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year end 2008

Year end business planning

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# Timely tips to tame the tax tiger

**A**s 2008 comes to a close, it's a good time to review your year end tax plans and take advantage of last-minute strategies that can reduce your company's tax bill. Here are some ideas to explore:

## Change accounting methods

Your accounting method can have a big impact on your tax bill. Your business may be required to use the accrual method — for example, if it has inventories or if it's a C corporation with average annual gross receipts of more than \$5 million.

But if you're eligible for either the cash or the accrual method, ask your tax advisor whether switching from your current method would lower your taxes.

## Defer tax on advance payments

If customers pay you in advance for products or services that aren't delivered or performed until a later year, you may be able to defer a portion of the tax on that income. Examples

of advance payments include license fees, subscriptions and warranty contracts.

The tax code allows you to defer the tax on advance payments to the extent they're reported as deferred revenue on your audited financial statements or are otherwise substantiated in accordance with IRS rules.

Income on the unredeemed portion of gift cards or gift certificates redeemable for merchandise can be deferred for up to two years. To claim this benefit, you must attach a schedule to your tax return that tracks gift card and gift certificate activity for the current and previous years.

## Buy equipment

If you're planning to buy equipment or other depreciable property, consider making the purchase by your business year end to take advantage of the Section 179 expensing election. For 2008, it generally allows you to immediately deduct up to \$250,000 in qualifying purchases. Note, however, that this benefit is phased out on a dollar-for-dollar basis once your total cost of Sec. 179 property tops \$800,000.

In addition, the Economic Stimulus Act of 2008 offers a 50% first-year "bonus" depreciation for most new depreciable personal property (including software and certain leasehold improvements) placed in service in 2008.

## Estimate estimated taxes

If your business is a small C corporation — that is, one with less than \$1 million in taxable income for each of its three preceding tax years — your estimated tax payments should be based on the lesser of 100% of the current year's tax or 100% of the preceding year's tax. But you can use the preceding year's tax only if you had a tax liability that year.

If you don't anticipate owing any taxes for 2008 but expect a more prosperous 2009, consider shifting some income from 2009 to 2008



to generate a small tax liability. That way, you can base next year's estimated tax payments on this year's tax.

### Shrinkage can shrink taxes

If your business has inventories and you don't do a physical count at the end of the year, be sure you have procedures for estimating and claiming a tax deduction for "shrinkage." Shrinkage refers to inventory lost as a result of undetected fraud or theft, breakage, book-keeping errors, spoilage (in the case of perishable goods), or other causes.

Various methods are available to estimate these losses. Note, however, that adopting one of these methods is considered a change in accounting method, which may require IRS approval.

### Food for thought

The ideas discussed above are just a few of the many strategies available to lower your tax bill. Talk with your CPA about any of these strategies (and others) during your year end tax planning process. ♦

## The manufacturers' deduction: Not just for manufacturers

In 2004, after years of challenges by the European Union, Congress scrapped its efforts to provide tax advantages for U.S. exporters. Instead, lawmakers added Section 199 to the tax code, creating a tax deduction for all U.S. businesses that engage in qualified domestic production activities, whether they export or not.

Although the manufacturers' deduction is often associated with large manufacturers, it's available to companies of all sizes. And it's not limited to manufacturers, either. Construction contractors, architects, engineers, software developers and others also may qualify.

### How big is it?

Currently, the deduction is 6% of your qualified production activities income (QPAI) or your taxable income (whichever is less). The 6% increases to 9% in 2010. The deduction is limited, however, to 50% of your company's W-2 wages attributable to qualified production activities.

For example, say your corporation earns \$400,000 in taxable income on \$2 million in gross receipts, all of it from qualified production activities. Assuming your W-2 wages are high enough, the deduction is \$24,000, reducing your federal tax bill by \$8,160. In 2010, when the rate increases



to 9%, the deduction will be \$36,000, for a tax savings of \$12,240.

### Who's eligible?

You may qualify for the manufacturers' deduction if your business derives revenue from:

- ♦ Manufacturing, producing, growing or extracting "qualifying production property" — including goods, agricultural products, oil and gas, computer software, and sound recordings — *in whole or in significant part* within the United States,
- ♦ Producing films that meet certain requirements (for example, at least 50% of compensation on the film must be for services performed in the United States),
- ♦ Producing domestic electricity, natural gas or potable water,

- ◆ Performing construction in the United States, or
- ◆ Performing architectural or engineering services in the United States for domestic construction projects.

Sec. 199 doesn't define "in significant part," but the regulations provide a safe harbor: You automatically satisfy the in-significant-part test if your U.S. labor and overhead costs make up at least 20% of the property's cost of goods sold. Even if you don't meet the test for a particular product, you may be able to claim the manufacturers' deduction for a product *component* that's produced in significant part in the United States. Note that, for purposes of the deduction, "United States" doesn't include U.S. possessions or territories.

### How do you calculate the deduction?

The first step is to determine your domestic production gross receipts (DPGR). This can be a challenge if your business involves both qualified and nonqualified activities. Note, however, that you may treat all of your receipts as DPGR if nonqualified activities account for 5% or less of your gross receipts.

The next step is to deduct the cost of goods sold and any other direct or indirect expenses properly allocable to DPGR to arrive at your QPAI. Finally, you compare your QPAI to your taxable income and multiply the lower of those two figures by the applicable percentage (6% now, 9% beginning in 2010). The result is your deduction, subject to the W-2 wage limitation discussed above.

### ***The deduction is 6% of your qualified production activities income (QPAI) or your taxable income (whichever is less).***

Allocating costs — especially overhead and other indirect costs — between DPGR and non-DPGR requires a solid system for cost tracking and accounting. Regulations provide detailed guidance on calculating the manufacturers' deduction, including special rules for affiliated groups, pass-through entities (such as S corporations and partnerships) and other

### Deduction for one?

The manufacturers' deduction isn't just for large businesses: Small companies, including sole proprietors, can take advantage of the deduction. The rules create obstacles for solo businesses, but they also create opportunities.

Perhaps the biggest obstacle is the W-2 wage limitation. If you don't have employees, you can't claim the deduction. If you have substantial qualified production activities income (QPAI), however, consider the cost/benefit of hiring at least one employee to take advantage of the deduction.

Another issue is that, for sole proprietors, the manufacturers' deduction is based on the lesser of QPAI or your own adjusted gross income (AGI). Even if you have QPAI from a profitable business, other losses on your tax return can wipe out the deduction.

On the other hand, a sole proprietor with QPAI from an unprofitable business may have a unique opportunity to claim the deduction. Suppose your solo business generates substantial QPAI, but losses from nonqualifying activities create a Schedule C loss. You may still be entitled to the deduction if you have sufficient AGI on your tax return from capital gains, your spouse's salary or other sources.

types of businesses. (For information on how the manufacturers' deduction applies to sole proprietorships, see "Deduction for one?" above.)

The regulations also offer a simplified cost allocation method: If your average annual gross receipts are \$100 million or less, you can allocate costs based on the ratio of DPGR to total receipts. However, keep in mind that, while this method may be easier to calculate, other methods may increase or decrease your deduction by allocating costs more accurately.

### Weigh your options

Claiming the deduction increases recordkeeping expenses, but for many businesses the benefits justify the added cost. If you think you qualify, consult your tax advisor to discuss your options. ◆

# When money and marriage are at odds

**M**oney and marriage — the two often mix about as well as oil and water. Many married couples are constantly at odds when it comes to money management matters. One may be a big saver, risk averse and concerned about a comfortable retirement. The other may be a big spender and risk taker, subscribing to the philosophy that “you can’t take it with you.”

Beyond a prenup and maintaining separate accounts, how can spouses reach a happy compromise?

## Sharing financial goals

When couples differ on financial goals, they’ll likely go nowhere fast. Therefore, it’s essential to have some frank discussions about long- and short-term goals and then meet with a financial advisor to discuss how to reach them.

Differences of opinion may also arise regarding what constitutes a pressing need. For example, one spouse may view investing in a home addition project as essential for the health and happiness of a growing family, while the other may feel it’s good for children to share bedrooms and view adding on as an unnecessary luxury. While a financial advisor shouldn’t fill the role of “marriage counselor,” he or she can help lead the spouses to agreement on goals.

With a shared understanding of each other’s financial goals, couples can develop a budget that provides for regular bill paying and allocates remaining funds for achieving their goals. It’s often smart to determine which financial goals will be shared, with each spouse contributing his or her part, vs. those that they’ll save for individually. For example, both spouses may want to contribute to a Coverdell Education Savings Account for their new baby, while they separately save for their own wish list — say, a new car or jewelry.

## Understanding is key

Viewing each other as team members in the game of life and finances instead of as adversaries will likely result in a happier marriage and a more secure financial status. These four

team-oriented tips can also facilitate harmonious money management:

1. Expenses should be reviewed together and spouses should take turns at paying bills to better understand living costs.
2. Big-ticket purchases should be made only if both spouses agree on them.
3. Spending limits for holiday and special occasion gifts for both sides of the family should be established early on.
4. Terms for personal loans to family and friends should be worked out in advance or avoided altogether.



Finally, though it’s common for one person to take over the bill-paying function, it’s critical that both spouses fully understand the cash flow situation at all times to avoid rash spending that can cripple a family’s finances.

## A balanced budget is bliss

There’s no one right way for married couples to manage money — but the goal should be to cover all bills and to balance shared and individual financial goals. Whatever the method used, open communication about money matters can help defuse contention. ♦

# Trouble finding a group health policy?

## The 411 on other options

Offering group health insurance through your company is a great benefit for your employees as well as for your business. But some businesses may find group health insurance cost-prohibitive. So what are your options?

### Private health insurance

When group health coverage through the company isn't feasible, you can purchase private health insurance for you and your family. And as an employer, you can inform your employees how to apply for their own private health insurance.



Obtaining private insurance, however, may entail a lengthy application process. And those who are at an advanced age or have pre-existing health conditions may encounter excessively high premiums and coverage exclusions. They may even be denied coverage altogether.

To navigate the private health insurance market, you need the 411:

**Medical underwriting.** The private health insurance market is regulated at the state level, so rules vary. But most states permit medical underwriting in which insurers determine benefits and premiums based on an individual's past and current health status and related factors.

To help you through the maze of terminology, work with a local broker specializing in private health insurance. He or she can offer insights into different insurers' underwriting

criteria and rate structures, and can facilitate the application process. For help locating a licensed broker, visit the National Association of Health Underwriters site at [nahu.org](http://nahu.org).

**Guaranteed-issue insurance.** Some states prohibit medical underwriting for private health insurance and require the sale of coverage on a "guaranteed-issue" basis. In effect, you can't be denied coverage. Plus, insurers may be prohibited from charging premiums based on your health condition and, instead, be required to charge all state residents the same community premium rate.

In addition, self-employed individuals (with no other employees) in some states may be eligible for guaranteed-issue coverage.

**High-risk insurance pools.** With this option, states allow medical underwriting but appoint one or more insurers to offer guaranteed-issue coverage. A premium still applies. Eligible individuals typically include state residents who have been denied coverage due to a pre-existing condition and don't have access to employer group coverage, and individuals with a continuous coverage history who have exhausted COBRA benefits and been denied private coverage.

For more information on these programs, visit the National Association of State Comprehensive Health Insurance Plans at [naschip.org](http://naschip.org).

### Consumer-directed programs

If a group health insurance plan just isn't feasible, you can also help your employees by establishing a consumer-directed program to cover their health expenses. Options to consider include:

**Health Reimbursement Arrangement (HRA).** With this option, the company contributes pretax dollars to employees' HRA accounts to reimburse them for qualified medical expenses. The amount contributed is entirely up to you, and you can deduct the administrative costs of your HRA as a business expense.

**Flexible Spending Account (FSA).** With an FSA, the company sponsors the plan but

doesn't make contributions to employee accounts. Your employees contribute pretax dollars to their accounts and are then reimbursed from the account for qualified medical expenses. One employee drawback to the FSA is that, if an employee doesn't use up his or her account funds by the end of the year (or 90 days after, if you draft the plan to allow it), unused funds are forfeited to the company. So employee education is essential.

**Health Savings Account (HSA).** To participate in an HSA, employees also must be enrolled in a high-deductible health plan. For 2009, the requirements specify a minimum annual deductible of \$1,150 for individual coverage or \$2,300 for a family. Pretax dollars placed in an HSA grow tax-deferred, and withdrawals used for qualified health costs are tax free.

The employer and employees together can make annual, tax-free contributions of up to \$3,000 for individual coverage or \$5,950 for a family in 2009. And, unlike FSA funds, unused HSA funds can be rolled over from one year

to the next, and they're portable. That is, the account stays with the employee when he or she changes jobs or retires.

### Membership organizations

Another option for business owners and their employees is to obtain group-type coverage on their own through an association program. Membership organizations, such as trade unions, industry professional associations, alumni associations and chambers of commerce, may provide access to group health insurance for paying members.

But, before going this route, research the credibility of the programs offered.

### Knowledge is key

With health care costs rising daily, it's important to find the health insurance and expense reimbursement plans that best fit you and your family, and, to the extent possible, your company and employees. Check with your tax advisor to learn about federal and state tax breaks on health care plans. ♦

## 5 things to consider before relocating

If your business is at a point where you need to relocate or expand operations to support continued growth or contain rising costs, remember: location, location, location. Five criteria you should consider when looking for new grounds include:

- 1. Labor.** Labor shortage and quality issues can bring your operations to a grinding halt. Compare your workforce's size, experience, education and skill requirements to the population demographics of a prospective location to help ensure a good match.
- 2. Proximity.** Consider environmental concerns and high fuel prices when selecting a location. Make sure you analyze the travel distances and driving times between your facilities and major suppliers and customer markets.
- 3. Quality.** If you're seeking a more *affordable* location, balance that need with important quality of life factors in the prospective area. For example, locating in an area that has access to good health care, education and recreational facilities will likely attract prospective sources of labor, suppliers and customers. Conversely, crime-ridden areas, lack of parking and high local taxes can be major business detractors.
- 4. Space.** If inadequate space is causing you to look elsewhere, consider expanding into an adjoining space, if available. But if moving to a new location is definitely in your future, consider both your current and *future* space needs.
- 5. Zoning.** Do your homework on how the municipalities you're considering support growth through zoning. Research permissible uses of property, environmental issues or compliance requirements, and infrastructure utility hookups. Also consider the potential impact of zoning for neighboring property.