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Eight Tax-saving Moves at Year-end

The usual year-end tax-planning strategies have been accentuated by the new American Recovery and Reinvestment Act (ARRA) passed early in 2009. Here are eight ways for individuals to reduce taxes before next year.

1. CHARITABLE DONATIONS:

Monetary gifts made to qualified charitable organizations before 2010 are generally deductible in full in 2009. However, donors must observe strict substantiation requirements. Note that donations by credit card are currently deductible if the account is charged before 2010.

A penalty may be avoided by ensuring that payments equal at least 90 percent of current liability or 100 percent of the prior year's liability.

2. ESTIMATED TAX PAYMENTS:

Normally, an individual must pay an underpayment penalty if the required "estimated tax" is

not paid in quarterly installments or tax withholding (or a combination). But a penalty may be avoided by ensuring that payments equal at least 90 percent of current liability or 100 percent of the prior year's liability (110 percent for an adjusted gross income [AGI] above \$150,000). ARRA allows certain small-business owners to base 2009 payments on 90 percent of the prior year's liability.

3. ALTERNATIVE MINIMUM TAX (AMT):

If a special tax calculation exceeds a taxpayer's regular income tax liability, he or she must pay the AMT for 2009. But it may be possible to reduce or eliminate AMT liability by postponing certain "tax preference" items. Note that the top AMT rate for 2009 remains at 28 percent.

4. KIDDIE TAX:

Under the "kiddie tax," unearned income received by a child may be taxed at the parent's top tax rate if the child's income exceeds a specified threshold. For 2009, the kiddie tax generally



applies to a child under age 19 (age 24 for full-time students) with unearned income above \$1,900. When it is practical, try to keep income under or near this threshold through astute investments.

5. EDUCATION CREDITS:

The tax law allows certain taxpayers to claim one of two special tax credits for sending their children to college. But the tax credits are phased out at relatively modest income levels. For 2009, the revamped "American Opportunity Tax Credit" has been extended by ARRA so that it is fully available to joint filers

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Tax-savers for Business Owners in 2009

Year-end tax planning is not just for individual taxpayers. Timely strategies may also reduce tax for employers in 2009, especially after enactment of the American Recovery and Reinvestment Act (ARRA). Here are several prime examples:

SECTION 179 DEDUCTIONS: Under Section 179 of the tax code, a business taxpayer may “expense” (i.e., currently deduct) the cost of qualified business assets placed in service during the year. The Economic Stimulus Act of 2008 effectively doubled the maximum annual deduction to \$250,000 for 2008. Now ARRA has extended this higher allowance for assets placed in service in 2009.



DEPRECIATION DEDUCTIONS: In addition to bigger Section 179 deductions, the Economic Stimulus Act of 2008 created a 50 percent “bonus depreciation” deduction for qualified assets placed in service in 2008. The bonus depreciation deduction has been extended through 2009 (2010 for certain equipment). Regular depreciation deductions are also still available.

BUSINESS TRAVEL: Travel expenses incurred by employees—including airfare, lodging and 50 percent of the cost of meals—may be deductible if the trips are business-related. When it is appropriate, move up business trips planned for early next year into November or December.

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This allows the business to write off the travel expenses in 2009 instead of waiting until 2010.

BAD DEBTS: During the current recession, it may be difficult to secure payments from clients or customers. As a general rule, business bad debts are deductible

only when they become worthless. Keep detailed records of collection efforts to support deductions based on the worthlessness of debts.

REPAIRS: Repairs made by a business before year-end are deductible on its 2009 return. However, capital improvements to the business premises must be capitalized. To preserve current deductions, try to implement separate plans for repairs and major renovations.

NET OPERATING LOSSES (NOLs): Normally, a business may carry back NOLs for a period of only two years before carrying the losses forward for up to 20 years. But ARRA allows a business with an NOL in 2009 to carry back the

loss for up to five years. This may require

ARRA allows a business with an NOL in 2009 to carry back the loss for up to five years.

astute timing of income and deductions at the end of the year.

COBRA SUBSIDIES: Under ARRA, an employee who is involuntarily terminated from the job this year may elect to pay only 35 percent of the required premiums for a nine-month period. The employer has to pick up the remaining 65 percent of the cost. However, the employer may then qualify for a special payroll tax credit or reduced withholding.

CHARITABLE DONATIONS: Deductions for charitable gifts by a corporation are generally limited to 10 percent of taxable income, but any excess may be carried over for five years. Note that certain enhanced tax breaks for charitable gifts of food, books and computer equipment have been extended through 2009.

It is recommended that business owners coordinate their year-end tax-planning techniques with a professional adviser. ■

Eight Tax-saving Moves at Year-end

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with an AGI up to \$160,000 (\$80,000 for single filers). Pay the next semester's tuition before 2010 to qualify for the credit this year.

The revamped “American Opportunity Tax Credit” has been extended by ARRA so that it is fully available to joint filers with an AGI up to \$160,000 (\$80,000 for single filers).

6. NEW-VEHICLE DEDUCTIONS:

Under ARRA, an individual who buys a new vehicle before 2010 may deduct the sales and excise taxes attributable to the first \$49,500 of the vehicle's price. But this new deduction is phased out for high-income taxpayers. The phaseout begins if AGI exceeds \$250,000 for joint filers (\$125,000 for single filers).

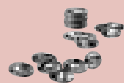
7. FIRST-TIME HOME BUYER CREDITS:

A tax credit may be available for home purchasers who have not owned a principal residence for the previous three years. ARRA increases the maximum credit for 2009 from \$7,500 to \$8,000 for purchases before December 1, but the credit is still phased out for high-income taxpayers. The phaseout begins at \$150,000 of modified AGI for joint filers (\$75,000 for single filers).

8. ENERGY CREDITS: ARRA triples the residential energy credit from 10 percent to 30 percent for installations made in 2009 and 2010. The list of qualified expenses ranges from skylights to energy-efficient furnaces to simple insulation materials. Also, the lifetime \$500 dollar cap is replaced with an annual limit of \$1,500.

Additional legislation being debated in Congress may have an impact on year-end tax planning. Your professional tax advisers will stay on top of the latest developments. ■

Loose Change



FAST BREAKS — There is a real benefit to having a company promote intramural activities like basketball teams. Besides improving general health of the staff, the recreation is a good way to improve workplace morale. It can influence cooperation and

create more enthusiasm about coming to work. On the other hand, if an employer doesn't encourage this or similar interaction, it may be more difficult to motivate the workforce.

HOME OFFICE DEDUCTIONS — Generally, home-office deductions are based on the percentage of square feet in the home used for business purposes. But the IRS says an alternative method based on the percentage of rooms in the home is permitted, as long as the rooms are of a similar size. The taxpayer

may choose to use the “rooms” method if it produces a bigger deduction on his or her 2009 return.

WEB SITE DESIGNS — A Web site has become the modern version of a business card. Virtually every business can benefit from having one. But do not try to design a Web site in a rush. It should be graphically stimulating and informative while remaining professional in appearance and style. If there is no one in-house with the requisite skill set, hire an experienced Web site designer to create the site.

Protections in New Credit Card Law

A new law recently signed by the President — the Credit Card Accountability, Responsibility and Disclosure Act of 2009 (CreditCARD) — is designed to provide protection from unfair practices in the credit card industry. The changes generally will take effect on February 22, 2010. **Here are several key provisions of interest to consumers:**

- A credit card issuer cannot raise the interest rate on an existing balance unless the payment is late by 60 days or more (effective August 20, 2009).
- Interest rates generally cannot be raised in the first year. Other rate increases require advance notice of 45 days (increased from 15 days).

- Fees assessed for exceeding a cardholder's personal limit are restricted.
- Consumers generally cannot be charged a fee to pay their credit card debt by telephone or online.
- Payment received by the due date (or the next business day if the credit card issuer is not accepting payments that day) will not trigger a late fee.

Individuals age 18 to 21 generally will not be able to obtain a credit card without a co-signer.

- Individuals age 18 to 21 generally will not be able to obtain a credit card without a co-signer.
- Credit card companies cannot use the pre-

vious billing cycle (i.e., double billing) to calculate interest charges.

- Payment must first be applied to the balance with the highest interest rate charge (contrary to current industry practice).
- Issuers must send statements at least 21 days before payment is due instead of the current 14-day requirement (effective August 20, 2009).
- Gift cards cannot expire for at least five years, and inactivity fees cannot be imposed unless the card goes unused for one year (effective August 22, 2010).
- Credit card contracts must be worded so consumers can easily understand the terms.

These are only some of the highlights of the new law. Obtain additional information when necessary. ■

New Opportunity for Roth IRA Conversions

A long-awaited change for IRA participants will finally take effect at the beginning of the new year. Specifically, beginning on January 1, 2010, an IRA account holder will be able to convert a regular IRA into a Roth IRA without regard to his or her income level. The eventual objective is a stream of tax-free distributions in the future.

Background: There are several similarities between a regular IRA and the Roth version. For instance, the contribution limit for the 2009 tax year is \$5,000 for either type of IRA or a combination of the two. *(The limit is \$6,000 if the account owner is age 50 or older.)* With each IRA, no current tax is due as earnings accumulate over time.

But the differences are far greater. For starters, regular IRA contributions may be tax-deductible, in whole or in part, based on income and active participation in other retirement plans. In contrast, Roth IRA contributions are never deductible. Also, IRA holders must take mandatory distributions from their accounts the year after the year they reach age 70-1/2. *(This rule is temporarily suspended for the 2009 tax year.)*

IRA holders must take mandatory distributions from their accounts the year after the year they reach age 70-1/2.

Lifetime distributions are not required with Roth IRAs.

Perhaps the biggest difference is that distributions from regular IRAs are taxed at ordinary income rates. Only the amounts attributable to nondeductible contributions are tax-free. Conversely, qualified distributions from a Roth in existence for

at least five years (e.g., *distributions made after age 59-1/2*) are completely exempt from tax.

If a regular IRA is converted to a Roth, the transfer is treated as a taxable event, such as a distribution. But this can lead to tax-free distributions in retirement. Under current law, such conversions are not allowed in a year in which the account holder has an adjusted gross income (AGI) above \$100,000.

Good news: Under the massive 2006 pension law, the \$100,000-of-AGI barrier is

An account holder who converts in 2010 can elect to pay the resulting tax liability over the following two years.

being removed for the 2010 tax year. Thus, many high-income earners will qualify for a conversion for the first time. To sweeten this tax break, an account holder who converts in 2010 can elect to pay the resulting tax liability over the following two years. This not only defers payment but it reduces the overall tax bill.

These changes represent a prime tax-planning opportunity, especially if IRA assets remain undervalued compared to several years ago. Furthermore, an account holder can elect to recharacterize a Roth IRA into a regular IRA in the event that future conditions dictate so. The recharacterization must take place prior to the tax return deadline (*plus extensions*) for the year of the conversion.

Bottom line: As the end of the year approaches, it is recommended that IRA owners consult with their advisers regarding their personal circumstances. ■

Four Ways to Minimize Unemployment Costs

In these days of rampant unemployment, employees are not the only ones who are suffering. Employers also have a burden to bear in the form of rising unemployment costs.

HOW IT WORKS: Under the Federal Unemployment Tax Act (FUTA), employers are charged 6.2 percent of the first \$7,000 of every worker's wages, although a state unemployment tax credit of 5.4 percent may reduce the federal rate to 0.8 percent. This works out to a maximum FUTA tax of \$56 per employee (0.8 percent of \$7,000) on an annual basis. One critical factor in maintaining the 5.4 percent credit under state unemployment systems is to demonstrate stability. In effect, employers with more unemployment benefit claims are generally required to pay more in state unemployment taxes. Thus, there is an extra financial incentive for keeping claims to a minimum. For instance, if an employee seeks unemployment benefits, the employer may be able to demonstrate

There is an extra financial incentive for keeping claims to a minimum.

that the employee quit voluntarily or that he or she was terminated for willful misconduct.

Short of using these two defenses, or some variation, the key to reducing unemployment costs is to avoid having claims filed in the first place. **Here are four practical suggestions:**

1. HIRE WITH DISCRETION. If an employee will be required to work

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Four Ways to Minimize Unemployment Costs

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unusual shifts, weekends and holidays, present this information at the outset. Even better, the employer can put such notice in a prominent place on the employment application and have the new hire sign it. In that case, if the employee leaves the job due to the work

Copies of performance evaluation forms showing prior warnings should be given to the departing employee.

schedule, the departure should be considered voluntary and unemployment

benefits may not be triggered.

2. FIRE WITH DISCRETION. If employment is terminated due to misconduct, such as insubordination or work rule violations, explain in writing the reasons for the dismissal. Copies of performance evaluation forms showing prior warnings should be given to the departing employee, along with a final statement showing no improvement in the deficient area.

3. CONDUCT AN EXIT INTERVIEW. When an employee leaves voluntarily, find out the reason. Have multiple employees interview the departing employee and retain notes from each

meeting. Ask for a formal letter of resignation. This may defuse a claim for unemployment benefits. It may also alert you to a condition you want to correct to head off more departures.

4. CHALLENGE QUESTIONABLE CLAIMS. This could signal the launch of a wrongful discharge lawsuit, so prepare documentation showing that the claim is groundless. You may want to involve your attorney from the outset.

By following these basic suggestions, employers may be able to keep their merit rating high and their costs low. Take a proactive stance in this area. ■

Do Not Ignore Embezzlement Risks

One of the negative side effects of the current recession is that embezzlement is on the rise. Yet many small-business owners still turn a blind eye to the risks, especially when trusted long-time employees have been placed in potentially compromising situations. The prudent course of action is to take steps to remove temptations to employees.

A good place to start is with an examination of the company's accounting procedures. Be sure to separate completely the accounts payable from the accounts receivable. In addition, have two employees handle the payroll—one to write the checks and one to distribute them. Allowing just one person to handle both tasks may be detrimental.

Similarly, the employee who receives cash should not be the same person who maintains the company records. When one em-

ployee performs both functions, embezzlement can be hidden for years without detection.

Furthermore, small-business owners should approve all checks over a certain amount. Payments should be made with an original invoice, not a copy. In addition, make sure all bank statements are reconciled. It is generally recommended that the business use an outside accounting firm to perform periodic surprise audits.

Of course, even if these safeguards are put in place, there is no guarantee that a firm will not be victimized. If embezzlement is suspected, consult with legal and business advisers to determine the best course of action.

Finally, remember that no firm is immune to the possibility of embezzlement. It is a growing danger in today's economic environment. ■

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