Polsinelli Shughart PC

Tax & Business Planning | e-Alert

November 2010

The Tax and Business Planning group provides these e-Alerts periodically to keep our clients, taxpayers and businesses updated on recently adopted legislation and key changes in tax laws.

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YEAR-END TAX CONSIDERATIONS

In this issue we cover Year End Tax Planning Tips, the recently passed Small Business Jobs, Credit Act of 2010 and the Plain Writing Act of 2010. In addition, anticipated congressional action on tax extenders, estate tax, and other legislation are briefly discussed. We will cover finalized legislation passed before the end of the year or beginning of 2011 in a future e-Alert as it is enacted. Please watch your inbox for further developments. Also, a brief review of the IRS Fast Tract Program is enclosed.

YEAR-END TAX PLANNING

As the 2010 tax year winds down there is still time to reduce this year's tax bill, and plan for the 2011 tax year. Congress now has little time to enact new legislation to change the expiring tax cuts (see Upcoming Legislation discussion below), year-end planning, such as shifting income and deductions between this tax year and the next, may have more impact than ever on maximizing your tax savings. Below are a few year-end tax savings tips. These examples vary with the taxpayer.

Business Year-End Tax Savings Tips:

- The much publicized expiration of tax cuts is not expected to affect corporation income tax rates and there has been little discussion to raise corporate income tax rates, therefore C corporations will usually benefit by deferring income into 2011 and accelerating expenses before year end.

- Businesses should consider making expenditures that qualify for the Section 179 deduction and bonus depreciation. Under recent legislation, for 2010 a business may elect to expense (instead of depreciating over several years) up to $500,000 of equipment costs if the asset was placed in service during the year. Also, businesses may claim a 50 percent bonus depreciation allowance for property placed in service in 2010.

- If you have purchased a car used in your business, the depreciation limit for certain vehicles placed in service before year end has been increased by up to $8,000. It may be possible to combine this incentive with other depreciation and expensing incentives that may allow your business to expense a substantial amount of the vehicle in the first year.

- If your business is an S corporation that was previously a C corporation and you made your S election before 2006, and your business is considering selling appreciated assets, you may consider whether the assets should be sold this year or during next year. S corporations that were formerly C corporations may be subject to a tax on gains that were built-in at the time of the election if assets are sold during the recognition period. A seven year recognition period applies for the 2009 and 2010 tax years, while a five year recognition period will apply for the 2011 tax year. Unless legislative changes are made, the normal ten year recognition period will apply after the 2011 tax year.

Individual Year-End Tax Saving Ideas:

- Unless Congress acts, after the end of the year the tax brackets above the 15 percent will revert to their pre-2001 levels. That means the top four brackets will be 39.6 percent, 36 percent, 31 percent and 28 percent, instead of the current top four brackets of 35 percent, 33 percent, 28 percent and 25 percent. Due to the impending tax rate increases, taxpayers may consider accelerating income into this year and deferring expenses into next year.

- Taxpayers with gains may consider selling appreciated stocks and bonds in 2010 to lock in this year's maximum long-term capital gain rate, which may be lower than next year's maximum capital gain rate. For 2010, long-term capital gains are taxed at a maximum rate of 15 percent. If no legislation is enacted, starting next year, long-term capital gain may be taxed at a maximum rate of 20 percent.

- Individuals who meet certain restrictions may make deductible contributions to an IRA. The annual deductible contribution limit for an IRA for 2010 is $5,000 plus the catch up contributions for individuals age 50 years or older.

- It may be advantageous to try to arrange with your employer to defer a bonus until 2011.

- Consider using a credit card to prepay expenses that can generate (accelerate) deductions into this year.

- You may want to pay contested state or local income or property taxes by year-end in order to deduct them this year while continuing to contest them next year. Also, if you anticipate a state income tax liability for 2010, consider making the payment before the end of 2010. Or, in the alternative, if you expect to have increased taxes next year due to the tax rate increases discussed above or otherwise, you may consider deferring these payments until after the year end.

- You may be able to save taxes by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.

- Self-employed individuals should consider setting up a self-employed retirement plan.

- You can save gift and estate taxes by making gifts sheltered by the annual gift tax exclusion before the end of the year. You can give $13,000 in 2010 to an unlimited number of individuals. This exclusion amount doubles for joint gifts made by a married couple.

- If you own an interest in a partnership or S corporation you may want to increase your basis in the entity so you can deduct a loss from such entity this year.

- Consider giving to a charity to create a charitable deduction in 2010.

- Consider converting a traditional IRA into a Roth IRA. Although the conversions will create a tax liability, future distributions should be tax free. The 2010 tax year is the first in which taxpayers may convert funds in regular IRAs to Roth IRAs regardless of their income level. Also, there is an option that provides taxpayers the choice of paying the tax on the conversion when they file their 2010 returns, or deferring the tax hit on the conversion to the 2011 and 2012 tax years. However, as discussed above, if tax rates increase, it may be better to elect to pay all of the tax with the 2010 tax return. In some cases, it may be possible to wait until April 18, 2011, the due date of the 2010 return, to see whether or not you should elect out or take the deferral. (There are many factors to take into consideration if converting an IRA. Please contact us if you are considering an IRA conversion.)

- If you plan on purchasing certain energy efficient products, such as windows, exterior doors, heating, ventilating units, air conditioning units, water heaters, and other energy efficient property, you may consider purchasing before year end to take advantage of the tax credit of up to $1,500.

These are just some examples of year-end steps that can be taken to save taxes. Please contact us to discuss all of your options and tailor a particular plan that will work best for you.

Small Business Jobs And Credit Act Of 2010

The Small Business Jobs and Credit Act of 2010 (the Act), signed into law on September 27, 2011, contains a number of valuable tax breaks. Two of the Act's biggest incentives are extended and improved rules for depreciation expenses.

Expanded Code Section 179 Expenses

Under Code Section 179, many businesses can instantly depreciate the cost of certain new and used assets in the year they are placed in service. The Act increases the expense allowed to $500,000 (up from $250,000 for tax years beginning in 2009) for qualifying new and used assets that are placed in service in tax years beginning in 2010 and 2011. For tax years beginning in 2012, however, the maximum deduction is scheduled to fall back to only $25,000, unless legislation is enacted providing otherwise.

In addition, for tax years beginning in 2010 and 2011, the new law generally increases the phase out threshold to $2 million (up from $800,000 for tax years beginning in 2009). Unless legislation is enacted, the phase-out threshold will drop to only $200,000 in 2012.

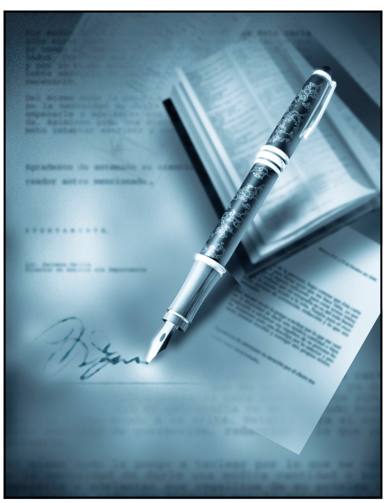
One key feature of the Act is that certain qualified real property improvements placed in service in tax years beginning in 2010 and 2011 are also eligible for the Section 179 deduction. Real property building and improvement costs have never been eligible before. This provision may be especially attractive to lessors of office buildings, restaurant owners, retail building owners, and other owners of qualifying real property. It is important to note that for purposes of applying the $500,000 expensing limitation, not more than $250,000 can be attributable to qualified real property.

Extended 50 Percent Bonus Depreciation

The Act also extended the 50 percent first-year bonus depreciation that had expired at the end of 2009 temporarily until the end of 2010. It is also important to note that a business may be able to combine bonus depreciation with the Section 179 deduction discussed above, resulting in greater tax savings.

Other Incentives

In addition to the depreciation incentives, the Act includes other beneficial tax provisions, including, shortened S corporation disposition time periods (discussed above), removal of cell phones from "listed property", extension to five years for the carryback of general business credits for eligible small businesses, a 100 percent exclusion for capital gain from the sale of qualified small business stock acquired after September 27, 2010 and before January 1, 2011 if the stock is owned longer than five years, increased deduction for start-up expenditures to $10,000 for 2010, and deduction for health insurance of certain business owners allowed in calculating self-employment tax for 2010.



President Signs "Plain Writing Act Of 2010"

In good news for taxpayers, the President signed into law the Plain Writing Act of 2010 on October 13, 2010. The Act requires all federal agencies, including the IRS, to write their rules and notices so that the intended audience (i.e. taxpayers) can clearly understand them. Some critics of the new law have stated that the new requirements may be difficult or impossible to enforce. Time will tell.

Upcoming Legislation

Congress is scheduled to return to Washington on November 15 after the midterm election recess. Congress has a lot on its plate, including expiring tax cuts, alternative minimum tax patch and other tax extenders, carried interest legislation, and estate tax. If nothing is done to the estate tax, the top rate increases to 55 percent with a 5 percent surtax that phases out the lower graduated tax rates with a unified credit amount (exemption) of only $1 million. A recent report by the Congressional Research Service indicated that extending all of the 2001 and 2003 tax cuts, while factoring in indexing of the alternative minimum tax and the cost of debt service, will cost more than $5 trillion over 10 years. This cost and the nuances in the proposed tax legislation are expected to be controversial among the political parties which may delay congressional action until after year-end. We will be following this closely and we will cover finalized legislation passed before the end of the year or beginning of 2011 in a future e-Alert as it is enacted.

IRS Fast Track Settlements

Polsinelli Shughart Phoenix and Kansas City attorneys recently worked together on an innovative IRS mediation procedure. The IRS Fast Track Settlement, a process for prompt resolution of business tax issues, formerly was used only for very large tax cases. Recently, however, the IRS opened the process to smaller business tax issues. Phoenix General Corporate Shareholder Phillip Guttilla teamed with Tax Shareholder Harlan Stamper of Kansas City in representing a client with a sizeable pending IRS tax case. The client had been dealing with the IRS for the past four years with no resolution in sight. Stamper heard from the IRS that it was opening its Fast Track Settlement process to smaller business tax issues, so together with Guttilla he counseled the client on the advantages of Fast Track, which include:

- Quicker resolution of audit issues (120 days or less)
- No need for a formal protest to request Fast Track
- Withdraw from the process at any time
- Retention of all traditional appeal rights

"If resolution can be reached through this modified mediation process, the taxpayer saves time, anxiety and money and the government saves human resources and collects the negotiated amount much sooner than it would if the case went through the normal dispute resolution process," said Stamper. The IRS estimates that Fast Track reduces the appeals process time by at least two years. All parties sign a Fast Track Settlement Session Report acknowledging a basis of settlement, and an appropriate settlement document is drafted to reflect the agreed upon treatment of the issue.

If you have a current or future tax controversy with the IRS, you may want to consider contacting us for more information on the Fast Track program.

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