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Tax & Business letter

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Year-end tax reminders

The clock is ticking on tax moves you might benefit from if you act before December 31. Here are some year-end reminders.

- If you don't itemize your deductions, you may still deduct 2009 property taxes you pay, up to a \$500 limit for singles and \$1,000 for couples.
- Max out contributions to retirement plans. You can put away \$16,500 in a 401(k) plan (\$22,000 if you're 50 or older), \$11,500 in a SIMPLE (\$14,000 for 50 and older), or \$5,000 in an IRA (\$6,000 for 50 and older).
- Need a new vehicle? Buy before year-end to take a deduction for sales taxes on up to \$49,500 of the purchase price. Income limits apply.
- Consider buying equipment for your business to utilize the \$250,000 first-year expensing option and 50% bonus depreciation.
- Get your investment records in order so you can make wise year-end sell decisions, either to rebalance your portfolio at the lowest tax cost or to offset gains and losses.
- Contact us for a year-end review of tax-cutting options suited to your specific situation. ♦



New rules open Roth IRA conversions to everyone

Beginning in 2010, the rules governing Roth IRA conversions will undergo a significant change.

Traditional IRA to Roth IRA conversions will be available to everyone, creating a financial planning opportunity that didn't exist previously. Under the 2009 rules, taxpayers with income of more than \$100,000 cannot convert a traditional IRA to a Roth IRA. Tax legislation enacted in 2006 changed the rules and ends the \$100,000 income limit, effective January 1, 2010.

The Roth IRA has been a popular investment vehicle, with its ability to give taxpayers tax-free distributions once the account has been in existence for five years and the taxpayer has reached age 59½. Another Roth benefit is the lack of required minimum distributions once the owner reaches age 70½.

The conversion to a Roth does have a cost. When you convert a traditional deductible IRA to a Roth, you must

include the entire amount converted in your taxable income.

If you do a conversion in 2010, you are allowed to report half of the income on your 2011 tax return and the remaining half on your 2012 tax return. You can also choose to pay the taxes due on the conversion on your 2010 return.

While prepaying seems counterintuitive, remember that present federal tax rates are set to expire December 31, 2010. Postponing income into future years could mean a bigger tax bill.

The new conversion rules are particularly advantageous to those upper-income taxpayers who could never participate in a Roth. Now taxpayers in high tax brackets will have access to Roth IRAs. One possible strategy is to set up a traditional IRA with non-deductible contributions in 2009 and then convert it to a Roth in 2010.

It's important to weigh the pros and cons of a conversion in your individual situation. Please give us a call if you would like to discuss the best strategy for you. ♦



No change in wage base

According to the Social Security Administration, the taxable wage base for 2010 will remain at the 2009 level of \$106,800. This will be the first year with no inflation adjustment to the taxable wage base since 1975.

New use for tax refunds

Starting next year, taxpayers can check a box on their tax returns to buy Series I savings bonds with their tax refund. Bonds can be purchased in the taxpayer's name in 2010; co-owners can be added to bond purchases starting in 2011.

IRA reminders

- If you are required to take annual distributions from your retirement plan, remember that these required minimum distributions (RMDs) were suspended for 2009.
- If you're 70½ or older, you can make a 2009 donation of up to \$100,000 directly from your IRA to a charity without treating the donation as a taxable IRA distribution.
- Beginning in 2010, employer qualified plans must permit rollovers to IRAs for nonspouse beneficiaries. Previously, employers could decide whether or not to allow nonspouses to transfer inherited 401(k) balances to IRAs.

Employment audits to begin

The IRS expects to begin employment tax audits in February 2010 to update audit selection formulas and estimates of noncompliance with the rules. It's estimated that there is a \$20 billion tax gap in the area of employment taxes (a difference in taxes owed and taxes actually paid). ♦



If you want your business to survive you, have a plan

Succession planning is very important for a family-owned business. Before you sit down with your tax and legal advisors to draw up a succession plan, you should think through three key issues: who do you want to succeed you, when do you want the transition to take place, and how do you want to structure the transition?

Who? The question of who will succeed you in the business can be the toughest of all, largely because there is so much emotion involved. Most owners want to pass the business on to the family. But are your children willing to take on the business, and if so, are they capable of running it? Will it cause a family squabble if one or two children want to run the business, but others are not interested? Resolving these issues may take a lot of honest, open discussion with family members to discover their true feelings. If there is not an obvious family successor, other alternatives include selling the business to an outsider, promoting an

existing employee to head the business while you retain ownership, or even selling the business to the employees.

When? When you make the transition depends on a number of factors, such as your age, health, retirement goals, and the readiness of a successor. Consider whether you want to maintain some involvement with the business or make a clean break. Remember, though, you should always have a contingency succession plan in case of sudden death or disability.

How? How you structure the transition depends partly on the answers to the earlier questions and partly on financial considerations. Think through issues such as whether you need retirement income from the business or whether you primarily want to minimize estate taxes. Knowing your goals for the transition will make it much easier to tailor a succession plan that fits your specific situation. ♦



Thank you

for giving us the opportunity to serve you this past year. We appreciate your business. We are a growing firm, and we would also appreciate your referrals. Please mention our name to your friends and business acquaintances who may be interested in our services. We wish you a happy holiday season and a prosperous new year.

An important tax issue for shareholder-employees

Scorporations are the most popular form of corporate business structure. There are excellent tax planning benefits uniquely available to S corporation shareholders who are also employees, not the least of which is the opportunity to manage self-employment and payroll tax liabilities. Unlike sole proprietorships, for example, S corporations can pay wages to shareholder-employees and also distribute income to them as corporate dividends, which are free of the payroll taxes that apply to wages.

Do a comparison

If your business is a sole proprietorship with net income of \$200,000, 92.35% of this amount (or \$184,700) will be subject to self-employment tax. The social security portion of the tax is 12.4% on the first \$106,800. The Medicare tax of 2.9% applies to the full \$184,700. So your self-employment tax will be \$18,600. You can take a deduction for 50% of this tax.

If you incorporate and elect to be taxed as an S corporation, the result can be dramatically different. Again assume that your business income is \$200,000, and the corporation pays you a salary of \$60,000 (which you can demonstrate as reasonable). You and the corporation, as your employer, will pay a combined 15.3% on your \$60,000 salary as payroll (FICA) taxes. The total tax is \$9,180. The remaining \$140,000 of business income can be distributed to you as S corporation dividends free of payroll or self-employment taxes. The result is a significant tax savings.

The IRS is very much aware of the potential for abuse by taxpayers paying unreasonably high or low salaries. In the example above, if the IRS determined that your salary was set low to avoid taxes, you could face a reclassification of all or part of your \$140,000 S corporation dividends as wages subject to payroll taxes. The key: Pay reasonable and well-documented salaries.



So what is “reasonable”?

Determining whether wages are reasonable involves many factors, including the nature of the services performed, the responsibilities involved, the time spent, the size and complexity of the business, prevailing economic conditions, compensation paid by comparable firms for comparable services, and salaries paid in prior years. There are no hard and fast rules, and there is no definition of “reasonable” in the tax law. To analyze this strategy for your particular business situation, give us a call. ♦

Take five steps to simplify your financial life

Managing your finances can be difficult in these complex times. All too often, people become overwhelmed and merely muddle along with scattered investments, poor recordkeeping, and little or no direction. But you may be able to improve your life and simplify your financial affairs with these five steps.

1. Take stock of your situation. Before you can reduce the clutter, you must figure out exactly what you own. Go through the stacks of your financial papers to list all your holdings. Don't forget to check your safe deposit box, file cabinets, and closet shelves for records of investment accounts, retirement plans, and insurance policies. Locate the latest copy of your will and other estate planning documents.

2. Organize your finances. Once you've assembled the pertinent financial information, divide it into categories. For instance, place all the insurance materials in one folder and retirement account materials in another. Note where the folders will be stored. Update your status on a regular basis. Otherwise, you'll soon find yourself back in the same state of disorder.

3. Consolidate. Apart from the concern for keeping

your accounts under the FDIC insurance limit, do you need to maintain multiple accounts at different banks? It's usually more practical to keep all your savings and checking accounts with one bank. Similarly, if you've opened several IRAs with different institutions over the years, you might consolidate them under one provider.

4. Streamline broker services. As with your bank and retirement accounts, it may make sense to use only one or two brokerage firms to handle all your investments. If you're concerned about the failure of a single brokerage firm, check the Securities Investment Protection Corporation (SIPC) coverage on various accounts. Transferring your holdings will involve some paperwork, plus you may owe tax resulting from securities sales. Be sure to take the tax consequences into account before you start moving investments around.

5. Review your portfolio. Now that you have a complete financial picture, fine-tune your holdings based on your latest objectives and time horizon.

To be effective, simplification requires real commitment. But it can pay off in future benefits. ♦

Do you own too much company stock?

Employees often have too much of their employer's company stock in their 401(k) or other retirement plan. Employees feel they know their company best, overlooking the risks of having too much of an investment in any one company, including their own.

What are some of the risks of loading up on your employer's stock?

► **Tremendous bet in a "safe haven."** Overweighting investment holdings in any company minimizes diversification, exposing your portfolio to increased downside return risk. The belief that employer shares are less risky is an illusion.

► **Double whammy potential.** No company is protected from economic downturns. If your employer's performance weakens, you may lose your income if you lose your job, as well as long-term earnings growth in your retirement portfolio from

the company's market value loss.

► **Lock-up periods.** Some companies prohibit employees from converting the employer retirement match contributions in company stock into other investments until after a number of years. In this case, use your own contributions to diversify your holdings.

► **Tendency to forget.** As you move closer to retirement, you may forget the riskiness of your employer's stock to your portfolio. At the same time, contributions of company stock may be growing, based on higher benefit matches – just when portfolio reallocation is becoming more important with your shortening investment horizon.

Your goal should be to create a well-balanced portfolio that suits your age (investment horizon) and your risk tolerance. Call us for assistance in reviewing your retirement situation. ♦



January 15, 2010 – Fourth installment of 2009 individual estimated tax is due.

February 1 – Employers must furnish W-2 statements to employees. 1099 information statements must be furnished by banks, brokers, and other payers.

February 1 – Employers must file 2009 federal unemployment tax returns and pay any tax due.

March 1 – Payers must file information returns (such as 1099s) with the IRS.*

March 1 – Employers must send W-2 copies to the Social Security Administration.*

March 1 – Farmers and fishermen who did not make 2009 estimated tax payments must file 2009 tax returns and pay taxes in full.

March 15 – Deadline for calendar-year corporations to elect S status for 2010.

March 15 – 2009 calendar-year corporation income tax returns are due. ♦

*March 31 if filing electronically

NOTE: This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.