourage Hiring Children By Family Businesses! There has long been a tax incentive for high-income owners of a family business to hire their children to work in the business. Generally, the parents could deduct their child's wages against their business income (which could be taxed as high as 35%), while the child would be taxed at rates as low as 10% (to the extent of child's unused standard deduction, the child's wages may avoid federal income taxes completely). Furthermore, if a child is under age 18 and working for a parent's sole proprietorship or a partnership where the only partners are the parents, the child's wages will be exempt from FICA tax while, at the same time, reducing the parents' self-employment (SECA) tax. Recent tax law changes have added additional incentives to hire children.

Expanded Refundable Credits. Let's say your child is an unemployed single parent. Paying your child W-2 wages for working in your business could enable your child to receive recently-expanded refundable credits. For example, assume that your single child has a daughter who is her qualifying child for tax purposes. For 2009, your single child would only need: **1)** *earned income* of at least **$9,667** to get the full **$1,000** refundable *child credit*; **2)** *earned income* of at least **$6,452** to get the full **$400** refundable *making work pay credit*; and **3)** *earned income* of at least **$8,950** to get the full refundable **$3,043** *earned income credit.*

> **Planning Alert!** Thus, assuming your child meets the other requirements for these credits and does not have any other income, paying the child $10,000 of salary in 2009 could result in the child receiving $4,443 of refundable credits from the IRS.
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> **Caution!** If you employ your children, be sure to **1)** carefully document that the wages are reasonable for the work actually performed, **2)** pay the wages as part of the regular payroll, **3)** make sure the payroll checks are timely cashed and placed in the child's account, and **4)** comply with all laws relating to the employment of children.

FINAL COMMENTS

Please call us if you are interested in a tax topic that we did not address in this letter. Tax law constantly changes due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes and we will be glad to discuss any current tax developments and planning ideas with you. **We urge you to call us before implementing any planning ideas addressed in this letter, or if you need more information.**

Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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