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CERTIFIED PUBLIC ACCOUNTANTS  
BUSINESS SPECIALISTS

thinking *forward*

# Tax Planning: Are you prepared for the changes ahead?

Presentation led by Greg L. Gandy, CPA  
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SAMPLE				
Tax Projection 2010				
		2010	2010	
	2009	Scenario #1	Scenario #2	
<b>Income</b>				
Wages	253,880	280,000	280,000	Annualized 2010 W-2s
Interest	335	335	335	
Dividends	998	998	998	
Capital Gains	(3,000)	(3,000)	(3,000)	
IRA Distributions	309,000	-	-	No 2010 IRA distribution
Business Income/(Loss)	(291,167)	100,000	150,000	2010 Projected business income is \$100-\$150K
Other Income	1,000	1,000	1,000	
<b>Total Income</b>	<b>271,046</b>	<b>379,333</b>	<b>429,333</b>	
<b>Adjusted Gross Income</b>				
	271,046	379,333	429,333	
Itemized deductions	66,974	66,974	66,974	
Subtotal	204,072	312,359	362,359	
Exemptions	19,710	19,710	19,710	
<b>Taxable Income</b>	<b>184,362</b>	<b>292,649</b>	<b>342,649</b>	
<b>Tax</b>	<b>39,885</b>	<b>74,395</b>	<b>90,895</b>	
<b>Other Taxes</b>				
IRA Penalty	30,900	-	-	
<b>Total Taxes</b>	<b>70,785</b>	<b>74,395</b>	<b>90,895</b>	
<b>Payments</b>				
Fed W/H	(64,749)	(74,000)	(74,000)	Annualized 2010 tax withheld
(Refund)/Owe	6,036	395	16,895	

# Tax breaks and incentives

- ◉ Enhanced small business expensing (Section 179 expensing)
- ◉ Extension of 50% bonus first-year depreciation
- ◉ Deductibility of health insurance for the purpose of calculating self-employment tax
- ◉ 100% exclusion of gain from the sale of small business stock for qualifying stock acquired after Sept. 27, 2010 and before Jan. 1, 2011
- ◉ General business credits of eligible small businesses for 2010 allowed to be carried back five years

# Tax breaks and incentives (cont.)

- ⦿ General business credits of eligible small businesses in 2010 aren't subject to AMT
- ⦿ S corporation holding period
- ⦿ Special rule for long-term contract accounting
- ⦿ Boosted deduction for start-up expenditures
- ⦿ Limitation on penalty for failure to disclose certain reportable transactions (including listed transactions) on a return
- ⦿ Cell phones removed from listed property category

# Offsets (revenue raisers)

- ⦿ Allow rollovers from elective deferral plans to designated Roth accounts
- ⦿ Information reporting required for rental property expense payments
- ⦿ Increased information return penalties (effective for information returns required to be filed after Dec. 31, 2010)
- ⦿ Application of continuous levy to tax liabilities of certain federal contractors
- ⦿ Allow participants in governmental 457 plans to treat elective deferrals as Roth contributions
- ⦿ Nonqualified annuity contracts
- ⦿ Guarantee fees

# Breaking News

- ⦿ Possible extension of Bush Tax Cuts - Latest information

# Expiration of Bush Tax Cuts

- ⦿ Bush Major Tax Legislation
  - Economic Growth and Tax Relief Reconciliation Act of 2001
  - Jobs and Growth Tax Relief Reconciliation Act of 2003
- ⦿ EGTRRA created six rate brackets (2010 Amounts)
  - \$0 - \$16,750 = 10%
  - \$16,751 - \$68,000 = 15%
  - \$68,001 - \$137,300 = 25%
  - \$137,301 - \$209,250 = 28%
  - \$209,251 - 373,650 = 33%
  - \$373,651 and over = 35%

# Expiration of Bush Tax Cuts

- ⦿ Expiration of tax cuts would create five rate brackets (**Amounts Estimated**)
  - \$0 - \$70,040 = 15%
  - \$70,041 - \$141,420 = 28%
  - \$141,421 - 215,528 = 31%
  - \$215,529 - 384,860 = 36%
  - 39.6% in excess of \$384,861
- ⦿ \$1,000 Child tax credit will expire after 2010
  - \$500 credit in 2011 with tougher eligibility standards

# Expiration of Bush Tax Cuts

- ⦿ 15% long term capital gains rate will move to 20%
  - 0% rate for those in low income tax brackets will be move to 10%
- ⦿ Qualified dividend income will no longer be taxed at rates 15% or below
  - Will be taxed as ordinary income
- ⦿ Marriage penalty relief will be gone
  - Standard deduction will no longer be twice that of single filer
  - Rates for married individuals will no longer be adjusted to remove the impact of the marriage penalty

# Expiration of Bush Tax Cuts

- ⦿ Phase out of personal exemptions will be restored
  - No phase out in 2010
  - Phased out at incomes of \$122,500 and above
- ⦿ Phase out of itemized deductions will be restored
  - No phase out in 2010
  - Phased out at AGI levels of \$170,000 and above

# Estate Tax

## ◎ 2011

- \$1,000,000 exclusion per decedent
- Full basis step up
- \$1,000,000 life time gift tax exclusion
- Top rate of 55%
- Annual Gift Tax Exclusion is \$13,000

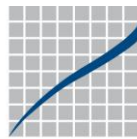
## ◎ 2010

- No estate tax in 2010
- Limited basis step up (\$1,300,000 non spouse/\$3,000,000 spouse)
- \$1,000,000 life time gift tax exclusion
- No Generation Skipping Tax
- Annual Gift Tax Exclusion is \$13,000

# Questions?

## ⦿ Contact Us:

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The midterm elections have changed the Congressional landscape, with Republicans winning control of the House of Representatives and picking up seats in the Senate. Even so, it's still too early to know exactly how this will affect open tax issues for 2010 and 2011.

Specifically, when the "lame-duck" Congress returns this month, it must decide whether to "patch" the alternative minimum tax (AMT) for 2010 (increase exemption amounts, and allow personal credits to offset the AMT), as it has done in past years. It also must decide whether to retroactively extend a number of tax provisions that expired at the end of 2009. These include, for example, the research credit for businesses, the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes, and the additional standard deduction for State and local real property taxes.

In addition, Congress must decide whether to extend the Bush tax cuts for some or all taxpayers. They and other Bush-era tax rules expire at the end of this year. Without Congressional action, individuals will face higher tax rates on their income, including capital gains. Also, unless Congress changes the rules, the estate tax, which isn't in effect this year, will return next year with a 55% top rate.

In short, year-end planning—which always involves some educated guesswork—is a bigger challenge this year than in past years. That said, we have compiled a checklist of actions that can help you save tax dollars if you act before year-end. These moves may benefit you regardless of what the lame-duck Congress does on the major tax questions of the day. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

### **Year End Moves for Individuals**

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year. Don't forget that you cannot set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids (2010 is the last year that FSAs can be used for nonprescription drugs).
- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.
- Increase your withholding if you are facing a penalty for underpayment of federal estimated tax. Doing so may reduce or eliminate the penalty.
- Take an eligible rollover distribution from a qualified retirement plan before the end of 2010 if you are facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2010. You can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2010, but the withheld tax will be applied pro rata over the full 2010 tax year to reduce previous underpayments of estimated tax.
- Make energy saving improvements to your main home, such as putting in extra insulation or installing energy saving windows or buying and installing an energy efficient furnace, and qualify

for a 30% tax credit. The total (aggregate) credit for energy efficient improvements to the home in 2009 and 2010 is \$1,500. Unless Congress acts, this tax break won't be around after this year. Additionally, substantial tax credits are available for installing energy generating equipment (such as solar electric panels or solar hot water heaters) to your home (this break stays on the books through 2016).

- Convert your traditional IRA into a Roth IRA if doing so is expected to produce better long-term tax results for you and your beneficiaries. Distributions from a Roth IRA can be tax-free but the conversion will increase your adjusted gross income for 2010. However, you will have the choice of when to pay the tax on the conversion. You can either (1) pay the tax on the conversion when you file your 2010 return in 2011, or (2) pay half the tax on the conversion when you file your 2011 return in 2012, and the other half when you file your 2012 return in 2013.

- Purchase qualified small business stock (QSBS) before the end of this year. There is no tax on gain from the sale of such stock if it is (1) purchased after September 27, 2010 and before January 1, 2011, and (2) held for more than five years. In addition, such sales won't cause AMT preference problems. To qualify for these breaks, the stock must be issued by a regular (C) corporation with total gross assets of \$50 million or less, and a number of other technical requirements must be met. Our office can fill you in on the details.

Take required minimum distributions (RMD) from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70 1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. A temporary tax law change waived the RMD requirement for 2009 only, but the usual withdrawal rules apply full force for 2010. So individuals age 70 1/2 or older generally must take the required distribution amount out of their retirement account before the end of 2010 to avoid the penalty. If you turned age 70 1/2 in 2010, you can delay the required distribution to 2011, but if you do, you will have to take a double distribution in 2011—the amount required for 2010 plus the amount required for 2011. Think twice before delaying 2010 distributions to 2011—bunching income into 2011 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels.

- Make annual exclusion gifts before year end to save gift tax (and estate tax if it is reinstated). You can give \$13,000 in 2010 or 2011 to an unlimited number of individuals free of gift tax. However, you can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

## **Year End Moves for Business Owners**

- Hire a worker who has been unemployed for at least 60 days before year end if you are thinking of adding to payroll soon. Your business will be exempt from paying the employer's 6.2% share of the Social Security payroll tax on the formerly unemployed new-hire for the remainder of 2010. Plus, if you keep that formerly unemployed new-hire on the payroll for a continuous 52 weeks, your business will be eligible for a nonrefundable tax credit of up-to-\$1,000 after the 52-week threshold is reached. This credit will be taken on the business's 2011 tax return. In order to be eligible, the formerly unemployed new-hire's pay in the second 26-week period must be at least 80% of the pay in the first 26-week period.

Put new business equipment and machinery in service before year-end to qualify for 50% bonus first-year depreciation allowance. Unless Congress acts, this bonus depreciation allowance won't be available for property placed in service after 2010.

Make expenses qualifying for the \$500,000 business property expensing option. The maximum amount you can expense for a tax year beginning in 2010 is \$500,000 of the cost of qualifying property placed in service for that tax year. The \$500,000 amount is reduced by the amount by which the cost of qualifying property placed in service during 2010 exceeds \$2 million. Also, within the overall \$500,000 expensing limit, you can expense up to \$250,000 of qualified real property (certain qualifying leasehold improvements, restaurant property, and retail

improvements). Note that at tax return time, you can choose not to use expensing (or bonus depreciation) for 2010 assets. This is something to consider if tax rates go up for 2011 and future years, and you'd rather have more deductions after 2010 than for 2010.

- Set up a self-employed retirement plan if you are self-employed and haven't done so yet.
- Increase your basis in a partnership or S corporation if doing so will enable you to deduct a loss from it for this year. A partner's share of partnership losses is deductible only to the extent of his partnership basis as of the end of the partnership year in which the loss occurs. An S corporation shareholder can deduct his pro-rata share of an S corporation's losses only to the extent of the total of his basis in (a) his S corporation stock, and (b) debt owed to him by the S corporation.
- Consider whether to defer cancellation of debt (COD) income from the reacquisition of an applicable debt instrument in 2010. The business can elect to have the cancelled COD income included in gross income ratably over five tax years beginning with the fourth tax year following the tax year in which the repurchase occurs (i.e., beginning with 2014).

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

## **2010 Small Business Jobs Act**

The recently enacted **2010 Small Business Jobs Act** includes a wide-ranging assortment of tax breaks and incentives for small business, paid for with various revenue raisers. Here's a brief overview of the tax changes in the new law.

### **Tax breaks and incentives**

***Enhanced small business expensing (Section 179 expensing).*** In order to help small businesses quickly recover the cost of certain capital expenses, small business taxpayers can elect to write off the cost of these expenses in the year of acquisition in lieu of recovering these costs over time through depreciation. Under pre-2010 Small Business Jobs Act law, taxpayers could expense up to \$250,000 of qualifying property—generally, machinery, equipment and certain software—placed in service in tax years beginning in 2010. This annual expensing limit was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service in tax years beginning in 2010 exceeded \$800,000 (the investment ceiling). Under the new law, for tax years beginning in 2010 and 2011, the \$250,000 limit is increased to \$500,000 and the investment ceiling to \$2,000,000.

The new law also makes certain real property eligible for expensing. For property placed in service in any tax year beginning in 2010 or 2011, the up-to-\$500,000 of property expensed can include up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

***Extension of 50% bonus first-year depreciation.*** Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, placed in service in 2008 or 2009 (2010 for certain property), by permitting the first-year write-off of 50% of the cost. The new law extends the first-year 50% write-off to apply to qualifying property placed in service in 2010 (2011 for certain property).

***Deductibility of health insurance for the purpose of calculating self-employment tax.***

The new law allows business owners to deduct the cost of health insurance incurred in 2010 for themselves and their family members in calculating their 2010 self-employment tax.

**100% exclusion of gain from the sale of small business stock for qualifying stock acquired after Sept. 27, 2010 and before Jan. 1, 2011.** Before the 2009 Recovery Act, individuals could exclude 50% of their gain on the sale of qualified small business stock (QSBS) held for at least five years (60% for certain empowerment zone businesses). To qualify, QSBS must meet a number of conditions (e.g., it must be stock of a corporation that has gross assets that don't exceed \$50 million, and the corporation must meet active business requirements). Under the 2009 Recovery Act, the percentage exclusion for gain on QSBS sold by an individual was increased to 75% for stock acquired after Feb. 17, 2009 and before Jan. 1, 2011. Under the new law, the amount of the exclusion is temporarily increased yet again, to 100% of the gain from the sale of qualifying small business stock that is acquired in 2010 after Sept. 27, 2010 and held for more than five years. In addition, the new law eliminates the alternative minimum tax (AMT) preference item attributable for that sale.

**General business credits of eligible small businesses for 2010 allowed to be carried back five years.** Generally, a business's unused general business credits can be carried back to offset taxes paid in the previous year, and the remaining amount can be carried forward for 20 years to offset future tax liabilities. Under the new law, for the first tax year of the taxpayer beginning in 2010, eligible small businesses can carry back unused general business credits for five years. Eligible small businesses consist of sole proprietorships, partnerships and non-publicly traded corporations with \$50 million or less in average annual gross receipts for the prior three years.

**General business credits of eligible small businesses in 2010 aren't subject to AMT.** Under the AMT, taxpayers can generally only claim allowable general business credits against their regular tax liability, and only to the extent that their regular tax liability exceeds their AMT liability. A few credits, such as the credit for small business employee health insurance expenses, can be used to offset AMT liability. The new law allows eligible small businesses, as defined above, to use all types of general business credits to offset their AMT in tax years beginning in 2010.

**S corporation holding period.** Generally, a C corporation converting to an S corporation must hold onto any appreciated assets for 10 years following its conversion or face a business-level tax imposed on the built-in gain at the highest corporate rate of 35%. This holding period is reduced where the 7th tax year in the holding period preceded the tax year beginning in 2009 or 2010. The 2010 Small Business Jobs Act temporarily shortens the holding period of assets subject to the built-in gains tax to 5 years if the 5th tax year in the holding period precedes the tax year beginning in 2011.

**Special rule for long-term contract accounting.** The new law provides that in determining the percentage of completion under the percentage of completion method of accounting, bonus depreciation is not taken into account as a cost. This prevents the bonus depreciation from having the effect of accelerating income.

**Boosted deduction for start-up expenditures.** The new law allows taxpayers to deduct up to \$10,000 in trade or business start-up expenditures for 2010. The amount that a business can deduct is reduced by the amount by which startup expenditures exceed \$60,000. Previously, the limit of these deductions was capped at \$5,000, subject to a \$50,000 phase-out threshold.

**Limitation on penalty for failure to disclose certain reportable transactions (including listed transactions) on a return.** The new law limits the penalty to 75% of the decrease in tax resulting from the transaction. The minimum penalty is \$10,000 for corporations and \$5,000 for individuals (for failure to report a listed transaction, the maximum penalty is \$200,000 and \$100,000, respectively). These changes are retroactively effective to penalties assessed after Dec. 31, 2006.

**Cell phones removed from listed property category.** This means that cell phones can be deducted or depreciated like other business property, without onerous recordkeeping requirements.

### **Offsets (revenue raisers)**

**Allow rollovers from elective deferral plans to designated Roth accounts.** The new law allows 401(k), 403(b), and governmental 457(b) plans to permit participants to roll their pre-tax account balances into a designated Roth account. The amount of the rollover will be includible in taxable income except to the extent it is the return of after-tax contributions. If the rollover is made in 2010, the participant can elect to pay the tax in 2011 and 2012. Plans will be able to allow these rollovers immediately as of Sept. 27, 2010.

**Information reporting required for rental property expense payments.** For payments made after Dec. 31, 2010, the new law requires persons receiving rental income from real property to file information returns with IRS and service providers reporting payments of \$600 or more during the tax year for rental property expenses. Exceptions are provided for individuals renting their principal residences on a temporary basis (including active members of the military), taxpayers whose rental income doesn't exceed an IRS-determined minimal amount, and those for whom the reporting requirement would create a hardship (under IRS regs).

**Increased information return penalties (effective for information returns required to be filed after Dec. 31, 2010).**

**Application of continuous levy to tax liabilities of certain federal contractors.** For levies issued after Sept. 27, 2010, the new law allows IRS to issue levies before a collection due process (CDP) hearing on Federal tax liabilities of Federal contractors (taxpayers would have an opportunity for a CDP hearing within a reasonable time after a levy is issued).

**Allow participants in governmental 457 plans to treat elective deferrals as Roth contributions.** For tax years beginning after Dec. 31, 2010, the new law will allow retirement savings plans sponsored by state and local governments (governmental 457(b) plans) to include designated Roth accounts. Contributions to Roth accounts are made on an after-tax basis, but distributions of both principal and earnings are generally tax-free.

**Crude tall oil (a waste by-product of the paper manufacturing process) is excluded from eligibility for the cellulosic biofuel producer credit.** The new law limits eligibility for the tax credit to fuels that are not highly corrosive (i.e., with an acid number of 25 or less), effective for fuels sold or used after Dec. 31, 2009.

**Nonqualified annuity contracts.** The new law permits holders of nonqualified annuities (annuity contracts held outside of a qualified retirement plan or IRA) to elect to receive part of the contract in the form of a stream of annuity payments, leaving the remainder of the contract to accumulate income on a tax-deferred basis.

**Guarantee fees.** Amounts received directly or indirectly for guarantees of indebtedness of a U.S. payor issued after Sept. 27, 2010 are sourced, like interest, in the U.S. As a result, amounts paid by U.S. taxpayers to foreign persons will generally be subject to U.S. withholding tax.

Please keep in mind that I've described only the highlights of the most important changes in the new law. If you would like more details about any aspect of the new legislation, please do not hesitate to call. Thank you for attending our Entrepreneurial Corner. If you have any questions, please contact Michael McDevitt at [mcdevitt@biggskofford.com](mailto:mcdevitt@biggskofford.com) or Greg Gandy [gandy@biggskofford.com](mailto:gandy@biggskofford.com) or feel free to call us at (719) 579-9090.