

Tax Law Changes Require Additional Planning Strategies

Be prepared to implement changes to get the best tax advantages.

by Jed P. Dallek

There's nothing more fulfilling than nurturing a business to success. But success doesn't come overnight, and it's never simple. You must be in tune not only with the technological, economic, and marketplace changes, but also with the nuances of tax law changes. Here are just a few planning strategies you should consider utilizing in 2007.

Evaluate business structure: Businesses may operate under a variety of structures, ranging from sole proprietorship to C Corporation. Income taxation and owner liability are the main factors that differentiate one from another. Many new businesses lean toward the flow-through taxation of a sole proprietorship, partnership, Limited Liability Company or S Corporation. The C Corporation has lost some of its luster because the maximum federal tax rates are equal to the tax rates for individuals.

Defer income and accelerate deductions: In potentially high-income years, consider deferring some income to later years. A simple example of a deduction that you can accelerate or defer is your state tax deduction for a cash-basis taxpayer. If you make an estimated state tax payment before December 31, you can deduct it in that year. Otherwise, you can wait until the due date of the return and it will be deductible the following year. However, you must watch out for the alternative minimum tax.

Expense when you can: Generally, equipment with a useful life well beyond the taxable year must be capitalized. An exception is the Section 179 expensing election. It allows a current deduction for assets that otherwise would be subject to normal deduction rules. The maximum Section 179 deduction for 2006 is \$108,000, and it will be indexed for inflation from 2007 through 2009. With the current rules in place, and the deduction set to decrease in 2009, it may be appropriate to schedule major capital asset purchases in the next few years when the greatest tax benefits may be available.

Maximize depreciation with a cost segregation study: If you have recently purchased or built a building, or are remodeling existing space, make sure you

maximize your depreciation deductions. Although real property generally must be depreciated over 27.5 or 39 years using the straight-line method, certain parts of the “building” can qualify for a shorter depreciable life. Certain methods that you can utilize may be able to dramatically increase your current deductions.

Take other depreciation rules into account: Careful planning during the year can help you maximize depreciation deductions in the year of purchase. You generally will want to use the Modified Accelerated Cost Recovery System, also known as MACRS, instead of the straight-line method, in order to get a larger deduction in the early years of an asset’s life.

Claim all business losses: Generally, a net operating loss may be carried back two years to obtain a current tax refund, which can provide a cash infusion in times of loss. Any loss not absorbed in the prior two-year period is then carried forward for up to 20 years. If you prefer, you may choose to waive the carryback and carry the entire loss forward, which may be beneficial if your marginal tax rate in the carryback years is unusually low, or if the alternative minimum tax in prior years makes the carryback less beneficial.

Write off bad debts: Bad business debts are treated as ordinary losses. They can be deducted when they become either partially or wholly worthless. For individuals and certain other entities, the IRS may consider loans made to closely held corporations as non-business related and, if not repaid, reclassify them as non-business bad debts (wholly worthless), which are treated as short-term capital losses.

Manage your inventory for tax savings: You must calculate the dollar amount of inventory you have on hand at year’s end. If your ending inventory value is low and the cost of merchandise sold is higher, your taxable income will be lower. The inventory method you choose can significantly affect your taxable income.

Maximize tax credits: Tax credits reduce your business’s tax liability dollar-for-dollar. Credits that may be available include Empowerment Zone, Research, Work Opportunity, and Welfare-to-Work.

Follow the rules for nonqualified deferred compensation: Nonqualified deferred compensation arrangements are promises to pay executives and key employees sometime in the future for services currently performed. The plans are often geared to the individual and are based on his or her performance or on the company’s performance. Under the Pension Protection Act of 2006, employers with underfunded or terminated single-employer pension plans cannot fund nonqualified deferred compensation plans.

Look into qualified deferred compensation plans: To attract and retain the best employees and manage your tax liability, qualified deferred compensation plans can be useful. They include pension, profit-sharing, and 401(k) plans, as well as

Savings Incentive Match Plans for Employees, known as SIMPLEs, Simplified Employee Pensions, 403(b)s, and 457s. You can enjoy a tax deduction for your contributions to employees' accounts under the plan, and they offer tax-deferred savings benefits for employees.

Provide fringe benefits: Fringe benefits are a crucial part of any compensation package. Some fringe benefits aren't included in employee income. With these benefits, both the employer and the employee come out ahead: The employer receives a deduction, but the value of the benefit is tax free to the employee. Plus, the business usually avoids payroll taxes on these amounts. Examples of benefits treated in this manner include group-term life insurance up to \$50,000, health insurance, and employee discounts. Other types of fringe benefit offerings – subject to various rules and limitations – range from Flexible Spending Accounts to athletic facilities or on-site day care.

Develop a comprehensive succession plan: All business owners should create a strategy to sell their companies or pass them on to their children or other family members. Insurance, maximizing valuation discounts, developing a buy-sell agreement, and determining whether an employee stock ownership plan, known as an ESOP, could work for you are all important factors in developing a successful succession plan.

No matter what challenges come your way in 2007, putting in place creative tax and business strategies can help you maximize your potential deduction and make your business more successful.

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