



2007

Small Business

advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS

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# Planning Ahead With Year-End Tax Strategies

**T**he end of the year is traditionally a time to celebrate the holidays, and your 2007 taxes may be the furthest thing from your mind. However, with a few exceptions, it is your last opportunity to alter the results of your 2007 taxes. The following are some of the many possible strategies that can be employed before the year's end that can help you achieve tax savings for 2007.

**State Estimated Tax Payments** – Although the deadline to make the 4th quarter 2007 state estimated tax payment is January 15, 2008 for most states, the payment will count as a tax deduction on the federal Schedule A for 2007 if that payment is made before the end of December 2007.

**Property Taxes** – Generally, your property taxes are billed in installments, and that's how most people pay them. However, the tax can be paid all at once, if it provides a greater tax benefit for the current year.

**Caution:** The preceding two strategies do not benefit taxpayers who are subject to the alternative minimum tax (AMT), since taxes are not deductible to the extent a taxpayer is subject to the AMT. Taxpayers subject to the AMT might, instead, consider deferring deductible tax payments to the subsequent year.

**Required Minimum Distributions (RMD)** – If you are 70½ or older, make sure that the minimum

distribution amount is withdrawn from your IRA or other qualified plans to avoid the 50% penalty for underwithdrawals.

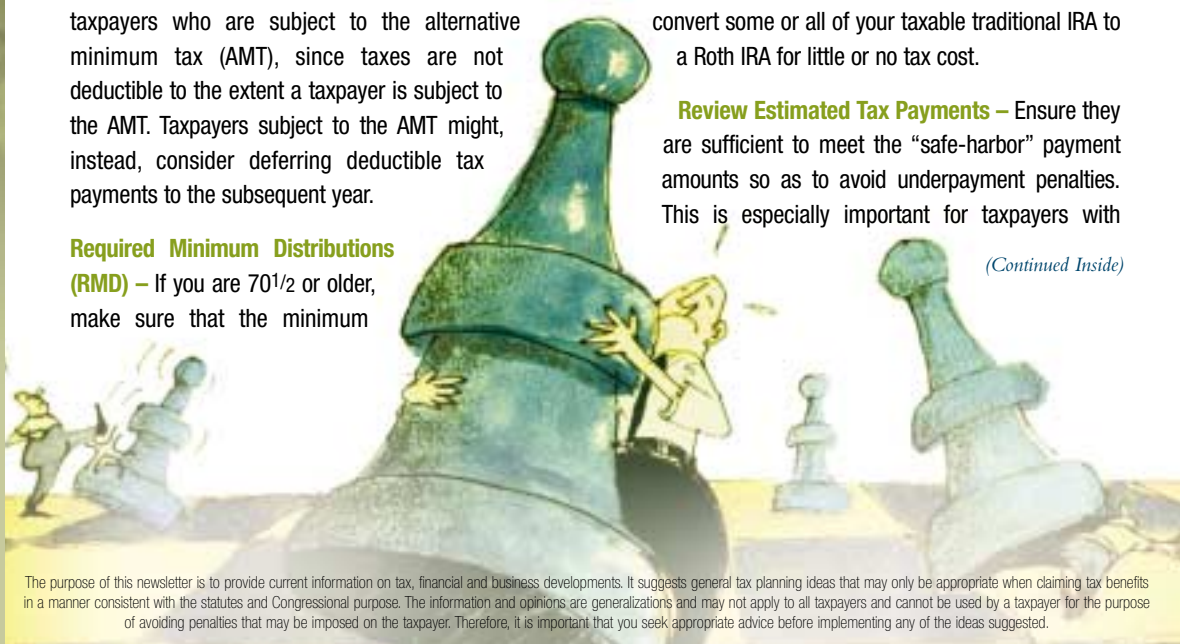
**IRA Withdrawals** – If you are retired and taking IRA distributions, make sure that you maximize your withdrawal with respect to your tax bracket. It may be tax-effective to actually withdraw more than is needed. If you receive Social Security benefits, IRA distributions can sometimes be planned to minimize the taxability of the Social Security income.

**Bunch Deductions** – If you are marginally able to itemize each year, it may be appropriate to “bunch” deductions in one year and then claim the standard deduction in the alternate year. This technique frequently can be applied to tax payments, charitable contributions, some medical expenses and to certain business expenses.

**Roth IRA Conversions** – If your taxable income is low or a negative amount for the year, it may be appropriate to convert some or all of your taxable traditional IRA to a Roth IRA for little or no tax cost.

**Review Estimated Tax Payments** – Ensure they are sufficient to meet the “safe-harbor” payment amounts so as to avoid underpayment penalties. This is especially important for taxpayers with

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# Maximize Your Tax Benefits By Timing

# Business Asset Acquisitions

Small to medium-sized businesses can significantly alter their profits for the year by timing asset acquisitions and taking advantage of depreciation and liberal expensing provisions. Understanding these provisions will help you plan your acquisitions so as to maximize the tax benefits and reduce your taxes.

One important goal is to preserve your deductions for years when your taxable income is high. Don't jump the gun and take a big write-off in a low taxable income year. The tax code now allows taxpayers to expense, rather than depreciate, significant capital purchases, and it is tempting to save tax dollars immediately rather than consider the long-range effects of that decision. Therefore, we urge you to plan your purchases carefully.

**Equipment Depreciation** – Generally, tangible business assets must be written off (depreciated) over a period of years. The tax code includes specific recovery periods (number of write-off years) for different types of business assets. For most businesses, these recovery periods fall into three categories: 3-year, 5-year and 7-year life properties. The following are examples of each:

- **3-Year Property** – This category includes tractor units for over-the-road use, race horses over two years old when placed in service and other horses over twelve years old when placed in service.
- **5-Year Property** – Examples in this category include computers, typewriters, copiers, duplicating equipment, heavy trucks, trailers, cargo containers, autos, light-duty trucks and certain technological and research equipment.
- **7-Year Property** – Includes office furnishings, fixtures and equipment.

Generally, the above-type assets are depreciated under the "half-year convention," which means the depreciation deduction for the first year is one-half of a year's depreciation. The accelerated Declining Balance (200% DB) method, which frontloads the deduction, is typically used. To spread the deduction more evenly, a different depreciation method can be selected. The table below illustrates the annual deduction for 3-, 5- and 7-year properties using the 200% DB method and the straight-line method (SL), which applies the deduction evenly over the depreciable life of the asset.

**Half-Year Exception** – *If the total basis of personal property placed in service during the last three months of a tax year exceeds 40% of the total basis of personal property placed in service during the entire year, then a mid-quarter convention must be used instead of the half-year convention for all personal property placed in service during the tax year. The mid-quarter convention tables are too extensive to reproduce in this article.*

Depreciation (% of Asset Cost) – Half-Year Convention						
Year	3-Yr Property		5-Yr Property		7-Yr Property	
	200% DB	SL	200% DB	SL	200% DB	SL
1	33.33	16.67	20.00	10.00	14.29	7.14
2	44.45	33.33	32.00	20.00	24.49	14.29
3	14.81	33.33	19.20	20.00	17.49	14.29
4	7.41	16.67	11.52	20.00	12.49	14.28
5			11.52	20.00	8.93	14.29
6			5.76	10.00	8.92	14.28
7					8.93	14.29
8					4.46	7.14

As you can see, the second year, rather than the first year, provides the largest write-off for assets being depreciated with the 200% DB method and mid-year

convention. Thus, if you expect to buy property in 2008, consider accelerating the purchase into 2007 if you wish to maximize the regular depreciation deduction in 2008.

**Asset Expense Election (Sec. 179 Deduction)** – Generally, if you purchase depreciable tangible personal property (including off-the-shelf computer software) in 2007, you may choose, using the Sec. 179 election, to treat up to \$125,000 as a deduction for property placed in service in the taxable year. However, the benefits of this election begin to phase out if more than \$500,000 of qualifying property is placed in service. (The maximum amount that can be expensed [\$125,000] is reduced "dollar for dollar" for eligible property placed in service in excess of \$500,000.) The \$125,000 amount is increased to \$160,000 for qualifying property placed in service by a qualifying "enterprise zone business." This election is allowed only in the first year that the property is placed in service and is generally limited to the taxable income from the trade or business. However, if more than can be claimed is taken in the first year, the excess can be carried over to subsequent years, providing a way to benefit from this deduction in more than one year.

If you are thinking of applying the Sec. 179 expense deduction to a business vehicle, you should be aware that vehicles with a gross unladen weight of 6,000 pounds or less are limited to a first-year depreciation deduction of \$3,060 (\$3,260 for light trucks) in 2007; those weighing more than 6,000 and not exceeding 14,000 pounds (typically SUVs) are limited to a Sec. 179 expense of \$25,000.

**AMT Depreciation** – The alternative minimum tax (AMT) is imposed on corporations and individuals and is added to the regular tax if, and to the extent that, the tentative AMT exceeds the regular tax. AMT is based on alternative minimum taxable income (AMTI), which consists of a taxpayer's regular taxable income increased by various adjustments for certain tax preferences and items of deferral, such as depreciation. "Small" corporations with average gross receipts of less than \$7.5 million for the prior three taxable years (less than \$5 million if the corporation had only one prior year) are exempt from the AMT. For purposes of depreciation, the AMT adjustment is the difference between the 200% and 150% declining balance methods of depreciation. Thus, taxpayers who elect to use the 150% or straight-line methods will not have an AMT depreciation adjustment. Planning Tip: There is no AMT adjustment for a deduction of payments for leased property or the Sec. 179 expense deduction.

**Leasehold Improvements** – Generally, any leasehold improvements made during 2007 are deducted over a 15-year period.

**Real Property** – The depreciation deduction is stretched out over 27.5 years for residential rental property and 39 years for nonresidential property, both using straight-line methods and mid-month conventions. Real property is ineligible for the Sec. 179 deduction. Thus, in terms of depreciation method and recovery period, there are generally no planning opportunities for real estate property depreciations.

If you are in the market to purchase equipment in the near future, let us help you maximize the tax benefits.

# Say Hello and Say Goodbye

**W**ith Congress changing tax laws faster than a speeding bullet, it is sometimes difficult for taxpayers to keep up. In recent years, Congress has made a number of changes at the last minute, so there is a chance that some of these provisions might be extended or modified after this newsletter has been printed. Here is a brief overview (not all the details and limitations are included) of some of the extended and future business tax provisions:

**Section 179 Expense Deduction Increases Extended and Enhanced** – For 2007, the amount that a taxpayer can deduct annually as a Sec. 179 expense (instead of depreciating) was increased to \$125,000, and the phase-out threshold amount was upped to \$500,000. Both values will be inflation-adjusted beginning in 2008. After 2010, the maximum deduction will revert back to \$25,000. Extended through 2010 is the provision treating off-the-shelf computer software as eligible Sec. 179 property.

**Spouses May Elect Out of Partnership Rules** – Effective for 2007 and later tax years, a husband and wife operating a business together who file a joint return may elect out of the partnership rules. Thus, a joint venture between them is not treated as a partnership for tax purposes. Instead, all items of income, gain, loss, deduction and credit are divided between the spouses according to their respective interests in the venture, and each spouse takes into account his or her respective share of these items as if they were attributable to a trade or business conducted by the spouse as a sole proprietor. Thus, each electing spouse will report his or her shares on the appropriate form, such as Schedule C.

**Domestic Production Deduction** – For 2007 through 2009, the deduction percentage has been increased to 6% (from 3% in 2006 and 2005). Then, in 2010 and future years, the percentage will increase to 9%. The deduction is essentially equal to the lesser of the applicable percentage multiplied by the net income from eligible production activities or 50% of the W-2 wages paid to employees during the year properly allocated to the qualified production activity.

**Work Opportunity Tax Credit Extended and Expanded** – The elective work opportunity tax credit (WOTC) provides a tax credit of as much as \$2,400 per eligible employee hired from one or more of nine targeted groups (higher for certain veterans and special categories). The credit will now offset the alternative minimum tax (AMT) and has been extended by 44 months to August 31, 2011. The requirements were eased for “high-risk youths,” and the provisions for hiring certain veterans were enhanced. If you have questions regarding this credit, please give us a call.

**Research and Development Credit** – The research and development credit (R&D), which expired at the end of 2005, was reinstated retroactively for 2006 and extended through 2007. In addition, for tax years ending after 2006, the new law enhances the credit by increasing the rates of the alternative incremental credit and creates an alternative simplified credit that does not use gross receipts as a factor, thus allowing newer businesses to qualify for the credit.

**Last Year for Sales Tax Deduction** – Even though 2007 is the last year that taxpayers who itemize their deductions on their individual returns will be allowed to deduct the greater of the state income tax or state and local general sales tax, sales tax incurred as a business expense will continue to be deductible as part of the expense of the purchased item or capitalized as part of the item's cost, as applicable.

If you have any questions regarding these tax issues and how they may impact your unique tax situation, please give us a call.

*(Planning Ahead With Year-End Tax Strategies Continued...)*

windfall income from bonuses, property sales, etc. Employed taxpayers can also increase their withholding for the balance of the year. This is especially helpful in terms of avoiding penalties, since the withholding is treated as if it were received evenly throughout the year.

**Profits From Stock Sales** – If you have net profits from the sale of stocks or other capital assets during the year, consider selling holdings that will generate losses to offset those gains and even produce a loss up to \$3,000 in excess of the gains.

**Education Credits** – If you qualify for one of the higher education tax credits and have not paid enough tuition during the year to achieve the maximum credit, the law allows you to prepay tuition for an academic period beginning within the first three months of the next year, and claim the tuition for the current year's credit.

**Business Deductions** – Before the year's end, business owners can purchase and place into service equipment needed for the business, and utilize the Section 179 expense allowance to write-off the entire cost of the equipment in 2007. There are some limitations. If you are short of cash, the deductible purchase can be made on credit.

**Energy Credits** – If you are thinking “green,” you might consider making some credit-eligible, energy-saving improvements to your home. This is especially important, since most credits, except for solar and fuel cell, expire at the end of 2007. A substantial tax credit is still available for certified hybrid vehicles, excluding Toyota and Lexus vehicles (Toyota and Lexus credits expired for purchases after 9/30/07). Purchases must be made before the year's end.

**Defer Income** – It might be appropriate to make arrangements with your employer to defer a bonus until early 2008.

**Charitable Contributions** – If you have been planning to contribute used clothing and household goods to a charity, doing so before the year's end can increase your itemized deductions. But keep in mind that under the stringent new rules, the items must generally be in good or better condition, and your contribution will need to be substantiated. Used vehicle contributions are still allowed, but the deduction is generally limited to the amount that the charity receives from the sale of the vehicle.

**IRA to Charity Distributions** – 2007 is the final year for taxpayers age 70½ and older to transfer funds from their IRA accounts to charities. The transfer counts toward the year's required minimum distribution but is not counted as either income or a charitable contribution. This is an opportunity for those who do not itemize to effectively benefit from contributions that they would be unable to deduct. At the same time, it reduces the AGI, the amount on which certain deduction limitations are based. A lower AGI may also reduce the amount of Social Security income that is taxed.

If you would like to discuss other possible strategies or how any of the ones listed above applies to you, please call this office.



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**QUESTION:** I recently replaced the computer system for my unincorporated business office and plan to donate the old system to charity. How do I determine what my charitable deduction is?

**ANSWER:** You may or may not have a deduction. Assuming your use of the computer was all business, you would have been writing off the cost of the computer by depreciating it or expensing it under the special Sec. 179 expense allowance. Keep in mind that a taxpayer can't deduct something twice. Thus, if it was already written off for business, then there are no further deductions available for the cost of the computer. If it has not been completely written off, then a taxpayer can scrap it and take the remaining value as a loss from the disposition of a business asset on his or her tax return but not as a charitable contribution. (Note: Charitable contributions are not allowed on a sole proprietor's Schedule C and must be deducted as itemized deductions.)

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## Tax Calendar

November 2007 – April 2008

### November - December 2007:

Time for 2007 year-end and 2008 tax planning! This is highly recommended if you have substantial increases in income or fewer deductions than last year. Please call for an appointment.

### December 31, 2007:

- Last day to pay deductible expenses for the 2007 return. This doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after December 31, 2007.
- Last day to make the minimum required withdrawal of funds from a traditional IRA account in order to avoid a penalty if you turned age 70½ before 2007.
- Last day to set up a Keogh retirement account if you plan to make a 2007 contribution.

### January 15, 2008:

The fourth quarter 2007 federal estimated tax payment is due unless the 2007 return is filed by January 31, 2008. **Caution:** Some states may have different filing dates for state estimated payments.

### January 31, 2008:

Deadline for providing 1099s and W-2s to those people you paid during 2007. 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 need to provide 1099s for

those workers by January 31, 2008. "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 February 29, 2008. Our firm can prepare these documents for you.

### February 29, 2008:

Deadline for filing (sending) 1099s and W-2s to the government.

### April 1, 2008:

Last day to withdraw funds from your traditional IRA if you turned age 70½ in 2007 and haven't taken your 2007 distribution yet. In addition, this is the last day to withdraw funds from a SEP or Keogh plan for individuals who are retired and turned age 70½ in 2007. Failure to take the required distributions can result in substantial penalties.

### April 15, 2008:

- Deadline for individuals to file a 2007 federal return or request an extension of time to file.
- The first installment of the 2008 federal estimated tax payment is due.
- The first installment of the 2008 defined benefit pension plan contributions is due.