



2009

Small Business

advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS

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Business Tax Breaks: It's Going, Going, Gone!

A recent report issued by the Joint Committee on Taxation included a list of business tax breaks that will be expiring at the end of 2009, barring any additional extensions by Congress. Many of the deductions have been previously extended on a year-by-year basis, including the recently enacted American Recovery and Reinvestment Act of 2009. While some of these provisions may ultimately be extended, business clients are encouraged to review the expiring provisions. Where it makes good business sense, they should take action now to prevent losing out on the tax breaks if they are not extended.

Additional first-year 50% bonus depreciation for qualified property – Qualified property is allowed a 50% depreciation (bonus depreciation) in the year that the property is placed in service (with corresponding reductions in basis and reductions of the regular depreciation deductions otherwise allowed in the placed-in-service year and in later years). In addition, an \$8,000 increase in the first-year depreciation limit for passenger automobiles that are qualified property is also extended through 2009. (Certain aircraft and long-production-period property can continue to be placed in service through 2010.)

Increased Sec. 179 expensing election – The increased expensing election up to \$250,000 (with an \$800,000 investment ceiling limit) is extended through 2009. Taxpayers can elect to deduct the cost of any

Section 179 property, generally equipment, placed in service during the tax year as an expense that is not chargeable to a capital account. (For 2010, without Congressional action, expensing will be limited to \$125,000 with a \$500,000 investment ceiling limit (both figures indexed for inflation)).

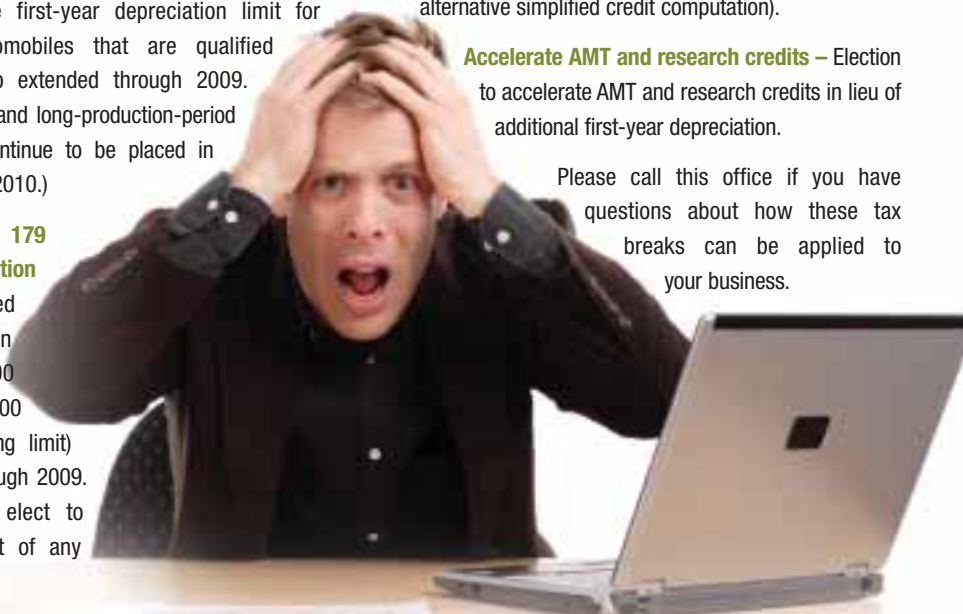
Faster depreciation for farm machinery – Five-year depreciation for farming business machinery and equipment.

Fifteen-year cost recovery for leasehold improvements – Fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements.

Incremental research credit – A taxpayer is generally allowed a research credit of 20% of the amount by which the taxpayer's qualified research expenses exceed a specific base amount (unless the taxpayer elects the alternative simplified credit computation).

Accelerate AMT and research credits – Election to accelerate AMT and research credits in lieu of additional first-year depreciation.

Please call this office if you have questions about how these tax breaks can be applied to your business.



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The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

New Estimated Tax Rules

Taxpayers, including small business owners, are required to prepay their taxes for the year through withholding or by making estimated tax payments. Due to the lack of a withholding source, small business owners are most frequently affected by this requirement.

When a taxpayer fails to prepay enough, he or she can be subject to a nondeductible penalty for underpayment of estimated taxes. The problem for small business owners is that they cannot always accurately predict their profits for the year, especially in this troubled economy. This leaves them with only two options: (1) determine their profits through each quarter and base their estimated tax on those profits projected through the end of year, or (2) base their estimates on one of the available safe harbor estimates.

Although there are several exceptions that can avoid or mitigate the imposition of underpayment of estimated tax penalties, only the ones based on the prior year's tax liability provide safe harbor payments. Prior to the passage of the "American Recovery and Reinvestment Act of 2009" last February, there were only two "safe harbor" payment amounts, both predicated on the taxpayer's AGI for the year – 100% of the prior year's tax liability if the taxpayer's AGI for the prior year is \$150,000 or less or 110% of the prior year's tax liability if the taxpayer's AGI for the prior year is over \$150,000. This left many taxpayers with only the option of paying 110% of the AGI for the prior year.

Thanks to the new tax law, many small business taxpayers can now base their safe harbor estimates on 90% of the prior year's tax. This provides them with a substantial reduction in the amount that needs to be prepaid and possibly helps them to avoid substantial overpayments at a time when money is tight for most small business owners. However, like all things taxable, there are qualifications

Give Small Business Owners a Break



and limitations associated with this new safe harbor. First of all, at least 50% of the prior year's gross income must be attributable to a small trade or business (one that, on average, employs no more than 500 people). Secondly, the taxpayer's AGI must be less than \$500,000 (\$250,000 if married filing separately) on the prior year's return.

Each installment payment must be equal to 25% of the safe harbor amount, whether it is based on 90%, 100% or 110% of the preceding year's tax. Failing to pay the required installment amount or paying it late could void the safe harbor provision and expose the taxpayer to the underpayment of estimated tax penalty.

There are special rules for farmers and fishermen that allow them to pay their entire estimated tax by January 15 of the subsequent year or file their return and pay their total tax liability by March 1 of the subsequent year.

If you need help with your estimated payments or wish to adjust them, please contact this office.

You are cautioned to check your federal tax withholding on your paystub before and after the change. Determine the amount of the withholding reduction for each paycheck and then, based on the number of paychecks for the year with the reduced withholding amount, determine the amount of the reduction for the year. If you hold multiple jobs or have a spouse who also works, determine the total reduction for all of the paychecks.

Then compare that amount with the allowable credit, which is 6.2% of your earned income or a maximum of \$400 for a single individual and \$800 for joint filers. The credit phases out for higher-income taxpayers, so you may not even be entitled to the maximum credit. The phase-out is 2% of the taxpayer's modified adjusted gross income in excess of \$75,000 (\$150,000 for joint filers) and is totally phased out at \$95,000 (\$190,000 for joint filers).

So, if your withholding adjustment exceeds the credit, that excess will reduce the refund amount or add to the tax due when the 2009 tax return is prepared. If you feel the adjustment is excessive for your circumstances and you would like this office to run an analysis and/or help you make an adjustment, please call to make an appointment.

“Making Work Pay” Credit May Reduce Withholding Amount

As part of the tax law passed in February, many taxpayers will be entitled to the new “Making Work Pay” credit. Even though this credit will be calculated in the 2009 tax return, the federal income tax withholding tables used by employers have been adjusted to reflect this new credit in an effort to put the money into working taxpayers' hands right away.

However, there is a potential hazard. Since the adjustment is based on each individual's earned income from a particular employer, it does not make allowances for multiple job incomes, spousal income, or other forms of income.

The result could cause a taxpayer's withholding to be reduced inappropriately, which may substantially reduce his or her refund at the end of the year; or, worse yet, cause an unexpected tax due.

Buying or Selling a Business?

Don't Leave Asset Allocation to Chance.

If you are contemplating buying or selling a business, one of the most important and frequently overlooked issues is the allocation of the purchase/sales price to the various elements of the business.

Most businesses are made up of different types of assets, and those assets are treated differently for tax purposes. How those items are identified at the time of the sale/purchase can have a significant tax impact on both the buyer and the seller. A seller will, of course, want to designate items into classes that will yield a long-term capital gain on the sale and thus provide the best tax result from the sale. The buyer, on the other hand, will generally want to designate the purchased items into classes that provide the biggest up-front write-offs.

The IRS generally does not care how the class allocations are made so long as both the buyer and the seller use consistent treatment. That is where IRS Form 8594 comes in. The form allocates the entire purchase/sales price of the business into the various classes of assets; both the buyer and the seller are required to file the form with their tax returns. It is also very important that the allocations are spelled out in the sales/purchase agreement and that the treatment is consistent between the buyer and seller.

A seller would prefer to designate the major portion of the sales price to goodwill and minimize any allocation to furnishings and equipment. Why, you ask? Because goodwill is a capital asset and will be taxed at a maximum rate of 15% for federal purposes, while the furnishings and equipment can be taxed as high as 35%. Conversely, the buyer would prefer to have as much as possible designated as furnishings and equipment since they can be written off over a short period of time (usually 5 or 7 years) or even expensed under the Sec. 179 rules, as opposed to a 15-year amortized write-off for goodwill.

Whether you are the buyer or the seller, don't leave the asset allocations to chance. Negotiate the allocation as part of the sales agreement. If you don't, you could easily end up with inconsistent treatment and potential adjustments by the IRS.

If you are planning a purchase or anticipating a sale, please call this office so that we may assist you in structuring the transaction to your best benefit.

2009 Recovery Act Maximizes Deductions for Business-Use Vehicles

For vehicles purchased by an individual on or after February 17, 2009 and before January 1, 2010, the Recovery Act of 2009 modifies the definition of deductible taxes to include qualified motor vehicle taxes paid or accrued within the tax year. Thus, the sales tax paid on the purchase of a business vehicle will not be included in the capitalized cost of the vehicle and, therefore, can presumably be deducted as tax paid.

The Recovery Act generally allows this deduction to both itemizers and those claiming the standard deduction as an addition to that deduction. The deduction is subject to two limitations:

Purchase Price Limitation – Under a purchase price limitation, only taxes on that part of the qualified motor vehicle's purchase price not exceeding \$49,500 may be deducted.

Income Limitation – Under an income limitation, the amount of sales or excise taxes that may be treated as qualified motor vehicle taxes is phased out ratably for a taxpayer with modified AGI (MAGI) between \$125,000 and \$135,000 (\$250,000 and \$260,000 on a joint return).

The Recovery Act also extended the 50% bonus depreciation through 2009, thus increasing the first-year deduction for vehicles by \$8,000. This provides the unincorporated small business owner with two extra tax benefits for buying a new business vehicle between now and the end of the year: a sales tax deduction and boosted first-year depreciation.

Example: Peter, an unincorporated business owner, buys a new \$40,000 auto which he uses 100% for business driving. He paid \$3,400 (8.5%) in state sales tax on the car. If he had purchased the car before February 17, 2009, his business basis in the vehicle would be \$43,400 (\$40,000 cost plus \$3,400 of sales tax), and, assuming the luxury auto dollar limits are the same as 2008, his first-year depreciation deduction would be \$10,960 (the regular first-year depreciation allowance of \$2,960 plus the \$8,000 bonus depreciation amount). If Peter buys the car on March 1, his basis in the vehicle is only the purchase cost (\$40,000). His first-year depreciation is still \$10,960, but he gains a \$3,400 deduction for the sales tax. Counting both tax benefits, Peter ends up deducting \$11,400 more than normal for a purchase in 2009.

The sales tax deduction will not apply to C-corporations and it is unclear at this time whether it will apply to purchases made by S-corporations. Presumably, the deduction must be taken at the individual level either as an itemized deduction or as an add-on to the standard deduction by taxpayers not itemizing. Watch for further information in the future.

Please call this office with any questions related to these deductions.



Q & A

FOR SMALL
BUSINESSES

QUESTION: My wife and I are planning to start a new business in which both of us will be working. How do we report the income and expenses for a business that we will jointly own and operate?

ANSWER: Generally, where you and your spouse jointly own and operate an unincorporated business and share in the profits and losses, you would file a partnership return whether or not there is a formal partnership agreement. However, if you and your spouse are the sole owners, both materially participate in the business, and file a joint return for the year, you can elect to be treated as a qualified joint venture. This will allow you to split your income and deductions (in accordance with your individual ownership in the business) on separate sole proprietorship forms attached to your 1040 tax return and avoid filing a partnership return.

QUESTION: I am shutting down my business that I operate as a sole proprietor and have equipment that I have been

depreciating. I will keep some of the equipment for my personal use. The rest will be disposed of. What are the tax ramifications of doing this?

ANSWER: If you plan on keeping the equipment, you are taking it out of service and there generally will be no tax consequences at that time. However, if you had originally expensed the equipment under Sec. 179, this could result in a recapture of some of that write-off as additional income on your business schedule.

If you decide to sell an item, then you will have to report a gain or loss based upon the remaining undepreciated basis. On the other hand, if you scrap an item, the sales price is zero. Another route would be to contribute an item to charity. This gives you a charitable deduction equal to the remaining undepreciated basis. The deduction would be claimed as an itemized deduction, not as a business expense.

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Tax Calendar

June – September 2009

June 15, 2009:

- U.S. citizens living abroad on April 15, 2009 must file a 2008 income tax return (if not already filed) or file for an extension.
- The second installment of your 2009 individual estimated taxes is due. If your income or deductions have significantly changed, you should call this office to determine if any adjustment in estimates is appropriate.

July 2009:

- Time to review your 2009 year-to-date income and expenses to ensure that your estimated tax payments and withholding are adequate to avoid underpayment penalties. There have been a significant number of tax changes for 2009 that can impact your estimated taxes for 2009.

July 31, 2009:

- This is the due date for self-employed individuals and employers to file 5500 series returns for 2008 calendar year benefit plans (including Keogh/HR-10 plans).

September 15, 2009:

- The third installment of your 2009 individual estimated taxes is due.
- This is the due date for filing calendar year 2008 Fiduciary Income Tax (Form 1041), Corporation (Form 1120 and 1120S), and Partnership (Form 1065) returns for which extensions were previously filed.