CORDASCO
& COMPANY P.C.

Certified Public Accountants

2011

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

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INTRODUCTION

We have reached that time of year when businesses need to consider year-end tax planning. This year is particularly challenging because Congress has enacted a series of tax breaks which are generally scheduled to expire after 2011. For example, unless Congress acts to extend these provisions, the following business tax breaks will generally ***expire (or become less beneficial) after 2011*****:** 100% §168 bonus depreciation; larger and expanded §179 deduction; 100% gain exclusion for "qualified small business stock;" and relaxation of the S corporation built-in gains tax rules. There have also been recent IRS releases and Court cases that address: the ability of self-employed individuals, partners, and S corporation shareholders to deduct health insurance premiums (including Medicare premiums); whether compensation paid to S corporation shareholders is "reasonable"; the S/E tax exposure of owners of a limited liability partnership; and automatic accounting method changes.

This overview will help you navigate the many *new* tax planning opportunities available to businesses because of recent law changes and other current tax developments, while also reminding you of the *traditional* year-end tax planning strategies for businesses (including regular "C" corporations, "S" corporations, partnerships, LLCs, and self-employed individuals).

> **Planning Alert!** Since several, significant new tax breaks **expire after 2011,** you may have to act promptly to take advantage of these short-lived provisions! So, please pay close attention to the ***expiration dates*** for the various provisions discussed in this letter, which we ***highlight prominently*** in each section.

> **Planning Alert!** Although this guide 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 guide 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** or if you need more information.

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TAKING MAXIMUM ADVANTAGE OF THE 100% §168(k) BONUS DEPRECIATION DEDUCTION AND THE EXPANDED §179 DEDUCTION

The two most significant business tax breaks ***expiring after 2011*** are: **1**) the 100% §168(k) bonus depreciation deduction, and **2**) the expanded §179 deduction. These two provisions offer unprecedented up-front deduction opportunities for businesses considering significant capital expenditures.

The 100% §168(k) Bonus Depreciation Deduction Generally Expires After 2011.

For *qualifying* new business property placed-in-service from **2008 through September 8, 2010,** businesses were allowed a 50% first-year §168(k) bonus depreciation deduction. The Tax Relief Act of 2010 increased this deduction to 100% for "qualifying business property" ***acquired*** and ***placed-in-service*** after **September 8, 2010 and through December 31, 2011** (through December 31, 2012 for certain long-production-period property and qualifying noncommercial aircraft). In other words, for §168(k) property acquired and placed-in-service during this period, the *entire cost* of the property can be fully deducted. For qualifying §168(k) property placed-in-service ***during 2012***, the §168(k) bonus depreciation deduction reverts back to **50%,** and generally ***expires*** altogether for property placed-in-service ***after 2012.***

> **Tax Tip.** *Qualifying business property* that is "acquired" *after* September 8, 2010 and before 2012 pursuant to a binding contract entered into *before* September 9, 2010 will still qualify for the 100% §168(k) bonus depreciation deduction, provided the binding contract was entered into after 2007 and the property is placed-in-service by ***December 31, 2011.***

> **Planning Alert!** Fiscal year taxpayers must generally acquire and place-in-service qualifying assets by December 31, 2011 to qualify for the 100% §168(k) deduction. In other words, the deadline is generally December 31, 2011 for both fiscal year and calendar year taxpayers.

The following paragraphs summarize the rules for determining if an asset qualifies for the §168(k) deduction:

- **Qualifying 50%/100% §168(k) Bonus Depreciation Property.** Property qualifying for the §168(k) bonus depreciation deduction is generally *new* 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, modern golf course greens, depreciable computer software, farm buildings, qualified motor fuels facilities and "qualified leasehold improvements").

  > **Tax Tip.** Make sure you properly classify "land improvements" as "15-year property" (and not as part of the building) since land improvements qualify for the 100% bonus depreciation deduction, and buildings (other than "qualified leasehold improvements," farm buildings, and qualified motor fuels facilities) generally do not.

Planning Alert! These are only *examples* of qualifying property. If you have a question about property that we have not mentioned, call us and we will help you determine if it qualifies.

- **Reconditioning Used Property.** Although §168(k) bonus depreciation property must generally be "new," the IRS regulations provide that capital expenditures incurred to recondition or rebuild used property may qualify. **For example,** lets assume that your business purchases a *used* machine during 2011 for $50,000. Also during 2011, you incur $20,000 to recondition the machine. The $50,000 cost of the used machine does not qualify for the §168(k) bonus depreciation deduction. However, the $20,000 expenditure to "recondition" the machine would qualify for the deduction.

Qualified Leasehold Improvement Property. Even though improvements to a commercial building *generally* do not qualify for the §168(k) bonus depreciation deduction, "qualified leasehold improvement property" (QLHIP) does qualify. Furthermore, QLHIP qualifies for the 100% deduction if it is "acquired and placed-in-service" after **September 8, 2010** and **before 2012.** *QLIP* is generally any capital improvement to an interior portion of a building that is used for nonresidential commercial purposes, provided that **1)** the improvement is made under or pursuant to a lease either by the lessee, sublessee or lessor of that interior building portion; **2)** the interior building portion is to be occupied exclusively by the lessee or sublessee; **and 3)** the improvement is placed-in-service **more than 3 years** after the date the building was first placed-in-service.

Planning Alert! *QLIP* **does not include** any improvement attributable to: the enlargement of the building; any elevator or escalator; any structural component benefitting a common area; or the internal structural framework of the building.

Caution! Leasehold improvements made to property leased between certain *related persons* **will not qualify.**

- **Newly Constructed Or Renovated Buildings And Cost Segregation Studies.** Depreciable components of newly-constructed or newly-renovated buildings that are properly classified as depreciable *personal* property under a ***cost segregation study*** are generally depreciated over 5 to 7 years. Since these non-structural components have a depreciable life of 20 years or less, they should qualify for the 100% 168(k) bonus depreciation if "acquired and placed-in-service" **after September 8, 2010 and before 2012.**

Planning Alert! In certain situations, these components of the building might qualify for the 100% bonus depreciation deduction even if the construction or renovation of the building itself began ***before*** *September 9, 2010*, provided you make a timely election to apply the 100% §168(k) acquisition rules separately to each component.

- **Entire Cost Of Property Received In A Trade-In Qualifies For 100% §168(k) Bonus Depreciation.** Let's assume that in 2011, your business trades in a used dump truck that has a tax basis of $50,000 in return for a new dump truck plus $30,000 cash. This trade in will generally constitute a tax-deferred "like-kind" exchange for tax purposes. However, the entire $80,000 basis (i.e., the $50,000 trade-in basis plus the additional $30,000 payment) will qualify for the 100% §168(k) bonus depreciation deduction.

- **100% 168(k) Bonus Depreciation Property Generally Must Be "Placed-In-Service" By December 31, 2011.** Whether your business has a "calendar" or "fiscal" tax year, in order to get the ***100% §168(k)*** bonus depreciation deduction, you must place the property in service ***no later than December 31, 2011*** (before the end of 2012 for certain long-production-period property and qualifying noncommercial aircraft). Generally, if you are purchasing "personal property" (equipment, computer, vehicles, etc.) "placed-in-service" means the property is **ready and available for use.** To be safe, qualifying property should be ***set up and tested*** on or before the ***last day of 2011.*** On the other hand, if you are dealing with building improvements (e.g., qualified leasehold improvement property, non-structural components of a building), a certificate of occupancy will generally constitute placing the building or improvement in service.

  Planning Alert! The §168(k) bonus depreciation deduction reverts **to 50%** for qualifying property **placed-in-service in 2012** (except for certain long-production-period property and qualifying noncommercial aircraft).

§168(k) Bonus Depreciation For Passenger Automobiles, Trucks, And SUVs.

The maximum annual depreciation deduction (including the §179 deduction, discussed below) for most *business automobiles* is capped at certain dollar amounts. For a business auto first placed-in-service in **calendar year 2011,** the maximum first-year depreciation deduction is generally capped at $3,060 ($3,260 for trucks and vans not weighing over 6,000 lbs). However, Congress previously increased the first-year depreciation cap for vehicles qualifying for the §168(k) up-front bonus depreciation deduction by $8,000 for 2008 and 2009. The Tax Relief Act of 2010 **extended this $8,000 increase through 2012 for new vehicles otherwise qualifying for the §168(k) bonus depreciation deduction.**

For example, let's say your business is planning to purchase a *new* vehicle weighing 6,000 lbs or less that will be used 100% for business purposes. If you buy the new car and place it in service during 2011, your first-year depreciation deduction will be $11,060. **Heavy Vehicles.** "Heavy Vehicles" (i.e., trucks, vans, and SUVs with loaded vehicle weights over 6,000 lbs.) are generally exempt from the passenger auto annual depreciation caps discussed above. Therefore, if you buy a new "heavy" truck or SUV and use it 100% for business **in 2011,** you could deduct the "entire cost" **for 2011** using the §168(k) deduction.

Tax Tip. If you purchase a passenger auto, truck, or SUV in 2011, to qualify for the 100% §168(k) bonus depreciation deduction, your business mileage **through December 31, 2011** must ***exceed 50% of*** the total mileage. By keeping your personal use to a minimum, you will maximize your business percentage for 2011 which could dramatically increase your 2011 depreciation deduction.

Planning Alert! If your business use percentage drops to ***less than 51%*** after 2011, you generally will be required to bring into income a significant portion of the depreciation that was originally taken. Therefore, it is important that the business use of the vehicle ***exceeds 50%*** for subsequent years.

Expanded §179 Deduction.

For the last several years, Congress has temporarily increased the maximum §179 up-front deduction for the cost of qualifying "new" or "used" depreciable business property (e.g., business equipment, computers, etc.). For **property placed-in-service in tax years beginning in 2010 and 2011,** the overall cap was increased from **$250,000** to **$500,000,** and the beginning of the deduction phase-out threshold was increased from **$800,000** to **$2,000,000.** In addition, for **2010 and 2011 purchases,** a taxpayer may elect for "qualified real property" to be §179 property. Prior to this change, real property generally did not qualify for the §179 deduction.

Caution! For tax years **beginning after 2011,** the maximum §179 deduction is currently scheduled to drop **back to $139,000** and there will be no §179 deduction for "qualified real property."

The following paragraphs contain additional information concerning the §179 deduction:

- **Up To $250,000 Of *"Qualified Real Property"* Temporarily Qualifies As §179 Property.** Traditionally, the §179 deduction has been limited to depreciable, tangible, "personal" property, such as equipment, computers, vehicles, etc. However, businesses may **"elect"** to treat qualified "real" property as §179 property, for property **placed-in-service in tax years beginning in 2010 or 2011.** The maximum §179 deduction that is allowed for *qualified real property* is $250,000. "Qualified Real Property" includes property within any of the following three categories: **1) Qualified Leasehold Improvement Property** (generally capital improvements to an interior portion of certain leased buildings that are more than 3 years old and that are used for nonresidential commercial purposes); **2) Qualified Retail Improvement Property** (generally capital improvements made to certain buildings that are more than 3 years old and which are open to the general public for the sale of tangible personal property); and **3) Qualified Restaurant Property** (generally capital expenditures for the improvement, purchase, or construction of a building, if more than 50% of the building's square footage is devoted to the preparation of, and seating for, the on-premises consumption of prepared meals).

- **Application of $250,000 Cap.** If you elect to take $250,000 of the §179 deduction on *qualified real property,* you may only take up to $250,000 of §179 depreciation on other qualifying assets ($500,000 - $250,000). In other words, the $250,000 §179 limitation for "qualified real property" is a part of the overall $500,000 §179 limitation and not in addition to the $500,000 limitation.

  Caution! If you want to take the §179 write-off **for "qualified real property" for your tax year beginning in 2011,** you must place the building (or improvements) in service by the ***end of your 2011*** tax year. If you are a calendar year taxpayer, this means that the property must be placed-in-service ***no later than December 31, 2011.*** A certificate of occupancy will generally constitute placing the building or an improvement to a building in service.

- The §179 rules for "qualified real property" 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 improving, acquiring, or constructing a building. We will help you devise a strategy that will maximize your depreciation deductions, including the §179 deduction.**

- **Two Limitations For §179 From Pass-Through Entities.** If you have a pass-through business entity (e.g., S corporation, LLC, partnership), you must apply the $500,000/$2,000,000 limitations and the *taxable income* limitation for the §179 deduction twice, once at the entity level and again to the owners (i.e., to S corporation shareholders, and to partners).

  Tax Tip. If wages are paid to a more than 2% S corporation shareholder or if "guaranteed payments" are paid to an owner of a partnership (or multiple-owner LLC), these payments are added back to the entity's business income for purposes of determining the entity's *taxable income limitation.* These rules can get quite complicated, please call us if you need additional guidance.

What If The §179 Deduction And The 100% §168(k) Bonus Depreciation Deduction Apply To The Same Property?

For qualifying property purchased and placed-in-service ***in 2011,*** in many cases both the §179 deduction and the 100% §168(k) bonus depreciation will apply to the same property. For example, both provisions would apply to new depreciable, tangible, "personal" property (e.g., new business equipment, computers, vehicles, etc). The 100% §168(k) bonus depreciation deduction may be preferable to the §179 deduction where the §179 deduction is limited by your business income. The 100% §168(k) bonus depreciation deduction is not limited by your business income and can generate an overall tax loss (i.e., "net operating loss"). You can use a *net operating loss* to offset income in the preceding 2 years as well as up to 20 future years. However, in other situations, the §179 deduction may actually be preferable where: **1)** your

business is purchasing "used" business property (§168(k) bonus depreciation only applies to "new" property); **2)** your business is purchasing ***"qualified restaurant property"*** or ***"qualified retail improvement property"*** which, as described above, temporarily qualifies for the §179 deduction but not for the §168(k) bonus depreciation deduction; **3)** your business is located in a state that allows some or all of the §179 deduction for state income tax purposes, while the state does not allow any or as much of the §168(k) bonus depreciation deduction; or **4)** your business is subject to the uniform capitalization (UNICAP) rules (the §179 deduction is not required to be capitalized into the cost of inventory while the §168(k) bonus depreciation deduction is not exempt from the UNICAP rules).

Tax Tip! If you decide that the 100% §168(k) bonus depreciation deduction is preferable to the §179 deduction, you do not need to make any election. The §168(k) bonus depreciation deduction applies automatically, unless you affirmatively "elect out." On the other hand, if you prefer the §179 deduction, you ***are required*** to make an affirmation election.

Planning Alert! These rules are complex. If your business is considering significant business asset acquisitions, please call our office so we can help you develop a strategy to maximize your tax savings.

OTHER "BUSINESS" TAX BREAKS EXPIRING AFTER 2011

In addition to the 100% §168(k) bonus depreciation deduction and the expanded §179 deduction, there are several other important business tax breaks currently scheduled to expire at the ***end of 2011.***

Planning Alert! Although Congress has traditionally extended many expiring tax breaks, there is no guarantee that Congress will do so in the future.

Tax Tip. Whether or not Congress ultimately extends these expiring tax breaks, there are real tax savings to be obtained if you take advantage of these provisions **before the end of 2011.**

The following are some of the more important expiring provisions that your business should consider utilizing ***before the end of 2011:***

- **Take Advantage Of The Two Percent Social Security Tax Holiday For "2011 Only".** For **2011 only,** there is *a* ***2%*** reduction in Social Security taxes for both employees and self-employed individuals. Therefore, **if you are an employee,** your take-home pay for 2011 is generally being increased by 2% of each dollar of compensation that you earn. However, since Social Security taxes apply only to the first $106,800 of compensation in 2011, your maximum savings will generally be $2,136 (i.e., $106,800 x 2%). Likewise, if you are self-employed, your Social Security taxes are reduced by 2% of your self-employment income for 2011 (up to $106,800). Therefore, if your self-employment income is $106,800 or more, your self-employment taxes will be reduced by $2,136.

  Tax Tip. This temporary Social Security tax reduction will not impact your future Social Security benefits.

  Tax Tip. Accelerating 2012 compensation or self-employed income ***into 2011*** will save you 2% on your Social Security tax to the extent the income acceleration does not cause you to exceed the $106,800 earned income cap.

- **100% Exclusion For "Qualified Small Business Stock."** If you sell "qualified small business stock" (QSBS) **acquired after September 27, 2010 and before January 1, 2012,** you may be able to exclude the **entire gain** from taxable income if you hold the stock for more than 5 years (the gain will also be exempt from the alternative minimum tax). QSBS is generally stock of a non-publicly traded domestic "C" corporation engaged in a qualifying business, purchased directly from the corporation, and **held for more than 5 years;** where the issuing corporation meets certain active business requirements and has assets at the time the stock is issued of $50 million or less. Businesses engaged in a professional service, banking, insurance, financing, leasing, investing, hotel, motel, restaurant, mining, or farming activity generally *do not* qualify.

Planning Alert! If you are considering investing in or starting a new business, we will gladly help you evaluate whether structuring your investment as QSBS will work to your overall tax advantage. However, you must act promptly to take advantage of this narrow window of opportunity to qualify for the 100% exclusion. Only stock acquired **from September 28, 2010 through December 31, 2011** qualifies for the 100% exclusion (after it has been held over five years). Also, to qualify, you must purchase the stock directly from the corporation that is issuing the stock or from an underwriter of the stock (stock purchased from other third parties does not qualify).

Caution! One of the key requirements for QSBS is that it be issued by a regular "C" corporation. Traditionally, a "C" corporation has **not** been the preferred entity for many new business ventures for various reasons, including the fact that the corporation's operating income is potentially subject to double taxation (once when earned by the corporation, and a second time when it is distributed to a shareholder as a taxable dividend).

- **Don't Overlook The "Retention Credit" For Qualified Unemployed Workers.** If your business **1)** hired a *qualified unemployed worker* **after February 3, 2010 and before January 1, 2011, 2)** the worker signed a ***IRS Form W-11*** ("HIRE Act Employee Affidavit"), and **3)** you retained the worker on your payroll for at least 52 **consecutive** weeks, you may be entitled to an "income tax" credit of up to $1,000 for each qualifying worker **on your 2011 return.** If you think your business qualifies for this credit, we will gladly help you determine the exact amount of credit available.

- **S Corp 10-Year Built-In Gain "Waiting" Period Temporarily Shortened To 5 Years.** If a regular "C" corporation elects "S" corporation status (a "Converted S corporation"), the election itself generally does not trigger income. However, the Converted S corporation must generally pay a 35% corporate "built-in gains tax" on gain from the sale of any built-in gain asset (up to the amount of appreciation in that asset on the effective date of the S election), if the asset is sold during the first 10 years following the S election. A *built-in gain* asset is generally any asset with a market value greater than the asset's basis on the effective date of the S election. The Jobs Act *has temporarily* reduced the 10-year waiting period *to 5 years* **for S Corp tax years beginning in 2011.** That is, the Jobs Act provides that there will be no 35% built-in gains tax on the net recognized built-in gain of an S corporation for any taxable year **beginning in 2011,** if the 5th year in the waiting period (i.e., "recognition period") preceded such taxable year.

  Planning Alert! For sales of "built-in gain" assets that occur in tax years beginning ***after 2011***, the waiting period to avoid the *built-in gains tax* is scheduled to revert to 10 years.

  Caution! We have just summarized these extremely complicated rules. If your S corporation plans to sell a built-in gain asset, please call us. We will gladly help you determine if the S corporation qualifies under this special 5-year rule.

- **Other Selected "Business" Tax Breaks Scheduled To Expire After 2011.** A host of other current tax breaks for businesses are scheduled to expire unless Congress takes action to extend these provisions. The following business tax breaks expire **at the end of 2011. 1)** 15-year (instead of 39-year) depreciation period for "qualified" leasehold improvements, qualified restaurant property, and qualified retail improvement property; **2)** 7-year depreciation period for certain motor sports racetrack property; **3)** research and development credit; **4)** employer differential wage credit for payments to military personnel; **5)** various tax incentives for investing in the District of Columbia; **6)** favorable S corporation charitable contribution provisions; **7)** several tax benefits for qualified energy-efficient expenditures; **8)** enhanced charitable contribution rules for qualifying business entities contributing computer equipment, book, and food inventory; and **9)** work opportunity tax credit for qualified employees.

OTHER RECENT DEVELOPMENTS IMPACTING BUSINESS PLANNING

Relief From Stringent 1099 And W-2 Reporting Requirements. Over the past 18 months, Congress enacted new information reporting requirements for businesses. After much pressure from the business community, both Congress and the IRS have recently provided the following relief from some of these new reporting requirements:

- **Congress Repeals Recently-Enacted 1099 Reporting Rules.** New rules enacted in 2010 expanded the 1099 reporting rules to include payments aggregating $600 or more made to "corporations" (previously, payments to corporate payees, other than attorneys and certain health care providers, were exempt from the 1099 reporting rules). These changes also expanded the 1099 reporting requirements to include payments of $600 or more for "property" (previously, the 1099 reporting rules applied predominantly to payments for "services"). Both of these changes were effective for payments made after 2011. In addition, effective for payments made after 2010, Congress imposed 1099 reporting requirements on taxpayers receiving real estate rental income, whether or not the taxpayers were in the rental real estate "trade or business." The *Comprehensive 1099 Taxpayer Protection Act of 2011* has now retroactively repealed all three of these provisions as if they had never been enacted.

  Practice Alert! If you are considered to be in the *"trade or business"* of renting real estate (traditionally a *facts & circumstances* determination), you may still be required to file a Form 1099 for payments of $600 or more to a service provider (e.g., payments to a plumber or painter). Also, the 1099 reporting requirements continue to apply to payments made to corporations for ***attorneys' fees,*** and to corporations providing ***medical or health care services.***

- **IRS Provides Relief From Reporting Cost Of Employer-Provided Health Insurance On W-2s.** Beginning with 2011 W-2s, employers were generally required to report the cost of employer-provided health insurance coverage on Forms W-2. In 2010, the IRS announced that this reporting would be "optional" for ***all employers*** for ***2011 Forms W-2*** (generally given to employees in January, 2012). The IRS recently extended this interim relief by making the reporting of the health insurance cost *"voluntary"* for "2012 Forms W-2" for employers that file less than 250 2011 W-2s. Therefore, if your business ***files less than 250 2011 W-2s (i.e. for compensation paid to employees in 2011),*** it will ***not be required*** to report the health insurance cost on the ***2012 W-2s*** (generally filed in January, 2013).

  Practice Alert! Reporting the health insurance cost on the W-2 is for information purposes only, it does not cause the premiums to be taxable to the employee.

- **The IRS Announces That More Small Tax-Exempt Organizations May File A Simplified Annual Information Return.** For tax years beginning on or ***after January 1, 2010,*** tax-exempt organizations with ***annual gross receipts of $50,000*** or less can file ***Form 990-N*** ("Electronic Notification e-Postcard"). The threshold previously was $25,000 in annual gross receipts.

Automatic Accounting Method Change Procedures.

Generally, if your business needs to change its tax accounting method, it must submit a request for approval to the IRS, pay a user fee, and wait until the IRS approves the change in writing.

Tax Tip. In 2011, the IRS issued its most recent set of procedures for businesses to obtain IRS approval for many common accounting method changes by submitting an accounting method change request with a timely filed tax return (including extensions) for the year of the change. There is ***no user fee*** if a taxpayer qualifies to use these "automatic accounting method change" procedures. In addition, if the request is properly completed, the request is "deemed" granted unless you hear from the IRS. In some cases, the request may even be filed with an amended return.

Example. Let's assume your business purchased or constructed a commercial building several years ago, and you have been depreciating the entire cost of the building over 39 years using the straight-line depreciation method. You now discover, after conducting a "cost segregation study," that 25% of the original cost of the building constitutes "nonstructural components," depreciable over 5 to 7 years using an accelerated depreciation method. Based upon these facts, your company could deduct the additional depreciation it should have taken for all prior years (utilizing the shorter lives) by using this recently-updated automatic accounting change procedure. By attaching a properly completed accounting method change form to the current year's tax return and timely sending a copy to the IRS National Office, your business may deduct, in the current year, all the depreciation it failed to deduct in prior years. **Please Note!** This automatic accounting method change procedure applies to many other accounting method changes listed within the procedure.

Planning Alert! Please do not attempt any accounting method change without contacting us first. The approval procedure does not apply to all accounting method changes and depends upon the proper completion and filing of Form 3115, and compliance with specific guidelines.

TRADITIONAL YEAR-END PLANNING FOR REGULAR "C" CORPORATIONS

Should A Closely-Held "C" Corporation Pay Dividends Rather Than Year-End Bonuses To Its Owners? Since a "C" 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 depends largely on the tax rates of both the corporation and the shareholder. If your corporation is experiencing the effects of the recession and would receive little or no tax benefit from a year-end bonus deduction (e.g., it is incurring current losses and/or has net operating loss carryovers to the current year), then a dividend **paid in 2011** taxed at a maximum rate of 15% may save overall taxes. On the other hand, if your corporation has significant income and is currently in a high tax bracket, then a bonus **paid in 2011** may save overall taxes.

> **Planning Alert!** If you decide that a year-end bonus would be more tax beneficial, be sure that you can justify the reasonableness of the bonus. 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 all shareholder/employees.
>
> **Tax Tip.** We will gladly help you tailor a compensation plan that will maximize the tax savings to you and your corporation.
>
> **Caution!** Paying dividends to shareholders of Personal Service "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 or only enough taxable income to use any credits available to the corporation. This may be accomplished by paying reasonable salaries and compensation to the stockholder/employees **by year-end.**

Be Wary Of Passive Loss Trap When Leasing Property To Your Closely-Held Corporation. Owners of closely-held C corporations frequently own the business office building, warehouse, etc. individually (or through a partnership or LLC), and lease the facility to their corporation. This is often recommended **1)** to help protect the leased facility from potential claims of the corporation's creditors, and **2)** to avoid the potential of generating a double tax (one tax at the corporate level and another at the shareholder level) when the building is sold. However, this planning technique can also create a "passive loss" trap, because 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 currently unless they have other passive income.

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

Newly-Formed Corporations. If you have started a new business this year and have filed articles of incorporation with the Secretary of State, you generally must treat the corporation as a regular C corporation. This can create a tax trap if your new business generates a tax loss in its first year. As a C corporation, the loss will be trapped inside the corporation and you will not be able to use the loss to offset income on your personal income tax return.

> **Tax Tip.** You may, however, be able to take this loss on your personal return if you file a timely S election for the first year of the new corporation. Generally, this election must be made no later than the 15th day of the third month following the date your corporation starts business. However, in certain situations, the IRS may allow a late S election if you intended to make a timely election, but failed to do so. Please call our office before you set up a new corporation, and we will help you decide whether an S election is advisable.

> **Planning Alert!** It is always best to call us before you set up any new business so we can help select the business entity that will offer the most flexible tax planning opportunities, and so we can assist you in filing any necessary elections, etc.

Pay Sufficient Estimated Tax. If your C corporation had less than $1 million of taxable income for each of the past three tax years, it will be classified as a "small corporation" and may base its current year quarterly estimated tax payments on 100% of its "prior" year tax liability. If the corporation is not a "small corporation," (i.e., it had $1 million or more of taxable income in any of the prior three tax years) it must generally base its quarterly estimated tax payment (after the first installment) on 100% of its "current" year tax liability, or 100% of its annualized tax liability.

> **Planning Alert!** If your "small corporation" had no income tax liability in the prior tax year (e.g., it incurred a tax loss for the prior year or was not in existence last year), it must pay 100% of the "current" year tax or 100% of the annualized tax to avoid an estimated tax underpayment penalty.

Tax Tip. If your "small corporation" anticipates showing a small tax loss in 2011, you may want to accelerate income (or defer expenses) in order to generate a **small income tax liability in 2011.** This will preserve the corporation's ability to use the "100% of last year's tax" safe harbor for 2012 estimates.
Caution! This technique may not be advisable if your corporation anticipates a 2011 net operating loss that can be carried back to previous years that would generate a sizeable refund.

Tax Tip. If the corporation expects taxable income of more than $1 million for the first time in 2011, you should consider **deferring income into 2012** or **accelerating deductions into 2011** to ensure the corporation's 2011 taxable income does not exceed $1 million, so that it maintains its "small corporation" status for 2012.

Properly Document Loans To Shareholders. If you borrow from your closely-held corporation, you should make sure there is a written agreement to repay your loan, a fair interest rate is charged, and the loan is authorized by a corporate resolution. Without adequate interest and proper documentation, the IRS may treat your loans as constructive distributions which could result in dividend treatment and double taxation.

Planning Alert! A corporation should charge interest at least equal to the Applicable Federal Rate (AFR) on loans to shareholders. Otherwise, subject to certain exceptions, the IRS will impute interest and the imputed interest (in excess of the interest actually charged) will result in dividend treatment if the corporation has earnings and profits.

Document Uncollectible Debts. In these tough economic times, an increasing number of shareholders have loaned money to their closely-held corporations to help fund the company's cash-flow needs. If you have loaned money to your corporation and the corporation cannot repay the loan, you may be entitled to a bad debt deduction. To take the deduction in 2011, you must establish that the debt was worthless **by December 31, 2011.**

Tax Tip. Generally, a shareholder's bad debt from the corporation is treated as a short-term capital loss (i.e., deductible up to the shareholder's capital gains plus $3,000). However, if you can establish that the primary purpose for loaning the funds to your corporation was to preserve your employment by the corporation, you may be entitled to a deductible "business bad debt" and avoid the limitations on capital losses. The IRS typically requires significant evidence showing you made the loan to preserve your job.

Planning Alert! If your loan to your corporation is treated as a business bad debt, it will constitute a "miscellaneous itemized deduction" which is subject to the 2% reduction rule, and is not deductible at all for alternative minimum tax purposes.

Charitable Contribution Planning. If your regular C corporation uses the accrual method for tax purposes, it can deduct an accrued charitable contribution if the contribution is authorized by the company's Board of Directors by year-end, and the contribution is paid on or before the 15th day of the third month after that year-end (e.g., March 15, 2012 for December 31, 2011 year-ends). Your corporation should have a "Board of Directors Charitable Contribution Resolution" on its year-end tax planning checklist.

> **Planning Alert!** A regular C corporation's charitable contributions generally cannot exceed 10% of its taxable income (after certain adjustments). Furthermore, contributions in excess of the 10% cap cannot be carried back to previous years, but may be carried forward for up to five years. This rule for accruing charitable contributions applies to regular corporations but not to S corporations.

> **Tax Tip.** If you own a closely-held C corporation, it may be more beneficial for you to make charitable contributions individually, rather than allowing your corporation to make contributions in excess of the 10% of taxable income limitation.

CORDASCO
& COMPANY P.C.
Certified Public Accountants

TRADITIONAL YEAR-END PLANNING FOR "S" CORPORATIONS

Properly Account For Health Insurance Premiums For S Corporation Shareholders - Including Medicare Premiums. Generally, if you own S corporation stock and the S corporation pays for your health insurance premiums, IRS says you can take an *"above-the-line"* deduction (i.e., unrestricted by the 7½% subtraction as an itemized medical expense deduction) for the premiums on your personal tax return if the S corporation timely reports the cost of the premiums paid on your W-2 as wages. However, if the medical insurance policy is your personal policy, the IRS says that your S corporation must pay the premiums directly, or reimburse you for the premiums ***before the end of the year and*** timely report the payment (or reimbursement) on your W-2 as wages for you to take an *"above-the-line"* deduction on your personal return.

> **Planning Alert!** Make sure your S corporation complies with these rules (including reimbursing any premiums you paid during 2011 by 12/31/11 and including any premiums the S corporation paid for you or reimbursed you on your 2011 W-2) so you will not be limited to a deduction only for the premiums in excess of 7½% of your AGI**.**

> **Tax Tip.** The above rules apply to premiums paid or reimbursed for you, your spouse, your dependents, and any of your children **under age 27 at the end of the year** (even if the child does not qualify as your dependent). In addition, the IRS has clarified that Medicare premiums qualify as medical insurance premiums. Therefore, the above rules also apply if the S corporation reimburses or pays **your Medicare premiums.**

Check Your Stock And Debt Basis Before Year End. If you think your S corporation will have a taxable loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You 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!** Making sure that you have sufficient basis is particularly important **in 2011** if your S corporation anticipates generating losses from the 100% §168(k) bonus depreciation deduction. The rules for restructuring existing loans to an S corporation to ensure basis are complicated. **Please do not attempt to restructure your loans without contacting us first.** Also, if you finance losses of an S corporation with loans from other entities controlled by you, or if you borrow from another shareholder, the IRS may take the position that these loans do not give you basis. It is best not to finance S corporation operations with funds borrowed directly from related entities or from other shareholders.

Pay Careful Attention To Payments On S Corporation Shareholder Loans. As discussed above, let's assume that you have previously loaned funds to your S corporation which, in turn, created basis that you have used to deduct pass-through losses. If all or a portion of the loan is paid back after the loan's basis has been reduced by pass-through losses, you will recognize a gain on the repayment. The amount, character, and timing of the gain is dependent on several factors, including: **1)** when during the tax year the payment is made, **2)** whether the loan is an "open account" advance, or evidenced by a written promissory note, and **3)** the amount of the unpaid balance on an "open account" advance as of the end of the tax year. For example, if the loan is an "open account" (i.e., not evidenced by a written promissory note), any gain triggered by a payment on the loan will generally be taxed at ordinary income tax rates. However, if the loan is evidenced by a written promissory note and has been outstanding for over one year, any gain triggered on the payback may qualify for favorable long-term capital gains treatment.

> **Tax Tip.** It may save you taxes in the long run if you postpone principal payments on the depleted-basis loan until the loan's basis has been restored by subsequent S corporation pass-through income. **Please consult with us before your S corporation repays any of your shareholder loans.** We will help you structure the loans and any loan repayments to your maximum tax advantage.

Salaries For S Corporation Shareholder/Employees. For 2011, an employer must pay FICA taxes of 7.65% of an employee's wages up to $106,800 and FICA taxes of 1.45% on wages in excess of $106,800. In addition, for 2011, an employer must withhold FICA taxes from an employee's wages of 5.65% on wages up to $106,800 (normally 7.65%, but reduced to 5.65% for 2011 only) and 1.45% of wages in excess of $106,800. If you are a stockholder/employee of an S corporation, this FICA tax is generally applied only to your W-2 income from your S corporation. Other income that passes through to you or is distributed on your stock is generally not subject to FICA taxes or to self-employment taxes.

> **Planning Alert!** If the IRS determines that you have taken an unreasonably "low" salary from your S corporation, the Service will generally argue that other amounts you have received from your S corporation (e.g., distributions) are disguised "compensation" and should be subject to FICA taxes. Determining "reasonable salaries" for S corporation shareholder/employees is a hot audit issue, and the IRS has a winning record on taking taxpayers to Court on this issue. The IRS has been particularly successful where S corporation owners pay themselves no salary even though they provided significant services to the corporation. However, in a recent case, the IRS took a CPA to Court who had paid himself $24,000 of salary from his S corporation, while receiving additional cash "distributions" from the S corporation of approximately $200,000. The Court concluded that his salary (subject to payroll taxes) should be $91,000 rather than $24,000. Therefore, the Court treated $67,000 of the $200,000 of distributions from the S corporation as additional wages.

Caution! Determining a "reasonable" salary for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is “reasonable.” However, this case makes it clear that salaries to S corporation shareholders should be supported by independent data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation.

Planning Alert! Keeping salaries low and minimizing your FICA tax could also reduce your Social Security benefits when you retire. Furthermore, if your S corporation has a qualified retirement plan, reducing your salary may reduce the amount of contributions that can be made to the plan on your behalf since contributions to the plan are based upon your “wages.”

TRADITIONAL YEAR-END GENERAL BUSINESS PLANNING

Self-Employed Business Income. If you are self-employed, it continues to be a good idea to defer as much income into 2012 as possible, if you believe that your marginal tax rate for 2012 will be equal to or less than your 2011 marginal tax rate. If you think that deferring 2011 income to 2012 will save you overall taxes, and you use the cash method of accounting, consider delaying year-end billings until 2012.

> **Planning Alert!** If you have already received the check in 2011, 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.

Self-Employed Individuals, Partners, And S Corp Owners Should Take Maximum Advantage Of Deduction For Health Insurance Premiums. Generally, if you are self-employed, a partner in a partnership, or a more than 2% shareholder of an S corporation, you may qualify for an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums you pay for yourself, your spouse, your dependents or your children under 27 at the end of the year (even if the child is not your dependent). Until recently, there was confusion as to whether Medicare premiums paid by a self-employed individual, a partner in a partnership, or a more than 2% shareholder of an S corporation, qualified for this treatment. The IRS has now confirmed that if you otherwise qualify for an *above-the-line* deduction for health insurance premiums, you may be able to deduct your Medicare premiums.

> **Tax Tip.** The IRS also says that if you are self-employed and failed to take this deduction for Medicare premiums in prior years for which the statute of limitations is still open (generally, three years back), we may be able to amend those returns and take the deduction. **Please contact us if you think this applies to you and we will assist in determining if you may amend prior year returns and take the deduction.**

> **Planning Alert!** If you are a partner in a partnership or a more than 2% shareholder in an S corporation and you are paying health insurance premiums on a personal medical policy during 2011 (including Medicare premiums), the IRS says that the partnership or the S corporation must reimburse you for those premiums ***before the end of 2011*** and include the reimbursement in your 2011 W-2 income for you to qualify for the *above-the-line* deduction. If you are in this situation, please call our office and we will help you structure the reimbursement of the premiums to maximize your deduction.

> **Note!** Please also see the section of this letter that addresses the tax treatment of health insurance premiums for S corporation shareholders for additional information for those individuals.

Year-End Accruals To Employees. Generally, if an accrual-basis business accrues year-end compensation to its rank-in-file employees (non-shareholder 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 the following rules in order for an accrual-basis business to deduct the accruals. These rules apply to fiscal year as well as calendar year businesses:

- **Regular "C" Corporations.** If a 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 2011 is significantly greater than the more-than-50% stockholder's individual rate for 2011, the accrued amount should be paid by the **end of 2011.**

- **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 2011. Calendar-year taxpayers wishing to establish a qualified retirement plan for 2011 (e.g. profit-sharing, 401(k), or defined benefit plan) *generally* must adopt the plan **no later than December 31, 2011.** However, a SEP may be established by the due date of the tax return (including extensions), and a SIMPLE plan must have been established no later than October 1, 2011.

FICA Withholding On Deferred Compensation. If your business sponsors a nonqualified deferred compensation plan, you may have certain FICA tax withholding and reporting responsibilities. IRS regulations provide that FICA taxes are due on most deferred compensation in the year the compensation is **earned, rather than the year it is paid.** The IRS says that your business can pay its portion of the FICA tax (and can withhold the executive's portion) with the final payroll of the year.

Personal Use Of Company Cars. If your company provides employees with company-owned cars, the company is required to include the value of the personal use of the car in the employees' W-2 income. However, this is not required if the employee reimburses the company for the personal use.

> **Planning Alert!** If your company does not report the employee's personal use as W-2 income and the employee does not reimburse the company for the personal use, the IRS says the company's deductions (for depreciation, gas, tires, insurance, etc.) are lost to the extent of the personal use. In addition, the IRS will include any unreimbursed personal use in the employee's income even if the company is not allowed a deduction for the personal use portion.
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> **Tax Tip.** If the employee chooses to reimburse the company for personal use of the car, the obligation for reimbursement should be established **on or before December 31st** so the employee will not have income in one year and a deduction in the next. This can be accomplished by establishing a published policy for reimbursement of personal use. Furthermore, your company should obtain signed statements from employees listing their business and personal mileage for the company car.

Mileage Reimbursement Rates. Each year the IRS provides an amount per mile that employers may reimburse employees for the business use of their vehicles rather than reimbursing actual expenses. This standard mileage reimbursement amount for 2011 is **51 cents-per-mile from January 1, 2011 through June 30, 2011, and 55.5 cents-per-mile from July 1, 2011 through December 31, 2011.**

Your Daily Transportation Might Constitute "Business Travel." Generally, daily travel from your home to your "regular place of business" is considered a nondeductible, personal commuting expense. However, the IRS says that if you have a "regular place of business," you can deduct daily travel from your home to any "temporary work location" even if the work location is within the metropolitan area in which you live. If you have no regular place of business, the temporary work location must be outside this "metropolitan area" for your daily travel to qualify as business travel.

Tax Tip. The IRS says you are considered traveling to a "temporary work location" if you realistically expect your work assignment there to last for *one year or less.* The IRS also says that if you have a qualifying home office, travel from your home to any other business location is generally business travel regardless of the distance or frequency. Please call us if you need additional information on what constitutes a *qualifying home office* or *business travel*.

Certain Business Modifications To Trucks And Vans Make Them 100% Business. Generally, if you use a passenger vehicle in your business, you are required to keep a log or other documentation to support your business mileage. However, if you make certain modifications to your business "pick-up" or "van", the IRS says that, for tax purposes, the vehicle will be deemed to be used 100% for business, even though you have some nonbusiness use. For example, a pick-up truck that has either permanently affixed decals or special painting advertising your business, ***and*** is equipped with either a hydraulic lift gate, permanently installed tanks or drums, or permanently installed side boards, is deemed to be used 100% for business. The same is true of a van that has the company name permanently affixed to the vehicle, has only seats for the driver and one passenger, and the back of the van is generally filled with shelving or merchandise during on-duty and off-duty hours.

Tax Tip. These specially-equipped business vehicles are not limited by the passenger automobile depreciation caps even if they do not have a gross vehicle weight of more than 6,000 lbs. Furthermore, if you inadvertently applied the depreciation limits to these vehicles in prior years, the IRS says that you may use the automatic accounting method change procedures to correct the prior year's returns.

Be Careful Before You Trade In A Business Vehicle. If you are considering a trade of your business auto for another business auto, please call us first.

Tax Tip. If the tax basis of the old vehicle is significantly greater than the fair market value at the date of the trade (due to annual depreciation limits), a sale of the old auto (and a purchase of the new one) could produce a deductible tax loss that will be deferred if you trade. However, the sales tax implications of a sale, rather than a trade, must also be considered.

Children Working In The Family Business May Reduce The Family's Taxes. 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. Several years ago, Congress expanded the so-called Kiddie Tax which added additional incentives to hire children. For example:

- **Kiddie Tax.** Previously, children under age 18 were taxed on their unearned income (e.g., interest, dividends, and capital gains) at their parents' marginal tax rate if the unearned income exceeded a *threshold amount*. This rule is commonly referred to as the "kiddie tax." Over the last several years, Congress has expanded the *kiddie tax* to any child (who is not filing a joint return with a spouse) with "unearned income" in excess of the *threshold amount* ($1,900 for 2011) if: **1)**The child *has not attained age 18* by the *close of the tax year*; **or 2)** The child *is age 18* (but not over age 18) by the *close of the tax year* AND the child's earned income does not exceed one-half the child's support; **or 3)**The child is *age 19 through 23* by the *close of the tax year* AND the child is a full-time student AND the child's earned income does not exceed one-half the child's support.

  Tax Tip. Since a child's *earned income* is not taxed at the parents' tax rates, the kiddie tax further encourages you to employ your child in your business and pay your child *reasonable* compensation. In addition, if your child is over age 17 and has wages (combined with other earned income) exceeding one-half of the child's support, the *new* kiddie tax rules will not apply to the child's unearned income.

  Tax Tip. By using this technique to avoid the kiddie tax rules, it would also open up tax planning opportunities for appreciated long-term capital gain property (e.g., stock) that you wish to sell and give the proceeds to your child. You could avoid paying the 15% capital gains tax by first giving the stock to your child. Depending on your child's other income, your child could then sell the stock and all or a portion of the capital gain could be taxed as low as zero percent.

  Caution! The proceeds from the sale of the stock belong to the child.

- **Make Sure Child's Wages Are Reasonable!** 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)** see that 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.

The "Production Deduction." If your business has "qualified production activities income" from manufacturing, construction, farming, ranching, engineering services, architectural services, software development, film production, production of sound recordings, etc., the business may qualify for a §199 *production deduction*. Generally, this deduction of **9%** of *qualified production activities income* cannot exceed 50% of the qualifying W-2 wages paid by your business.

- **Creating W-2 Wages For Purposes Of The Production Deduction.** Since the *production deduction* may not exceed 50% of W-2 wages paid to employees, the deduction is lost if there are no wages paid with respect to a qualifying business. Many farmers and small businesses reporting qualifying production activities income on Schedule F or Schedule C have paid no W-2 wages during 2011. However, in many of these businesses, a spouse has worked in the business but has not been paid.

  Tax Tip. One strategy to obtain a production deduction is to pay the spouse *reasonable* wages for services rendered **on or before December 31, 2011.**

  Planning Alert! This strategy will generally be beneficial only where the additional FICA tax paid on the amounts paid to the spouse are offset by an equal reduction in the proprietor's or farmer's self-employed SECA tax liability. Therefore, the strategy is generally most beneficial when the self-employed income of the proprietor or farmer is $106,800 or less (i.e., the SECA wage base for 2011) before the payment of the spouse's salary. These calculations can be complicated. Please call us and we will help you determine whether or not the payment of wages to your spouse is advisable.

Expenses Paid By Partners And Shareholders May Be Limited. It is not unusual for a partner in a partnership to individually pay business expenses of the partnership. Historically, the IRS has ruled that a partner may deduct business expenses paid on behalf of the partnership only if there is an agreement (preferably in writing) between the partner and the partnership providing that those expenses are to be paid by the partner, and that the expenses will not be reimbursed by the partnership.

Tax Tip. If you are a partner paying unreimbursed expenses on behalf of your partnership, to be safe, you should have a written agreement with the partnership providing that those expenses are to be paid by you, and that they will not be reimbursed by the partnership.

Planning Alert! The Courts continue to hold that corporate shareholders may not deduct expenses they pay on behalf of their corporation (whether an "S" or a "C" corporation) unless they are required to incur the expenses as a part of their duties as an employee. Even if the expenses are deductible, they are deductible by a shareholder/employee as miscellaneous itemized deductions which are subject to the 2% reduction rule, and are not deductible at all for alternative minimum tax purposes. This rule applies to both S corporation and C corporation shareholders.

Tax Tip. If business expenses paid by a shareholder for an S corporation or C corporation are reimbursed to the shareholder under a qualified *"accountable plan"*, the corporation can take a full deduction and the shareholder will exclude the reimbursement from taxable income. Please call our office if you need assistance in establishing a qualified "accountable plan" for employee reimbursements.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional 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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