

YEAR END TAX PLANNING

Year end is usually a hectic time for business owners who are scrambling to wrap up activities and making plans for the New Year. President Obama has given you one reason to breathe a little easier by extending the tax cuts enacted by the Bush administration for all income levels for two years. Critics said repealing the tax cuts could weaken the economy by hurting consumer spending. What's for sure is the deal will reduce worker payroll taxes for one year and will continue both jobless benefits for the long-term unemployed and tax credits for small businesses. By removing the uncertainty of what 2011 taxes will be, business owners can focus on the here and now.

Here are five steps you can take before year's end to make your tax planning a little less hectic.

1. Bring your books up-to-date. Before any tax planning can be done, it's vital to know whether your company made or lost money for the year. Accounting records must be up-to-date. Some business owners get months behind and may not be prepared to think about year-end tax planning.

2. Consider a retirement plan. It's wise to discuss the wide range of plan options with a CPA or other financial adviser.

Profits can be sheltered in qualified retirement plans. For example, a corporate owner or self-employed person whose salary or net earnings are sufficient can contribute a maximum of \$49,000 to a SEP (Simplified Employee Pension) plan, scoring a tax deduction while saving for their retirement. If you have employees, you could choose a 401(k) Profit Sharing Plan to benefit yourself and your employees.

Owners who don't yet have qualified retirement plans for their companies will need to complete the paperwork by Dec. 31. With an SEP they'll have until the extended due date of their 2010 return to make their contributions for the year.

Keep in mind, if you miss the Dec. 31 due date for setting up a qualified retirement plan, you still have one plan option – the SEP – which can be

set and funded as late as the extended due date of the return.

3. Don't forget health coverage. Owners (other than those with a C corporation) who pay for their health coverage can deduct it, but only as a personal expense rather than a business expense. However, for 2010, if you are self-employed, you can use the premiums to offset the amount of net earnings used to calculate self-employment taxes (which cover mandatory Social Security and Medicare contributions). Because of the tax savings, owners may want to reduce their estimated taxes. The last quarterly estimated tax payment for 2010 is due on Jan. 18, 2011.

Those who use the cash-basis accounting method might also want to pre-pay their 2011 premiums to boost their write-off for 2010 while saving on self-employment taxes. If the

insurance qualifies as a high-deductible health plan, then you're allowed a tax-deductible contribution to a Health Savings Account (HSA) for 2010. To be considered "high deductible" in 2010, the policy's deductible must be at least \$1,200 for individuals and \$2,400 for families, and meet certain other tests.

While the HSA 2010 contribution can be made as late as April 18, 2011, the sooner it is made, the more earnings you can build up on a tax-advantageous basis. Earnings will never be taxed if withdrawn to pay qualified medical costs.

4. Donate to charity. The donations are tax-deductible within the limits allowed by law. For example, if you own a C corporation, your charitable deductions are limited to 10% of taxable income.

For owners who record business income on personal tax returns (such as sole proprietors, or owners of S corporations or limited liability companies), note a change for 2010: There's no phase-out of itemized deductions for high-income taxpayers. That's a shift from prior years, when contributors lost part of their charitable deductions when income exceeded a threshold

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amount. If you're unsure whether an organization qualifies for tax-deductible contributions, check IRS Publication 78.

5. Upgrade equipment. If you need to invest in new business equipment or upgrade old machines, now is a great time to act. Whether the business is profitable or not, there is a tax break to help.

If the business is profitable: elect first-year expensing for the cost of equipment up to \$500,000. (This dollar limit is up from \$250,000 in 2009).

If the cost is more than the dollar limit: you can use 50% bonus depreciation and a regular depreciation allowance to effectively write off most of the cost of the purchase. The bonus depreciation option was set to expire on Dec. 31st but now may be extended.

If the business is not profitable: rely on 50% bonus depreciation to write off half the cost, plus a regular depreciation allowance on the other half. This write-off can create or increase a net operating loss, which can result in a carry back that can generate a cash refund.

While first-year expensing can be used for new or pre-owned equipment, bonus depreciation is limited to new equipment. However, the purchase of equipment for both first-year expensing and bonus depreciation can be financed in whole or in part without any impact on the tax write-off.

Sources:

Wall Street Journal
MSNBC

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