



2009

Small Business

advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS

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# Year-End Planning for Capital Purchases

Increased business spending for durable goods and capital items indicates that businesses are beginning to loosen their purse strings. From a tax standpoint, this is also a good time to consider capital purchases, thanks to some extraordinary tax benefits available through the end of the year. If your business is considering expansion or capital purchases, now may be the time to act – because without Congressional action, which is unlikely due to increasing federal budget woes, the following business benefits will no longer be available after the close of 2009.

**Bonus Depreciation** – Under the first-year bonus depreciation rules, taxpayers may generally claim an additional first-year depreciation deduction equal to 50% of the cost of qualified property placed in service in 2009. This bonus depreciation deduction is allowed for both regular tax and AMT purposes. Qualified property includes equipment and machinery that is purchased new and placed into service before the end of the year.

**Luxury Auto Limitations** – Generally, vehicles weighing 6,000 pounds or less are classified as luxury vehicles, and the first-year depreciation is 20% of the cost of the vehicle but limited to a maximum of \$2,960 (\$3,060 for light trucks), regardless of the cost of the vehicle. However, for 2009, and at the taxpayer's election, that maximum is increased to \$10,960 (\$11,060 for light trucks). This increase is attributable to the bonus depreciation allowable for 2009.

**Enhanced Expensing (Sec. 179)** – For equipment and machinery placed in service in 2009, the maximum expensing allowance is \$250,000; it phases out when the cost of eligible property placed in service during the year exceeds \$800,000. Barring any change by Congress, the \$250,000 and \$800,000 amounts will reduce to \$125,000 and \$500,000 in 2010, and drastically decline to \$25,000 and \$200,000 in 2011.

**Quick Write-Offs for Most New Farming Machinery and Equipment** – Those engaged in a farming business have the opportunity to depreciate qualifying new farming machinery and equipment over a 5-year period, instead of over the generally-applicable 7 years. To qualify, the original use of the property must have begun with the taxpayer after December 31, 2008, and before January 1, 2010. Grain bins, cotton ginning assets, and fences or other land improvements are not eligible for the 5-year write-off period.

Generally, farming machinery and equipment also qualifies for the increased expensing and bonus depreciation deductions previously discussed, providing extraordinarily large tax write-offs for 2009.

**15-Year Write-Off for Leasehold Improvements** – Qualified leasehold improvements, restaurant improvements, and retail improvements completed and placed into service before January 1, 2010 may be written off over 15 years instead of the usual 39 years. This more than doubles the annual write-off for these improvements.

The options for writing off capital expenditures in 2009 make it possible to customize the write-off for virtually all businesses through careful pre-year-end planning. So whether you wish merely to optimize the write-off for capital purchases already made, or you wish to plan additional purchases to take advantage of the special 2009 tax write-offs, give this office a call. Together we can strategize to maximize your benefits and minimize your tax liability.

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.

# KLEIN

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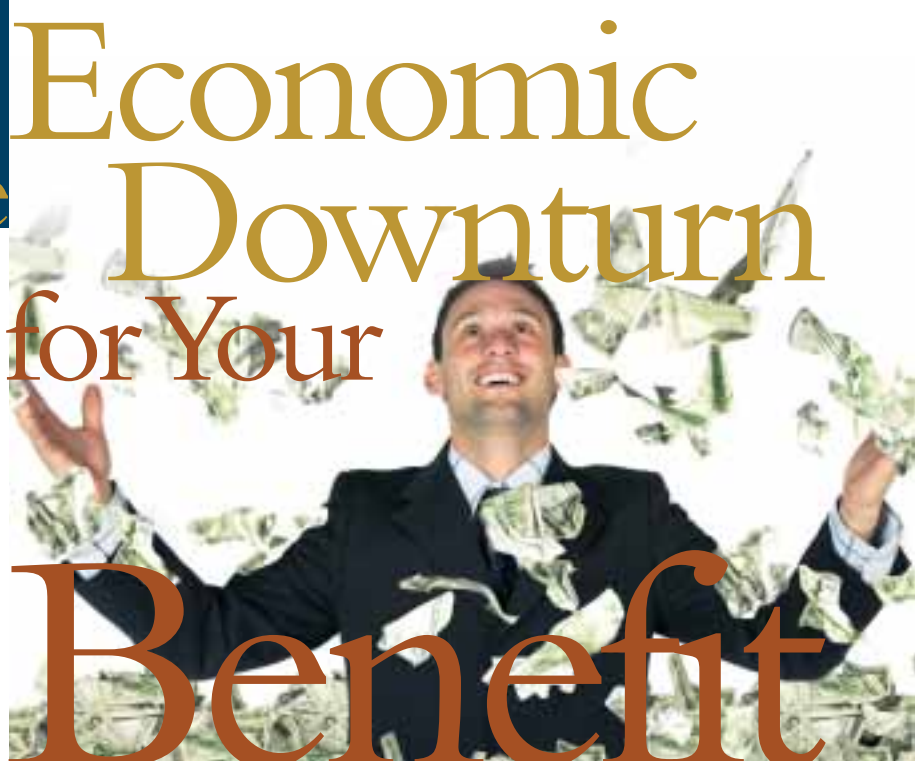
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# Using the

# Economic Downturn for Your Benefit



**A**lthough 2009 has been a tumultuous year for most people, there are some positive actions that can be taken to benefit in the current economic conditions.

**Make Gifts** – For 2009 and 2010, you can gift up to \$13,000 of value (\$26,000 if married and both spouses make a gift) to as many individuals as you would like without affecting your lifetime gift tax exclusion, paying any gift tax, or even having to file a gift tax return.

**Traditional IRA to Roth IRA Conversions** – When one converts a conventional IRA to a Roth IRA, the conversion is taxed at the individual's marginal tax rate, as if the individual withdrew the funds without being subject to any penalties. Thus, for 2009, if your taxable income is negative, your marginal tax rate is very low or you have tax credits that are not being fully utilized, it might be appropriate to convert some or all of your traditional IRA funds into a Roth IRA at no or a very small cost. The benefit is not immediate, but in the future at retirement time, the Roth IRA withdrawals, unlike traditional IRA withdrawals, will be tax-free.

**Use Up Capital Loss Carryovers** – If you are one of the lucky investors who has benefited from the recent market upswing and would like to reduce your position in a security or realign your portfolio, and you have unused capital loss carryovers, you might consider selling some of your existing holdings with gains. By utilizing the unused capital loss carryovers to offset those gains, you may pay little or no tax on the profits.

**Relinquish Dependency Rights** – If you are the custodial parent of a child, have the right to claim the child as a dependent, but have no need for the tax benefits associated with the dependency this year, you might consider relinquishing the exemption to the child's other parent.

**Exercise Options** – Employee stock options, when exercised, produce either ordinary income (non-qualified options) or alternative minimum tax preference income (qualified options) equal to the difference between the exercise price and the market value of the shares at the time of exercise (purchase). Employees who have stock options with a non-publicly-traded company, where the value is depressed because of the current economic climate but is expected to recover in the near future, should consider exercising their options while the stock value is low. In doing so, the employees will be able to acquire the stock at a preferential price and hold it for future appreciation with a minimum, or perhaps zero, current tax bite.

**Deduct IRA Losses** – A traditional IRA account often contains only contributions that were previously deducted, so if the account's value declines, no additional loss deduction can be claimed. However, if you have made nondeductible contributions to a traditional IRA and the value of all of your IRA accounts combined is less than the sum of your nondeductible contributions, you can take a loss – but to do so, you must take withdrawals from (close out) all of your IRA accounts. The result is a miscellaneous itemized deduction equal to the total of the nondeductible contributions less the sum of the withdrawn amounts. However, this loss is beneficial only if your deductions are itemized, and the loss, along with your other miscellaneous deductions, exceeds 2% of your income (AGI) for the year.

**Cash in Savings Bonds** – Two options are available for tax reporting of interest income from certain U.S. savings bonds, such as EE Bonds and I Bonds: include the increase in redemption value each year as interest, or postpone reporting any of the interest until the bonds are cashed in. Typically, most people choose the latter method. If you are holding savings bonds that are approaching their maturity and your taxable income for the year will be negative or lower than it normally is, and you haven't previously reported the interest, you may want to cash in some or all of these bonds to take advantage of your lower tax bracket. If you don't want to cash in the bonds, you can make an election to switch to the annual interest reporting method, but if you do so, on the return for the year of the change, you will have to include all of the interest accrued to date for all Series E, EE or I savings bonds that you hold, and then report the annual interest in each succeeding year for those and any bonds of these series that you may acquire in the future.

## Don't Cut Corners with Your Retirement Savings!

This has been a tough year for many small business owners, and many are looking for corners to cut to conserve cash. One corner that you should not cut unless you are desperate is contributing to your retirement plan. Not only do these contributions help you fund your future retirement, but they can also provide you with a current tax deduction when you contribute to a self-employed retirement plan or to most traditional IRAs.

The benefit derived from the deductions for pension contributions is based upon your tax bracket. The higher your tax bracket is, the larger the tax savings; thus, higher-income taxpayers benefit the most. For example, John and George both wish to contribute \$5,000 to their retirement plans. John is in the 15% tax bracket, and George is in the 35% bracket. Assuming both contribute to a deductible plan, George will save \$1,750 on his tax bill by making the contribution while John only saves \$750.

## *Don't Cut Corners with Your Retirement Savings! (Cont'd)*

Here is where some tax-planning strategies come into play. Distributions from deductible plans are taxable when withdrawn at retirement, while distributions from Roth IRA accounts are tax-free at retirement (provided a five-year holding period is met and withdrawals are made after age 59½). Thus, John may find it more beneficial to make a Roth contribution and forego a current tax deduction while having tax-free retirement income. George, on the other hand, would benefit from a nice deduction now but still may wish to consider the Roth options. However, he will be barred from making Roth IRA contributions because his income exceeds the AGI phase-out limitations. Instead, George might consider making a nondeductible traditional IRA contribution and then converting it to a Roth IRA in 2010 when the Roth IRA AGI limitations for conversions are removed.

There are a number of retirement account options available to a self-employed individual. The 2009 limits for the most commonly encountered plans are:

- **Traditional IRA** – Contributions are limited to \$5,000 (\$6,000 if age 50 or over) and are deductible, but the taxpayer can elect to treat the contribution as nondeductible. If the taxpayer participates in another pension plan, the deductibility may be limited depending on income.
- **Roth IRA** – Contributions are limited to \$5,000 (\$6,000 if age 50 or over), and the contributions are nondeductible. Contributions are limited for higher-income taxpayers. The yearly contribution limit for traditional and Roth IRAs is a combined limit.
- **Self-Employed Retirement Plan (SEP)** – The contribution limit is 25% of the net profits from self-employment (20% of the net profits before deducting the contribution itself) but not more than \$49,000. If you have employees, you generally must contribute the same percentage amount of their wages for the year to their SEP accounts (but not more than \$49,000).
- **Spousal IRA** – Frequently overlooked is the fact that the spouse of a self-employed individual may also be able to make a contribution to either a traditional or Roth IRA based on the self-employed spouse's self-employment income.

There are additional requirements that must be met for these plans as well as other options. Please call this office for further details and/or assistance with selecting the pension option that best suits your current situation and your long-term needs.

## Taxes & Worker Status: Employee vs. Independent Contractor?

If you are a small business owner, whether you hire people as independent contractors or as employees will impact the amount of taxes you withhold from their paychecks, as well as the amount and types of taxes you pay. Furthermore, it will affect how much additional cost your business must bear, what documents and information must be provided to you, and what tax documents must be given to the individuals you are hiring.

The obvious advantage to treating an individual as an independent contractor is avoiding the added expense of payroll taxes and employee benefits. Unfortunately, the decision is not an optional one, and employers must be careful when making the decision, lest they set themselves up for a payroll audit and back taxes, penalties and interest.

According to industry sources, the IRS will begin auditing companies in early 2010, focusing their efforts on businesses failing to pay taxes on fringe benefits and misclassifying workers as independent contractors instead of W-2 employees.

Here are some things every business owner should know about hiring people as independent contractors versus hiring them as employees.

- Three characteristics are used by the IRS to determine the relationship between businesses and workers: Behavioral Control, Financial Control, and the Type of Relationship.
- Behavioral Control covers facts that show whether the business has a right to direct or control how the work is done through instructions, training or other means.

- Financial Control covers facts that show whether the business has a right to direct or control the financial and business aspects of the worker's job.
- The Type of Relationship factor relates to how the workers and the business owner perceive their relationship.
- If you have the right to control or direct not only what is to be done, but also how it is to be done, then your workers are most likely employees.
- If you can direct or control only the result of the work done, and not the means and methods of accomplishing the result, then your workers are probably independent contractors.
- Employers who misclassify workers as independent contractors can end up with substantial tax bills. Additionally, they can face penalties for failing to pay employment taxes and not filing required tax forms.
- Workers can avoid higher tax bills and lost benefits if they know their proper status.
- Employers can request the IRS to make a determination on whether a specific individual is an independent contractor or an employee by filing a Form SS-8 (Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding) with the IRS. A worker may also file Form SS-8, requesting an IRS determination. IRS does not issue determinations for proposed or hypothetical situations.

If you need more information about the critical determination of a worker's status as an independent contractor or employee, please give this office a call.



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BUSINESSES

**QUESTION:** I used my vehicle approximately 70% for business and 30% for personal use. It qualified under the clunker program so I traded it in for a new vehicle. The new car qualifies for the hybrid credit and there is also the sales tax deduction for 2009. How will all of these items impact my tax return?

**ANSWER:** For federal purposes, the hybrid credit will be split 70% as a general business credit and 30% as a personal credit. With respect to the sales tax deduction, 30% will be allowed on your personal return with the balance capitalized into the business basis of the vehicle. The clunker rebate is treated as a reduction in purchase price so it has no effect on either your personal or business income. Not all states conform to the federal rules so there may be some additional ramifications for state purposes.

**QUESTION:** I own a small, unincorporated business and had a pretty good year in 2008. However, in 2009, business has been off quite a bit and I have cut back on my estimated tax payments. I am concerned that I may incur a penalty. What are the rules?

**ANSWER:** Normally for federal tax purposes you are required to pay, in advance, 90% of the current year's tax liability or 100% of the prior year's tax liability. However, for 2009, if you are a small business owner with an AGI less than \$500,000 (\$250,000 if filing married separate) on your 2008 tax return, and at least 50% of your income in 2008 was from a small trade or business, the prior year's safe-harbor amount has been reduced to 90%. A small business is one with fewer than 500 employees. Thus, for 2009, your safe-harbor estimate is the lesser of 90% of 2009's tax or 90% of 2008's tax. State rules may not be the same.

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## Tax Calendar

November 2009 – April 2010

### November-December 2009

– It's time for 2009 year-end and 2010 tax planning. This is highly recommended if you have substantial increases in income or fewer deductions. Please call for an appointment.

### December 31, 2009

– This is the last day to pay deductible expenses for the 2009 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2009.

– This is the last day to set up a Keogh Retirement Account if you plan to make a 2009 contribution.

### January 15, 2010

– The fourth quarter 2009 federal estimated tax payment is due unless the 2009 return is filed by February 1, 2010.

**Caution:** Some states may have different filing dates for state estimated payments.

### February 1, 2010

– This is the deadline for providing 1099s and W-2s to those people you paid during 2009. If you are a business owner or rental property owner and you paid \$600 or more for the services of individuals (other than employees) during the year, you will

need to provide 1099s to those workers by February 1, 2010. Note that the normal due date is January 31, but because it falls on a weekend, the due date is the next business day, February 1. "Services" can mean everything from labor and professional fees to rents on property. In addition, in order to avoid a penalty, copies of 1099s need to be sent to the IRS by March 1, 2010. This firm can prepare these documents for you.

### March 1, 2010

– This is the deadline for filing (sending) 1099s and W-2s to the government. Note that the normal due date is February 28, but because it falls on a weekend, the due date is the next business day, March 1.

### April 15, 2010

– This is the deadline for individuals to file a 2009 federal return or request an extension of time to file.  
– The first installment of the 2010 federal estimated tax payment is due. **Caution:** Some states may have different filing dates for state estimated payments.  
– The first installment of the 2010 defined benefit pension plan contributions is due.