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CLIENT'S tax & financial UPDATE

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A tax, business, and financial planning newsletter for our clients and friends

Last-Minute Year-End Tax Savers

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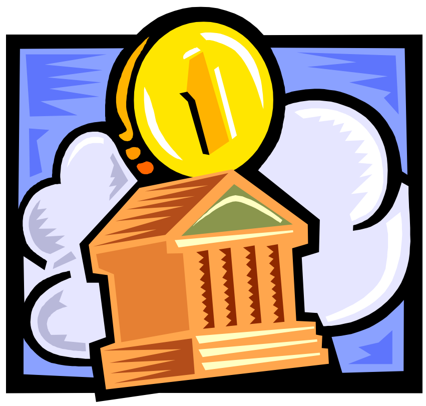
Last-Minute Year-End Tax Savers

You can use these ideas right through December 31 to cut your 2010 tax bill. *But if you wait until after that date, it will be too late…*



Personal costs

- **Deductible expenses**. Be sure to pay by year-end all of the year's expenses for which deductions are allowed on a personal return. ***Examples:*** Medical expenses – to the extent that they exceed 7.5% of adjusted gross income (AGI) – mortgage interest, alimony, investment fees, contributions, subscriptions to financial publications, and tax advisory fees.
- **Dependency exemptions.** Protect dependency exemptions (for other than qualified children) by being sure that you pay more than half the support of any person you intend to claim as a dependent. A year-end support payment may be needed to get you over the limit.
- **College savings.** Some states allow state income tax deductions for contributions to Section 529 college savings plans. If your state does, and you're planning to send a child to college, consider making one.
- **Adoptions.** An adoption tax credit of up to $13,170 is allowed for expenses of adopting a child. The credit reduces your 2010 tax bill dollar for dollar. So, if you're adopting a child, make sure qualifying expenses are paid by year-end to get the credit.

Prepaid expenses

- **Tuition and education costs** incurred for higher education for an academic period starting in the first quarter of 2011 can qualify for a tuition deduction, American Opportunity Credit, or Lifetime Learning Credit on the 2010 tax return, if paid by year-end.
- **Mortgage interest** owed in January 2011 is deductible this year if paid in December.
- **State and local income tax and property tax payments** due in 2011 (such as an estimated payment due on January 15) are deductible on the federal 2010 return if prepaid

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taxPOINTS

Carefully record, and continually update, your tax basis in your home. Many people mistakenly assume that they won't owe any tax when they sell their home due to the apparently generous provision for tax-free gain on home sales allowed by the Tax Code. So, they don't do any tax planning for their homes at all.

Rule: Up to $500,000 of gain can be taken tax free by joint return filers, or $250,000 by single filers, when the home was owned and used as a primary residence for two of the prior five years.

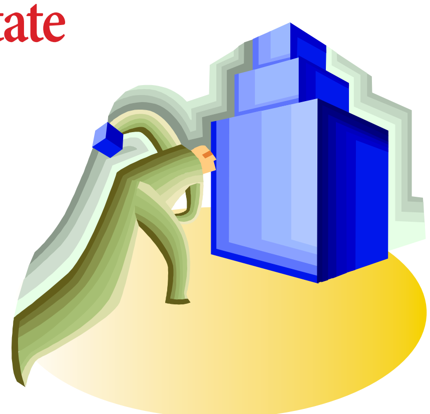
What to do: Record the cost of all improvements you make to your home because they can be added to its purchase price to increase your tax basis in it. (Basis is subtracted from sale price to determine gain on a sale.) These may range from big-ticket items, such as landscaping, room additions, and kitchen remodeling to small expenditures, such as upgrades of light fixtures, faucets and switches.

Avoid tax on more than $500,000 (or $250,000) of gain. If you're ready to sell and your home has appreciated in value beyond the tax-free threshold, you still can effectively sell it tax free by donating it to a charitable remainder trust (CRT).

How: You donate your home to a CRT that then sells it tax free and invests the proceeds to pay income to you for life. When you die, remaining funds from the sale held in the CRT pass to charity. You get a charitable contribution deduction today for the present value of that future gift.

Danger: If you donate your entire house to a CRT, you lose control of the principal. You can only get the periodic payments from a CRT – nothing more, even in an emergency.

The Three Basic Rules of Renting Commercial Real Estate



If your company is looking for commercial real estate to rent, there are many attractive opportunities all over the country. Rents have dropped dramatically, and space is readily available because of massive over-building and an economy that's struggling to recover from recession. However, there are so many good deals around that businesses can easily lose sight of what's really best for them. By following three basic rules, you can avoid mistakes that can be very costly over the long run.

Rule One: Look At The Big Picture

Don't sacrifice your company's needs merely for the sake of low rent. There's plenty of commercial space available, but if you make compromises about location or how much space you need, a bargain rent could turn out to be an expensive mistake.

Suppose, for example, that you can rent the same amount of space on one floor or on two floors and that the rent for the two-floor space is slightly lower. Is it truly cost-effective to choose the cheaper space? Have you considered how much it will cost to install your computer system so it will serve two floors? Or how much your work flow will suffer because of the inefficiency of two floors?

Rule Two: Negotiate. Negotiate. Negotiate.

In today's real estate slump, there is nothing that's not negotiable. Pay particular attention to negotiating for improvements. If you need additional lighting, a bigger electrical service, a fresh coat of paint, or additional building maintenance services, remember that landlords know what vacant space costs them.

Look for a rent abatement, too. In some parts of the country, you can get a free year's rent (sometimes even more) if you agree to a five-year lease.

Rule Three: Look For A Long-Term Bargain

Locking in a fixed rent for more than five years is usually difficult, but a landlord might be receptive to a five-year lease with an option to renew at the same rent for another five years. Even if you have to pay a slightly higher rent for the first five years, a fixed rent five-year option to renew protects your company against real estate market movements in any direction.

If rents begin to go up after five years, you can exercise your option to renew, and you've got a bargain for another five years. And if rents slide even lower, you can look at other properties after the first five years.

It's usually smart to seek expert help when you reach the negotiating stage. Don't rely on the advice of the broker who brought the property to your attention. Remember that the broker represents the landlord and that the broker's commission may be influenced by the nature of the rental agreement.

Why Pass-Through Entities Face Much Lower Audit Risk

Organizing a business as a pass-through entity (S corporation, partnership, or limited liability company taxed as a partnership) rather than a proprietorship can lower its audit risk in two ways.

First, pass-through entities have a much lower audit rate than a proprietorship in general.

In addition, some reporting items that can act as audit red flags on a proprietorship's Schedule C do not exist in a pass-through entity's tax filings.

Example: The home-office deduction is considered by many to be an audit red flag on an individual's tax return. It is claimed by attaching IRS Form 8829 to the Schedule C – thus "announcing" the deduction to the IRS and breaking out its component elements (the size of the office relative to the size of the home, amounts deducted for utilities and maintenance, etc.).

Contrast: If the same business is organized as a one-owner S corporation, the owner can have the same office and deduct the same costs – but won't deduct them directly on his/her personal return, and won't file Form 8829.

Instead, because he is an employee of the corporation, he will obtain reimbursement for his office expenses from the corporation. When the documentation requirements of an "accountable plan" are met, the reimbursement is tax free to the owner and deductible by the corporation.

Advantages: The reimbursement cost reduces the corporation's income (or increases its loss) – and, since its income is taxed to its owner, this reduction "passes through" to him and effectively provides the deduction on his personal return indirectly.

Meanwhile, no specific "home-office deduction" is claimed anywhere – so the audit red flag does not exist.

Tax Tips

Throw a holiday party

The normal 50% of cost deduction limit for meals and entertainment does not apply to events where all employees generally can attend, not just those who are highly compensated. The cost of such events, which can be good for employee morale, is fully deductible.

Hire family members for the holiday season

Children home from college and other family members who are in low tax brackets can receive wages that are deducted at the business's high tax rate and taxed at the family members' own lower tax rates. The "kiddie tax" that applies parental tax rates to a child's investment income does not apply to earned income.

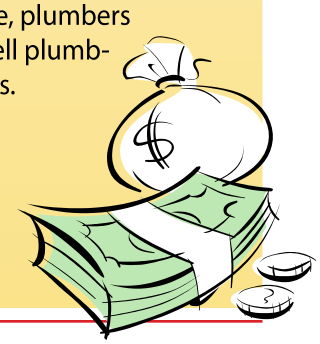
Save taxes by using the cash method of accounting.

How it works: Under the accrual method, businesses report income when they have a right to receive payment and deduct expenses when they become liable for them. Under the cash method, businesses report income and deduct expenses for monies actually received and paid. Businesses that have money owed to them do not have to pay tax on money they have not yet received.

Generally, companies with inventory must use the accrual basis, unless they meet certain small-business exemptions. A small business (one with less than $1 million in average sales) can use cash basis accounting even if it has inventory.

Note: C corporations with average sales of more than $5 million must use the accrual basis.

Service businesses that have no inventory and are not C corporations can use the cash method. This method is especially helpful to service businesses selling related products, for example, plumbers who also sell plumbing supplies.



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Last-Minute Year-End Tax Savers

in 2010, and if state law allows you to prepay such taxes. Note: Don't prepay if you're subject to the alternative minimum tax.

Charity

- **Last-minute donations** are deductible as long as they are made by year-end. Be sure to have proper documentation of any donation.

Retirement plans

- **401(k) plans.** Although you contribute during the year to your 401(k), some plans allow extra year-end contributions if you haven't contributed the maximum permitted. Consult your plan administrator.
- **Annual minimum distributions.** Take any annual minimum distribution you are required to receive from your IRA, Keogh, or other retirement savings plan. If you are age 70 ½ or older, you are subject to such distributions – and failure to take them by year-end results in a 50% penalty.
- **IRAs.** Convert a traditional IRA to a Roth IRA to obtain future tax-free investment returns from the Roth IRA while escaping minimum annual distribution requirements. (You can reconsider and reverse the conversion as late as October 15, 2011. You may reverse a conversion only once in a single year.)

Investments

- **Capital losses.** Take capital losses to end up with a $3,000 net loss for the year. A loss of up to that much is deductible against ordinary income.
- **Worthless securities.** Sell near-worthless securities and investments by year-end to get a capital loss in 2010 for their loss in value.

Small business

- **Business cars.** Depreciation deductions are sharply limited on autos, so business autos usually have a depreciated basis (purchase cost minus depreciation deductions) that's higher than their market value. When such an auto is sold for market value, this difference is a deductible loss. Don't trade such a vehicle in toward the cost of a new one, or no loss deduction will be currently allowed – it will be deferred until the replacement auto is sold.
- **Bills.** Pay all outstanding bills if the business uses cash-basis accounting to nail down deductions for this year.
- **Depreciation.** Abandon unneeded equipment that is not fully depreciated to deduct the firm's cost basis in them. Don't merely write these items off on the books – they must be physically disposed of (or donated to a qualifying charity) by year-end.
- **Holiday help.** Hire children and family members to work for the business during the holidays. Their salaries will be deducted at the business's high rate and taxed at their lower rate – and may be used by them to fund tax-favored IRAs.

Personal write-offs

- **Gifts.** Make gifts to younger family members using the $13,000 per recipient annual gift tax exclusion. While a gift on December 31 won't save income tax in 2010, it can save it from the very start of 2011 if it shifts income earned on the gift amount into a lower tax bracket. The gift may also reduce future estate tax. But, if it's not made by year-end, 2010's tax-free gift amount will be lost.
- **Credit cards.** Remember, use credit cards to make last-minute deductible expenditures if you lack cash to pay them. Charges made on a general-use card (not a store card) are deductible when made, even if paid off in a later year.

Security Tips

Office computer protection
The most effective way to prevent the theft of office computers and computer components is to lock them to their furniture, which is usually too large and too heavy to be moved. Cable locks that connect components to each other and to desks are often enough to foil casual thieves.

The best protection, however, is full-sized metal baseplates that can be attached between computer components and desks. Although they are more costly than cable locks, they provide the highest degree of security. In fact, some manufacturers of these devices will pay users of their security systems for any loss from theft.

Spotting fake checks
The first two digits of the account number printed at the bottom left of a check are the Federal Reserve Bank code for the state in which the issuing bank is located. Professional forgers know this and often print checks with an incorrect location code to delay the processing of a check.

For example, if a criminal prints phony checks for a Massachusetts bank and uses the bank location code for Oregon, it will take extra time for the check to reach the bank. The check forger uses this time to move on to another city. Lists of location codes are available from any Federal Reserve Bank.