



## Year End Tax Planning for Businesses

As we approach year-end, it's again time to focus on last-minute moves you can make to save taxes, both on your 2011 return and in future years. Here are a few tax-saving ideas to get you started. Before we get to specific suggestions, however, remember that effective tax planning requires considering both this year and next year, at least. Without a multiyear outlook, you can't be sure moves intended to save taxes on your 2011 return won't cost additional money in the future. As always, we would be happy to discuss these ideas and others with you.

### Deferring Income Until 2012

Deferring income to the next taxable year is a time-honored year end plan. Here are two ways to potentially accomplish this:

- *Use of Cash Method of Accounting:* By using the cash method of accounting instead of the accrual method of accounting, you can generally put yourself in the best position for accelerating deductions and deferring income. There is still time to accomplish this strategy, because an automatic change to the cash method might be able to be made by the due date of the return including extensions. The following three types of businesses can make an automatic change to the cash method: (1) small businesses with average annual gross receipts of \$1 million or less (even those with inventories that are a material income producing factor); (2) certain C corporations with average annual gross receipts of \$5 million or less in which inventories are not a material income producing factor; and (3) certain taxpayers with average annual gross receipts of \$10 million or less. If inventories are not a material income producing factor, sole proprietors, limited liability companies, partnerships and S corporations can change to the cash method of accounting without regard to their average annual gross receipts.
- *Delay Billing:* Cash basis taxpayers might consider delaying year-end billing to clients so that payments are not received until 2012.

### Accelerating Income into 2011

You may benefit from accelerating income into 2011 if you anticipate being in a higher tax bracket in 2012, or perhaps you will need additional taxable income in 2011 in order to take advantage of an offsetting deduction or credit that will not be available to you in future years. If you report income and expenses on a cash basis, issue bills and attempt collection before the end of 2011. Also see if some of your clients or customers are willing to pay for January 2012 goods or services in advance. Any income received using these steps will shift income from 2012 to 2011. Note, however, that accelerating income into 2011 may be disadvantageous if you expect to be in the same or lower tax bracket for 2012.

### Take Advantage of Tax Breaks for Purchasing Equipment, Software, and Certain Real Property.

If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property or to make certain improvements to real property, you might consider doing so before year-end to capitalize on the following generous, but temporary tax breaks:

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- **Bigger Section 179 Deduction.** Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. (However, limits apply to the amount that can be deducted for most vehicles.) For tax years beginning in 2011, the maximum Section 179 deduction is \$500,000 (with a phase-out for purchases in excess of \$2,000,000). For tax years beginning in 2012, however, the maximum deduction is scheduled to drop back to \$139,000.
- **Section 179 Deduction for Real Estate.** Real property costs are generally ineligible for the Section 179 deduction privilege. However, an exception applies to tax years beginning in 2011. Under the exception, your business may be able to immediately deduct up to \$250,000 of qualified costs for restaurant buildings and improvements to interiors of retail and leased nonresidential buildings. The \$250,000 Section 179 allowance for these real estate expenditures is part of the overall \$500,000 allowance. This temporary real estate break will not be available for tax years beginning after 2011 unless Congress extends it.

**Note:** You cannot claim a Section 179 write-off that would create or increase an overall business tax loss.

- **100% First-year Bonus Depreciation.** Above and beyond the Section 179 deduction, your business can also claim first-year bonus depreciation equal to 100% of the cost of most new (not used) equipment and software placed in service by December 31 of this year. (For a new passenger auto or light truck that's used for business and is subject to the luxury auto depreciation limitations, the bonus depreciation break increases the maximum first-year depreciation deduction by \$8,000 for vehicles placed in service this year.) In 2012, the bonus depreciation amount is scheduled to be reduced to 50%.

**Note:** 100% bonus depreciation deductions can create or increase a Net Operating Loss (NOL) for your business's 2011 tax year. You can then carry back a 2011 NOL to 2009 and 2010 and collect a refund of taxes paid in those years.

### Other 2011 Planning Considerations

Here are some other items for your consideration.

- **Bad Debts:** You may be able to accelerate deductions to 2011 by analyzing your business accounts receivable and writing off those receivables that are totally or partially worthless. By identifying specific bad debts, you should be entitled to a deduction.
- **Claim the Health Insurance Tax Credit for Small Employers.** Qualifying small employers can claim a tax credit that can potentially cover up to 35% of the cost of providing health insurance coverage to employees. A qualifying small employer is one that: (1) has no more than 25 Full-time Equivalent (FTE) workers, (2) pays an average FTE wage of less than \$50,000 and (3) has a qualifying healthcare arrangement in place. The allowable credit is quickly reduced under a complicated phase-out rule when the employer has more than 10 FTE employees or an average FTE wage in excess of \$25,000.

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- *Evaluate Inventory for Damaged or Obsolete Items.* Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items.

The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). [This rule does not apply to businesses that use the Last-in, First out (LIFO) method because LIFO does not distinguish between goods that have been written down and those that have not]. To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must be actually offered for sale at the price to which the inventory is reduced.

- *Employ Your Child.* If you are self-employed, don't miss one last opportunity to employ your child before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college or entering soon, having too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.
- *S Corporation Built-In Gains Tax.* An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who are taxed on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate on all gains that were built in at the time of the election if the gains are recognized during a special holding period. The special holding period is shortened to five years for the 2011 tax year.
- *Small Employer Cafeteria Plans.* In tax years beginning after December 31, 2010, certain small employer's cafeteria plans can qualify as simple cafeteria plans, under which the applicable nondiscrimination requirements of a classic cafeteria plan are treated as satisfied.
- *Reasonable Compensation by Corporations:* This is always a focus of IRS when it comes to corporations. For C Corporations, the argument is usually over whether compensation paid to owner/employees is unreasonably high. For S corporations, the argument is usually over whether compensation paid to owner/employees is unreasonably low. Keep this factor in mind when making decisions about year-end compensation for owner/employees.

### Other Items of Interest for Businesses

While not directly impacting year end income tax planning, there are some other items you should be aware of that may impact your 2011 and future tax returns.

- *Uncertain Tax Positions.* A corporation needs to file new Schedule UTP, Uncertain Tax Position Statement, with its 2011 income tax return if it: (1) files Form 1120, Form 1120-F, Form 1120-L, or Form 1120-PC; (2) has assets of at least \$100 million (a threshold amount that will drop



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starting with 2012 tax years); (3) issued (or a related party issued) audited financial statements reporting all or a portion of the corporation's operations for all or a portion of the corporation's tax year; and (4) has one or more "uncertain tax positions" (UTPs). A UTP is a tax position that will result in an adjustment to a line item on a return if the position is not sustained, provided the corporation has taken the position for the current or a prior tax year and the corporation (or a related party) either recorded a reserve for the position or did not record a reserve because it expects to litigate the position.

- *Worker Classification Relief*: The IRS recently announced a voluntary compliance program designed to allow employers to settle potential issues regarding worker classification (employee vs. independent contractor) on potentially favorable terms. While there are certain eligibility requirements to participate, employers operating in industries where worker classification is a constant concern may want to look further into this opportunity.
- *Congressional Super Committee*: This committee, formed as part of the budget and deficit reduction arguments earlier this year, is supposed to issue its recommendations by November 23, and it is anticipated that tax provisions will be a key component of those recommendations.

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