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Tax Planning Alert for Businesses

November, 2010

Now is an excellent time for tax planning for the year ahead as well as last minute planning for 2010. This Alert highlights several potential tax-saving opportunities for you to consider before the close of 2010 and for 2011 as well as some new reporting requirements. We would be happy to discuss with you specific strategies and issues.

Deferring Income into 2011

Deferring income to the next taxable year is a time-honored year-end plan. Deferring it from 2010 to 2011, however, is risky because the 2011 tax rates remain uncertain.

Nonetheless, if you expect your AGI to be higher in 2010 than in 2011, or if you anticipate being in the same or a higher tax bracket in 2010 than in 2011, you may benefit by deferring income into 2011. Some ways to defer income include:

Use of Cash Method of Accounting: By changing from the accrual method to the cash method of accounting, you can defer taxable income on accounts receivable. Many service businesses qualify for the cash method of tax accounting. Although, most businesses that maintain inventory do not qualify for the cash method.

Delay Billing: Delay year-end billing to clients so that payments are not received until 2011.

Interest and Dividends: Interest income earned on Treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income, consider buying short-term bonds or certificates that will not mature until next year. Consider timing of dividend payments.

Deferral of Debt Forgiveness Income: Ordinarily, debt forgiveness income is taxable for the year in which the debt is canceled or reduced. However, a special tax provision allows in 2010 certain debt forgiveness income to be deferred and included in taxable income ratably from 2014-2018.

Accelerating Income into 2010

You may benefit from accelerating income into 2010, particularly in light of the possibility that tax rates may increase next year. For example, you may anticipate being in a higher tax bracket in 2011, or perhaps you will need additional income in order to take advantage of an offsetting deduction or credit that will not be available to you in future tax years. Note, however, that accelerating income into 2010 will be disadvantageous if you expect to be in the same or lower tax bracket for 2011.

If you report income and expenses on a cash basis, issue bills and attempt collection before the end of 2010. Also see if some of your clients or customers are willing to pay for January 2011 goods or services in advance. Any income received using these steps will shift income from 2011 to 2010.

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Business Deductions

Equipment Purchases: If you purchase equipment, you may make a Section 179 election which allows you to expense (i.e., currently deduct) otherwise depreciable business property. Under a new law just enacted, you may elect to expense up to $500,000 of capital expenditures such as equipment (with a phase-out for purchases in excess of $2,000,000) if the asset is placed in service during 2010 or 2011. Also, new for 2010 and 2011, certain real property can qualify for the expense deduction, but the qualifying property cannot exceed $250,000 of the allowed deduction.

Bonus Depreciation: Although bonus depreciation was originally not in effect for 2010, the 2010 Small Business Jobs Act, enacted in late-September, revived it for 2010. Taxpayers can claim the 50% bonus depreciation allowance for property placed in service in 2010.

Bad Debts: You can accelerate deductions to 2010 by analyzing your business accounts receivable and writing off those receivables that are totally or partially worthless. By identifying specific bad debts, you should be entitled to a deduction. You may be able to complete this process after year-end if the write-off is reflected in the 2010 year-end financial statements.

Home Office Deduction: Expenses attributable to using the home office as a business office are deductible if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business.

Business Credits

Work Opportunity Credit: The work opportunity credit is an incentive provided to employers who hire individuals in groups whose members historically have had difficulty obtaining employment. Unemployed veterans and disconnected youth hired in 2010 qualify as a targeted group in addition to the existing targeted groups. This gives your business an expanded opportunity to employ new workers and be eligible for a tax credit against the wages paid.

Credit for Employee Health Insurance Expenses of Small Employers: For tax years beginning after 2009, eligible small employers are allowed a credit for certain expenditures to provide health insurance coverage for their employees. Generally, employers with 10 or fewer full-time equivalent employees (FTEs) and an average annual per-employee wage of $25,000 or less are eligible for the full credit. The credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than $25,000. The credit is phased out completely for employers with 25 or more FTEs or an average annual per-employee wage of $50,000 or more. The credit amount is 35% of certain contributions made to purchase health insurance.

Business Credit for Retention of Certain Newly-Hired Individuals in 2010: For qualified employers in tax years ending after March 18, 2010, the current-year general business credit is increased for each retained worker by the lesser of: (a) $1,000, or (b) 6.2% of the wages paid to the retained worker during the 52 consecutive week period for a “retained worker.”

Carryback of Business Credits: Pursuant to the 2010 Small Business Jobs Act, 2010, the business credit carryback period for eligible small businesses is extended from one to five years. Eligible small businesses are businesses with $50 million or less in average revenue for the preceding 3 years.

Alternative Minimum Tax

AMT Suspension for Eligible Small Businesses' General Business Credits: For 2010, eligible small businesses (see above) may use business credits (i.e., Research & Development credits) to reduce alternative minimum tax liability in 2010 and in the extended 5 year carryback period above.

Inventories

Subnormal Goods: You should check for subnormal goods in your inventory. Subnormal goods are goods that are unsalable at normal prices or unusable in the normal way due to damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange. If your business has subnormal inventory as of the end of 2010, you can take a deduction for any write-downs associated with that inventory provided you offer it for sale within 30 days of your inventory date. The inventory does not have to be sold within the 30-day timeframe.

Retirement Plans

In-Plan Roth Rollovers: A much anticipated provision of the 2010 Small Business Jobs Act allows Section 401(k) plan participants in elective deferral plans to rollover their pre-tax account balances to Roth-designated accounts within the plan. This will allow the Roth rollover funds to stay within the employer-sponsored plan, instead of migrating to Roth IRAs with brokers, mutual fund companies, banks, etc. The rule is effective on September 27, 2010.

Other 2010 Opportunities

S Corporation Built-In Gains Tax: An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who are taxed on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate on all gains that were built in at the time of the election if the gains are recognized during a special holding period. For tax years beginning in 2009 and 2010, the special holding period is shortened to seven years. Under the Small Business Jobs Act, the special holding period was shortened to five years for tax years beginning in 2011.

Qualifying Dividends: Qualifying dividends received in 2010 are subject to rates similar to the capital gains rates. Therefore, qualifying dividends are taxed at a maximum rate of 15%. Note that if Congress does not act to extend the reduced dividend rates, beginning in 2011 the rates will revert back to pre-2001 levels (i.e., will be taxed at the taxpayer's ordinary income rate, up to a maximum of 39.6%). You may want to accelerate dividends into 2010 to ensure the 15% tax rate.

Planning Ahead for 2011

Information Reporting Requirements: Under new law, beginning January 1, 2011, individuals and entities operating rental real estate making payments of $600 or more (annually) to service providers (e.g., repairman, contractor, professional, management, etc.) must issue a Form 1099-MISC to the IRS and to the service provider.

This information is general in nature. We should discuss your specific circumstances before taking any action. Please do not hesitate to contact us to further explore any of the matters discussed herein. There is still time to implement many strategies to minimize your 2010 and 2011 tax liabilities.

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