

HEAVEN AND ASSOCIATES, P.C.

Prosperity Accounting for Emerging Businesses

Re: 2009 Year-end Tax Planning for Individuals & Businesses

Dear Client:

Year-end tax planning for 2009 presents a unique chance for you to lower your tax liability, especially in light of the significant tax law changes that were enacted in response to the struggling economy. Although traditional planning techniques remain fundamentally important considerations, new opportunities and risks provide planning variables unique to this year-end. We have included tax planning information and strategies for personal returns as well as for small businesses to possibly reduce your tax burden as 2009 draws to a close.

Individuals

Managing the income that you recognize or defer in 2009 may be beneficial, but with tax reform on the horizon, balancing tax rates between 2009 and 2010 and beyond becomes more difficult. Proposed increases in income and capital gain tax rates for 2011 make the traditional year-end strategy of deferring your 2009 income into 2010 less attractive. Deferring too much income could result in excessive income in 2010, especially if you also accelerate 2011 income into 2010 to escape higher rates.

However, many of the tax breaks in recent stimulus tax bills are due to expire at the end of this year. Since it is uncertain whether Congress will extend any or all of the expiring tax incentives, taking advantage of this tax relief while it is still available should be considered. Some tax incentives that are set to expire include:

- * the above-the-line deduction for teachers' classroom expenses;
- * the above-the-line higher education tuition deduction;
- * the additional standard deduction for real property taxes;
- * the AMT exemption amount patch;
- * the itemized state and local sales tax deduction;
- * the moratorium on required minimum distributions (RMDs);
- * the motor vehicle sales tax deduction, which applies to qualified new vehicle purchases after February 16, 2009 and before January 1, 2010;
- * tax-free IRA distributions to charity;
- * the nonrefundable tax credit offset of regular and AMT tax liability; and
- * COBRA premium assistance for unemployed workers who are involuntarily terminated between September 1, 2008 and December 1, 2009.

In addition to those provisions that are scheduled to expire in 2009, there are others that continue to apply. A variety of popular tax exclusions, deductions and credits for individuals were provided, extended or enhanced by the American Recovery and Reinvestment Tax Act of 2009 (2009 Recovery Act), as follows:

Exclusions from Income:

- * Qualified bike commuting reimbursements of up to \$20 per month
- * Discharged principal residence indebtedness of up to \$2,000,000 (\$1,000,000 for married separate filers)
- * \$250 economic recovery payments
- * Increased \$460 per month limitation for transportation fringe benefits offered by an employer
- * Exclusion of the first \$2,400 (per person) of unemployment compensation benefits received
- * The percentage of exclusion is increased to 75% for sales of small business stock acquired after February 17, 2009 and before January 1, 2011 (stock must be owned and held for more than five years).

Deductions:

- * Safe harbor method to calculate theft loss deduction for fraudulent investment (Ponzi) schemes
- * Qualified mortgage insurance premiums obtained in connection with acquisition indebtedness
- * Computer equipment and technology, and internet access and related service costs are qualified higher education expenses for qualified tuition programs for 2009 and 2010.

Tax Credits:

- * The American Opportunity Tax Credit replaces the Hope Scholarship Credit for 2009 and 2010, and now applies to the first four rather than the first two years of a student's post-secondary education. The maximum credit is increased to \$2,500 per eligible student.
- * The refundable earned income credit is increased to a maximum of \$5,657 for qualifying families with three or more children.
- * Beginning with purchases after December 31, 2008, the maximum first-time homebuyer credit (FTHBC) amount is increased to \$8,000 (\$4,000 for married separate filers). The FTHBC is extended by the Worker, Homeownership, and Business Assistance Act of 2009 (2009 Worker Act) to include qualifying purchases after April 9, 2008, and before May 1, 2010. In addition, for 2009 and 2010, the 2009 Worker Act waives the recapture of the credit if the home is used as a principal residence for at least three years.
- * Certain government retirees can claim a refundable \$250 tax credit (\$500 on a joint return if both spouses are eligible).
- * A refundable Making Work Pay Credit (MWPC) is advanced to eligible workers, generally through reduced income tax withholding. The MWPC is equal to the lesser of 6.2 percent of earned income, or \$400 (\$800 for married joint filers).
- * The refundable portion of the child tax credit (CTC) is increased to 15% of earned income in excess of \$3,000 (the previous threshold amount was \$12,550, making the maximum increase in the refundable CTC \$1,432.50).

- * The credit for nonbusiness energy property (CNEP) is extended through 2010, and the credit amount increases from 10 to 30 percent of qualified energy efficiency improvements (including doors, windows, furnaces, central air conditioners, water heaters, heat pumps, biomass stoves, and certain asphalt roofs). The credit is limited to a total of \$1,500 over the 2009 and 2010 tax years.
- * The residential energy efficient property (REEP) annual credit maximums of \$2,000 for solar hot water heaters, \$500 for each half kilowatt of electric capacity generated by a wind turbine (not to exceed \$4,000 annually), and \$2,000 for geothermal heat pumps are eliminated for tax years 2009 through 2016. The maximum annual credit for each half kilowatt of electric capacity from fuel cell plants remains at \$500.
- * For tax years beginning in 2009, the alternative motor vehicle (AMV) credit is treated as a nonrefundable personal tax credit.
- * A credit is available for qualified plug-in electric drive motor vehicles (PEDMVs) placed in service in 2009 through 2014. The maximum PEDMV credit is between \$7,500 and \$15,000 depending upon the weight of the vehicle.
- * A new credit is available for converting an existing motor vehicle into a qualified PEDMV. The maximum credit of \$4,000 applies to conversions made after February 17, 2009 and before December 31, 2011.
- * The new plug-in electric vehicle credit (PEVC) is modeled on the PEDMV credit, and provides a credit equal to 10% of the cost of acquiring certain electrically powered 2-wheeled, 3-wheeled, and low-speed vehicles. The PEVC is capped at \$2,500, and generally applies to vehicles purchased after February 17, 2009 and before January 1, 2012.

Small Businesses

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

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

end of the 2009 tax year. Many businesses that anticipate 2009 tax year losses should be taking steps before end year to accelerate deductions to maximize the size of their 2009 NOLs for a larger carryback refund.

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

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

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

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

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

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

Charitable contributions. Businesses, like individuals, may deduct contributions to charitable organizations within certain limits. Corporations, but not other business entities, enjoy an enhanced deduction for contributions of computer technology and equipment for educational purposes. This

enhanced deduction will expire after December 31, 2009. All businesses regardless of how they are organized can claim an enhanced deduction for donations of food. However, the deduction for donations of food will expire after December 31, 2009.

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

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

Capital gains taxation. Earlier this year, Congress expanded the 50 percent exclusion from tax for capital gains realized on the sale of qualified small business stock held for more than five years to 75 percent. The exclusion is limited to individual investors. The enhanced exclusion will expire after December 31, 2010. The Obama administration has proposed to increase the exclusion to 100 percent, effective for qualified small business stock issued after February 17, 2009.

New tax laws from Congress. Part of year-end tax planning for this year should be focused on remaining flexible and being ready to capitalize on any new opportunity -or pitfall--that may come your way because of last minute tax law changes. Congress is now considering several changes, including extension of bonus depreciation and enhanced Code Sec. 179 expensing. If any of these provisions pass, or if other, similar proposals move quickly on Capitol Hill, taking prompt action before year end could reward you with significant tax benefits.

With the year drawing to a close, now is an ideal time to review your tax situation and evaluate strategies that may help minimize your tax bill. Hopefully, this letter provides some alternatives that you would like to discuss in greater detail. Please call our office at your earliest convenience to arrange an appointment.

Sincerely yours,

Ranae Heaven, CPA