

2010 YEAR-END INCOME TAX PLANNING FOR CORPORATE AND NON-CORPORATE BUSINESSES

INTRODUCTION

It is that time of year again to evaluate year-end tax planning for corporations and other businesses. Year-end tax planning is particularly critical for 2010 because Congress has enacted a series of business tax breaks that are scheduled to expire **after 2010**, and several others that expire **after 2011**. These tax provisions are contained in: **1) The *Hiring Incentives Act of 2010*** (HIRE Act) which addresses high unemployment; **2) The *Health Care Act of 2010*** (Health Care Act) which overhauls the health care industry (but also contains an array of tax provisions impacting businesses), and **3) The *Small Business Jobs Act of 2010*** (Jobs Act) with tax incentives that encourage businesses to make capital investments. Collectively, this legislation contains an extended menu of new tax breaks and temporary tax incentives for businesses, such as: a credit for small employers offering employee health insurance; tax incentives for employers that hire qualified unemployed workers; extension of the 50% bonus depreciation; and a doubling of the §179 expense deduction. Also, **starting in 2013**, the *Health Care Act* not only imposes a new Medicare Surtax on a higher-income taxpayer's earned income, it also creates a separate Medicare Surtax on "investment income" that could apply to the pass-through operating business income of "passive" owners of S corporations, partnerships, and limited liability companies (LLCs).

We are sending you this letter to bring you up-to-date on these new rules, and the planning opportunities that they create for corporate and non-corporate businesses. This letter also reminds you of the *traditional* year-end tax planning strategies for businesses (including regular "C" corporations, "S" corporations, partnerships, LLCs, and self-employed individuals). **Caution!** Several of the most significant new tax breaks **expire after 2010** (and others after 2011). Consequently, you may have to act promptly to take advantage of these short-lived provisions!

To help you locate items of interest, we have divided the planning ideas into the following categories:

- Highlights Of Recent Legislation Impacting Year-End Planning For Businesses
- Expiring (And Expired) Business Tax Provisions
- Should We Pay Compensation Or Dividends To Shareholder/Employee
- Traditional Year-End Planning For "S" Corporations
- Traditional General Business Planning For Year-End
- Preparing For Potential Tax Increases

Planning Alert! Although this letter contains many planning ideas, you cannot properly evaluate a particular planning strategy without calculating the overall tax liability (including the alternative minimum tax) with and without the strategy. In addition, this letter contains ideas for Federal income tax planning only. You should also consider any state income tax consequences of a particular planning strategy. We recommend that **you call our firm before implementing any tax planning technique** discussed in this letter, or if you need more information.

HIGHLIGHTS OF RECENT LEGISLATION IMPACTING YEAR-END PLANNING

Overview

One of the key features of the **Health Care Act of 2010** (Health Care Act) is that its expansive provisions are phased in incrementally over an eight-year period. Thus, it will take several years before the full impact of this massive legislation is felt. Most of the *Health Care Act's* insurance coverage mandates are **not required until 2014**, however several of the most important *tax changes* that impact business are effective **as early as 2010**, and other key tax changes **become effective in 2011**. Therefore, businesses generally have several years to prepare for the Act's insurance coverage mandates, but the *tax changes* will require more immediate attention. Consequently, this letter addresses primarily the **tax provisions** in the *Health Care Act*. By contrast, most of the tax provisions in the **Hiring Incentives To Restore Employment Act of 2010** (HIRE Act) and the **Small Business Jobs Act of 2010** (Jobs Act) have a very short life, with some of the tax breaks **available only in 2010**, and several **others expiring in 2011**.

The following are *selected* provisions from this tax legislation that we believe will have the greatest impact on 2010 year-end planning for corporations and other businesses. **Planning Alert!** Due to the temporary nature of many of these tax breaks, please pay careful attention to the **effective date** and **expiration date** (if applicable) for each new provision, which we **highlight prominently** in each segment. **Tax Tip.** The recent legislation contains a host of accelerated depreciation write-offs for qualifying equipment, vehicles, buildings, software, start-up expenses, and capital improvements to certain buildings, several of which are available only if the property is "*placed-in-service*" generally **no later than December 31, 2010**. If your business plans to take advantage of any of these increased write-offs for 2010, make sure that you order, purchase, acquire, or construct the property early enough so that your business can actually *place it in service no later than December 31, 2010!*

§179 Deduction Increased From \$250,000 To \$500,000 For 2010 And 2011. For the last several years, Congress has temporarily increased the maximum §179 deduction for the cost of qualifying new or used depreciable business property to \$250,000 to help spur the economy. However, for **property placed-in-service in tax years beginning in 2010 and 2011**, the *Jobs Act* has increased the cap from \$250,000 to **\$500,000**, and has also increased the beginning of the deduction phase-out threshold from \$800,000 to **\$2,000,000**. In addition, the *Jobs Act* provides that for **2010 and 2011 purchases**, a taxpayer may elect for "*qualified real property*" (discussed in the next segment) to be §179 property. Prior to this change, real property did not generally qualify for the §179 deduction. **Tax Tip.** If you plan on making substantial acquisitions of machinery, equipment or other property qualifying for the §179 deduction, these new limitations will enable you to acquire more property during your 2010 year and obtain an up-front §179 deduction. However, if you want the §179 deduction this year, make sure you place the property in service on or before the end of your tax year. Generally, "*placed-in-service*" means the property is ready and available for use. If you want to take the §179 deduction **for 2010**, to be safe, qualifying property should be set up and tested on or before the last day of your tax year. **Planning Alert!** For tax years beginning *after* 2011, the maximum §179 deduction cap is currently scheduled to drop back to \$25,000.

- **Beware Of Taxable Income Limitation!** The §179 deduction generally is not allowed to the extent the deduction exceeds the taxpayer's business taxable income (determined without the §179 deduction). Thus, due to this so-called *taxable income limitation*, the §179 deduction generally cannot create a taxable loss (or NOL). **Tax Tip.** On a joint return, spouses can combine their business income from all sources for purposes of the *taxable income limitation*. Thus, business income includes not only trade or business income, but also W-2 compensation income of either spouse on a joint return. For example, a wife who generates a §179 deduction from her sole proprietorship, partnership, or S corporation may use her husband's W-2 compensation (as well as her own W-2 income) generated from an entirely separate business to satisfy the §179 taxable income limitation, if they file jointly. Thus, the §179 deduction from one source can essentially be used to offset the taxpayer's (and spouse's) W-2 income or other business income from other sources.

Please Note. If your business is considering a significant equipment or business vehicle purchase, please call our office. We will help you develop a strategy to maximize tax savings.

May "Elect" To Treat Up To \$250,000 Of "Qualified Real Property" As §179 Property For 2010 And

2011. Traditionally, the §179 deduction has been limited to depreciable, tangible, “personal” property, such as equipment, computers, vehicles, etc. The *Jobs Act temporarily* allows taxpayers to “elect” to treat qualified “real” property as §179 property, provided the property is **placed-in-service in tax years beginning in 2010 and 2011**. The maximum §179 deduction that is allowed for *qualified real property* is \$250,000. “Qualified Real Property” includes property within any of the following three categories: **1) Qualified Leasehold Improvement Property** (generally capital improvements to an interior portion of certain leased buildings that are used for nonresidential commercial purposes), **2) Qualified Retail Improvement Property** (generally capital improvements made to certain buildings which are open to the general public **for the sale of tangible personal property**), and **3) Qualified Restaurant Property** (generally capital expenditures for the improvement, purchase, or construction of any building (new or used), if more than 50% of the building's square footage is devoted to the preparation of, and seating for, the on-premises consumption of prepared meals). If you elect to take up to \$250,000 of the §179 deduction on qualified real property, the \$500,000 overall §179 deduction limitation is reduced to \$250,000 (\$500,000 - \$250,000). In other words, the \$250,000 §179 limitation for “qualified real property” is a part of the overall \$500,000 §179 limitation and not in addition to the \$500,000 limitation. **Tax Tip.** If you are currently acquiring business assets or making capital improvements to “qualified real property,” and you want to take the §179 write-off **for your tax year beginning in 2010**, you must place the building (or capital improvements) in service **by the end of your 2010 tax year**. A certificate of occupancy will generally constitute “placing the building or improvement in service.”

Planning Alert! The rules dealing with improvements to leased commercial buildings, buildings used for retail, and buildings used as restaurants are extremely tricky. Furthermore, the depreciation rules become even more complicated if you are planning to do a cost segregation study where you break out nonstructural components of a building for depreciation purposes. Please call our firm if you are improving, acquiring, or constructing a building. We will help you devise a strategy that will maximize depreciation and §179 deductions.

50% Bonus Depreciation Extended Through December 31, 2010. In 2008, Congress reinstated the 50% bonus depreciation deduction for calendar year 2008, and later extended it to calendar year 2009. The *Jobs Act* extends the 50% bonus depreciation for one more year, **through calendar year 2010**. Therefore, the 50% bonus depreciation deduction is available for new “qualifying property” **acquired and placed-in-service during calendar years 2008, 2009, and 2010** (2011 for certain long production period property or specified aircraft). **Planning Alert!** Whether your business uses a fiscal or calendar tax year, the 50% bonus depreciation deduction is allowed only if “qualified property” is “acquired” and “placed-in-service” **during calendar years 2008, 2009, or 2010. Qualifying 50% Bonus Depreciation Property.** This generally includes *new* property that has a depreciable life for tax purposes of *20 years or less* (e.g., machinery and equipment, furniture and fixtures, cars and light general purpose trucks, sidewalks, roads, landscaping, depreciable computer software, farm buildings, qualified motor fuels facilities) and “qualified leasehold improvements” (capital improvements to certain commercial buildings under lease). **Planning Alert!** These are only *examples* of qualifying property. If you have a question about property that we have not mentioned, call us and we’ll help you determine if it qualifies.

- **Special Rule For Long-Term Contractors.** For property placed-in-service in 2010 that has a **depreciable life of 7 years or less**, the *Jobs Act* provides that income reported under the “percentage of completion” method will be determined without taking into account the 50% bonus depreciation. If your business is using the percentage of completion method for long-term construction or production projects, **please call our office**. We will give you more information on how this “**2010 only**” provision could provide tax relief to your business.

Bonus Depreciation For Passenger Automobiles, Trucks, And SUVs. The maximum annual depreciation deduction (including the §179 deduction) for most *business automobiles* is capped at certain dollar amounts. For a business auto first placed in service in calendar year **2010**, the maximum first-year depreciation deduction is generally capped at \$3,060 (\$3,160 for trucks and vans not weighing over 6,000 lbs). The *Jobs Act* increased this cap **by \$8,000** for new vehicles qualifying for the §168(k) depreciation deduction first placed in service in calendar year **2010**. **For example,** let’s say you are self employed and you are planning to purchase a *new* vehicle weighing 6,000 lbs or less that will be used 100% in your business. If you buy a new car and place it in service before the end of 2010, your first-year depreciation

deduction will be \$11,060. If you wait until 2011 (assuming Congress doesn't extend the bonus depreciation deduction and the 2011 first-year depreciation cap is the same as for 2010), your first-year depreciation deduction would be only \$3,060. **Trucks and SUVs with loaded vehicle weights over 6,000 lbs** are generally exempt from the passenger auto annual depreciation caps discussed above. However, the §179 deduction for an *SUV* is limited to \$25,000 (instead of \$500,000 for 2010 and 2011). However, *pickup trucks* heavier than 6,000 lbs are *not* subject to the \$25,000 limit imposed on SUVs, if the truck bed is at least six feet long. **Tax Tip.** If you purchase the passenger vehicle, truck, or SUV in 2010, to qualify for the §179 deduction and/or the 50% bonus depreciation, your business mileage of the vehicle through **December 31, 2010** must exceed 50% of the total mileage. Therefore, by keeping your personal use to a minimum, you will maximize your business percentage for 2010 which could dramatically increase your 2010 depreciation deduction. **Planning Alert!** If your business use percentage drops to 50% or below after 2010, you may be required to bring into income a significant portion of the depreciation and/or §179 deduction that was originally taken. Therefore, it is imperative that the business use of the vehicle exceeds 50% for subsequent years.

Self-Employed Individuals May Deduct Health Insurance Premiums In Calculating Self-Employment Taxes For 2010 Only. Generally, if you are self-employed, you are entitled to deduct your health insurance premiums, paid for you and your family, as an “above-the-line” deduction (i.e., unrestricted by the limitations on “itemized deductions”). However, traditionally, your health insurance premiums *were not deductible* for purposes of computing the Self-Employment (S/E) tax (Social Security and Medicare taxes) that is imposed on your self-employed income. **For tax years beginning in 2010**, the *Jobs Act* allows self-employed individuals to deduct their health insurance premiums for S/E tax purposes, as well as for regular income tax purposes. **Tax Tip.** If you are self-employed and you are planning to pay health insurance premiums in the early part of 2011, **accelerating that payment into 2010** will salvage a deduction for S/E tax purposes.

Up-Front Deduction For Business Start-Up Expenses Increased For 2010 Only. If you start a new business, you are generally not allowed to deduct any portion of your start-up expenses until the tax year your business actually begins operations. Start-up expenses are generally expenses incurred prior to the date you “begin business” (e.g., before you open your doors for business). Under the *Jobs Act*, for tax years **beginning in 2010**, the first \$10,000 (previously \$5,000) of start-up expenses are deductible up-front. However, the \$10,000 up-front deduction is reduced for each dollar the total start-up expenditures exceed \$60,000. As under prior law, start-up expenses in excess of the up-front deduction amount are amortized over 180 months beginning with the month business begins. **Tax Tip.** If you are in the process of starting a new business (whether a sole proprietorship, corporation, partnership, or LLC) and wish to take advantage of the increased deduction for *start-up expenses*, you should take steps to establish that your business has actually begun operations on or before the end of your 2010 tax year. You may be able to show your business has begun operations by offering your product or service to the public, engaging a client or customer, opening your doors for business, beginning manufacturing operations, etc.

Tax Incentives To Hire The Unemployed. Under the *HIRE Act*, an employer that **hires a qualified unemployed worker after February 3, 2010 and before January 1, 2011**, is exempt from the employer's 6.2% share of Social Security taxes on *wages paid* to the employee from **March 19, 2010 through December 31, 2010**. In addition, for each qualified worker retained for at least 52 **consecutive** weeks, the employer will also generally get an “income tax” credit, of up to \$1,000. A **Qualified Unemployed Worker** generally includes workers who began employment **after February 3, 2010 and before January 1, 2011**, if the new worker: **1)** has been employed for no more than 40 hours during the 60-day period immediately preceding the date the employment begins, **2)** is *not related* to a more than 50% owner of the employer, **3)** signs an affidavit (using Form W-11) that he or she meets the 40-hour/60-day requirement, and **4)** was not hired to replace an existing worker who was terminated (*unless* the previous worker terminated voluntarily or was terminated for cause). **Planning Alert!** In determining if a worker has been employed more than 40 hours during the 60-day period ending with the date employment begins, self-employment does not count as “employment.”

Tax Tip. The 6.2% exemption applies to compensation “paid” from **March 19, 2010 through December 31, 2010**, regardless of when the compensation is “earned.” Thus, a bonus paid to a qualified unemployed worker on December 31, 2010 would qualify, while the same bonus in early January, 2011 would not. Likewise, a signing bonus for a qualified worker (who could presumably be an executive meeting the

40-hour/60-day requirement) hired late in 2010, that is **paid no later than December 31, 2010**, should qualify.

Small Employers Get New Credit For Providing Employee Health Insurance. One of the pleasant surprises included in the *Health Care Act* is a new tax credit for **“eligible small employers”** that **1)** provide health insurance to employees, **2)** pay a uniform percentage of the cost for each covered employee, and **3)** pay at least 50% of the cost of insurance. For **tax years beginning after 2009 and before 2014**, the *Health Care Act* allows an *eligible small employer* a credit of up to 35% (up to a 25% “refundable” credit for tax exempts) of the employer’s cost of qualifying employee health insurance. For **tax years beginning after 2013**, the maximum credit is increased to 50% (35% for tax exempts).

To receive any credit, an **Eligible Small Employer (ESE)** must have less than **25 full-time equivalent employees (FTEs)** during the year, and **average annual FTE wages of under \$50,000**. In addition, to receive the full 35% or 25% credit, the employer must have no more than 10 FTEs and average FTE wages of no more than \$25,000. The credit is phased out as FTEs go from 10 to 25 and as average FTE wages go from \$25,000 to \$50,000. **Tax Tip.** The IRS has recently added links to its main website (www.irs.gov) providing “tax tips,” “guidance,” and “answers to frequently asked questions” with respect to this credit.

“Eligible Small Businesses” Get Temporary Tax Breaks For General Business Tax Credits.

Generally, a business that does not have sufficient tax liability to use its general business tax credits may carry its unused credits back one taxable year to offset the taxes it paid in that previous year. Any remaining amount may be carried forward up to 20 years to offset future tax liabilities. Moreover, many business tax credits are not available to offset a taxpayer’s alternative minimum tax (AMT) liability and, therefore, have limited benefit. Under the *Jobs Act*, “eligible small business credits” **determined in the first tax year beginning in 2010** can be carried back to the 5 years (instead of 1 year) preceding 2010 and carried forward for up to 20 years. These 2010 credits may also offset the taxpayer’s AMT during 2010, the carryback years and/or the carryforward years. An *“eligible small business credit”* is a general business credit generated by a taxpayer: **1)** that is a sole proprietorship, a partnership (which generally may be a limited liability company), or a non-publicly traded corporation (which includes S corporations and closely-held C corporations), and **2)** that has \$50 million or less in average annual gross receipts for the prior three years. **Planning Alert!** Businesses that wish to take advantage of this temporary tax break should take all necessary steps to make the expenditure, or place the property in service, that generates the business credit – **no later than the end of the tax year beginning in 2010**.

S Corp 10-Year Built-In Gain Period Temporarily Shortened To 5 Years. If a regular “C” corporation elects “S” corporation status (a “Converted S Corporation”), the election itself generally does not trigger income. However, the Converted S Corporation must generally pay a 35% corporate “built-in gains tax” on the sale of any built-in gain asset, if sold during the first 10 years following the S election (“10-Year Recognition Period”). A *built-in gain* asset is generally any asset with a market value greater than the asset’s basis on the effective date of the S election. The *Jobs Act* temporarily reduces the original 10-Year Recognition Period **to 5 years for tax years beginning in 2011**. The Act provides that there will be no tax on the net recognized built-in gain of an S corporation for any taxable year beginning in 2011, if the 5th year (i.e., 12-month period) in the recognition period precedes such year.

EXPIRING (AND EXPIRED) BUSINESS TAX BREAKS

Congress has given us an ever-expanding list of temporary tax breaks that expire every few years. However, even though it often waits until the last minute, Congress has historically extended most of the more popular provisions before they actually expire. Unfortunately, Congress has yet to extend many popular tax breaks that expired after 2009.

Selected Business Tax Breaks That Expired At The End Of 2009. Some of the more popular business tax benefits that **expired at the end of 2009** include the: **1)** 15-year (instead of 39-year) depreciation period for “qualified leasehold improvements;” **2)** 15-year (instead of 39-year) depreciation period for “qualified restaurant property;” **3)** 15-year (instead of 39-year) depreciation period for “qualified retail improvement property;” **4)** 5-year (instead of 7 year) depreciation period for certain farming business machinery and equipment; **5)** research and development credit; **6)** employer differential wage credit for payments to military personnel; **7)** various tax incentives for investing in the District of Columbia; **8)** favorable S

corporation charitable contribution provisions; and **9)** enhanced charitable contribution rules for qualifying business entities contributing computer equipment, book, and food inventory. **Planning Alert!** Although several pieces of “proposed” legislation would have extended these provisions, at least through 2010, they have yet to be enacted. Our firm continues to monitor the status of these expired provisions. Please call us if you want an update.

Selected Business Tax Breaks That Are Currently Scheduled To Expire At The End Of 2010. The following are selected tax breaks that are scheduled to expire **after 2010**; consequently, this will be the last year you will be able to take advantage of these tax breaks unless Congress extends them beyond 2010: **1)** maximum long-term capital gain and qualified dividend rates of 15% (scheduled to return to 20% and 39.6%, respectively, after 2010); **2)** employer-provided educational assistance tax-free fringe; **3)** credit for employer-provided child care facilities; **4)** *accumulated earnings* and *personal holding company* penalty tax rates of 15% (scheduled to return to 39.6% after 2010); **5)** Work Opportunity Tax Credit (WOTC) for certain *unemployed veterans* and *disconnected youth*; and **6)** deferral and ratable inclusion of income from certain business debt discharges.

SHOULD WE PAY COMPENSATION OR DIVIDENDS TO SHAREHOLDER/EMPLOYEES

Since your regular “C” corporation can generally deduct a bonus, and cannot deduct a dividend, the advisability of paying a shareholder/employee a dividend in lieu of a year-end bonus is based largely on the tax brackets of both the corporation and the shareholder. If your corporation is feeling the effects of the recession and would receive little or no tax benefit from a year-end bonus deduction (e.g., it is incurring current losses and/or has net operating loss carryovers to the current year), then a dividend **paid in 2010** taxed at a maximum rate of 15% will generally save taxes. On the other hand, if your corporation has significant income and is currently in a high tax bracket, then a bonus **paid in 2010** would likely save taxes. **Planning Alert!** If you decide that a 2010 dividend will save you and your corporation overall taxes, the corporation should declare and pay the dividend no later than **December 31, 2010** to ensure the benefit of the current 15% maximum tax rate (assuming that Congress does not extend the 15% dividend rate beyond 2010). On the other hand, if you decide that a year-end bonus would be more tax beneficial, be sure that you can justify the reasonableness of the bonus. If your corporation pays compensation to a shareholder/employee that is considered unreasonably high, the IRS may attempt to re-classify the payment as a dividend payment. Therefore, the corporation should document the reasonableness of compensation paid to all shareholders/employees. **Tax Tip.** We will gladly help you tailor a compensation plan that will maximize the tax savings to you and your corporation.

TRADITIONAL YEAR-END PLANNING FOR “S” CORPORATIONS

Check Your Stock And Debt Basis Before Year End. If your S corporation is anticipating a taxable loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless you have adequate “basis” in your S corporation. You will have basis to the extent of the amounts paid for your stock (adjusted for net pass-through items and distributions), plus any amounts you have personally loaned to your S corporation. If you do not have sufficient stock basis for the pass-through loss, a mere guarantee of a third-party loan made to your S corporation will not give you basis. **Tax Tip.** It may be possible to restructure an outside loan to your corporation in a way that will give you adequate basis. However, this restructuring must occur **before the end of the tax year**. **Planning Alert!** Making sure that you have sufficient basis is particularly important in **2010** if your S corporation anticipates generating losses from the 50% bonus depreciation. The rules for restructuring existing loans to an S corporation to ensure that you have basis are complicated. **Please do not attempt to restructure your loans without contacting us first.** Also, if you finance losses of an S corporation with loans from other entities controlled by you, or if you borrow from another shareholder, the IRS may take the position that these loans do not give you basis. It is best not to finance S operations with funds borrowed directly from related corporations or from other shareholders.

TRADITIONAL GENERAL BUSINESS PLANNING FOR YEAR-END

Self-Employed Business Income. If you are self-employed, it continues to be a good idea to defer as much income into 2011 as possible, you believe that your marginal tax rate for 2011 will be equal to or less

than your 2010 marginal tax rate. If you think that deferring 2010 income to 2011 will save you overall taxes, and you use the cash method of accounting, consider delaying year-end billings until 2011. **Planning Alert!** If you have already received the check in 2010, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Establishing A New Retirement Plan For 2010. Calendar-year taxpayers wishing to establish a qualified retirement plan for 2010 (e.g. profit-sharing, 401(k), or defined benefit plan) *generally* must adopt the plan **no later than December 31, 2010**. However, an SEP may be established by the due date of the tax return (including extensions), and a SIMPLE plan must be established no later than October 1, 2010.

The "Production Deduction." If your business generates "qualified production activities income" from manufacturing, construction, farming, ranching, engineering services, architectural services, software development, film production, production of sound recordings, etc., the business may qualify for a §199 *production deduction*. Generally, this deduction of **9% for 2010** (up from 6% in 2009) of the *qualifying income* cannot exceed 50% of the qualifying W-2 wages paid by your business. Since the production deduction may not exceed 50% of W-2 wages paid to employees, the deduction is lost if there are no wages paid with respect to a qualifying business. Many farmers and small businesses reporting qualifying production activities income on Schedule F or Schedule C have paid no W-2 wages during 2010. However, in many of these businesses, a spouse has worked in the business but has not been paid. **Tax Tip.** One strategy to obtain a production deduction is to pay the spouse *reasonable wages on or before December 31, 2010*. **Planning Alert!** This strategy will generally be beneficial only where the additional FICA tax paid on the amounts paid to the spouse are offset by an equal reduction in the proprietor's or farmer's self-employed SECA tax liability. Therefore, the strategy is generally most beneficial when the self-employed income of the proprietor or farmer is \$106,800 or less (i.e., the SECA wage base for 2010) before the payment of the spouse's salary. These calculations can be complicated. Please call us and we will help you determine whether or not the payment of wages to your spouse is advisable.

PREPARING FOR POTENTIAL TAX RATE INCREASES

Unless Congress changes current law, most individual owners of pass through business entities are facing an increase in their federal income tax rates beginning next year. For example, in 2011, the top individual income tax rate on income, other than long-term capital gains, is scheduled to jump from 35% to 39.6%. The maximum tax rate on long-term capital gains is scheduled to increase from 15% to 20%. And, the top tax rate on dividends is scheduled to increase from 15% to 39.6%. Furthermore, **starting in 2013**, the *Health Care Act* imposes a new **.9% Medicare Surtax** on the *earned income* of higher-income taxpayers. Also, beginning **in 2013**, there will be a **3.8% Medicare Surtax** on the *net investment income* of higher-income taxpayers, which could apply to the pass-through operating income taxed to a "passive" owner of an S corporation, partnership, or LLC unless the income is subject to self-employment taxes. **However, there is no scheduled increase in the maximum 35% tax rate for regular "C" corporations.**

Until we have firm guidance as to the 2011 income tax rates for the individual owners of proprietorships, partnerships, and S corporations, taking actions in 2010 in anticipation of the 2011 rates is full of uncertainties. However, as we approach year-end we can hopefully decide if individual business owners should accelerated income into 2010 to avoid any increase in the tax rates for 2011 and future years. We will be ready to assist you with these calculations and with other year-end planning considerations as we approach the end of 2010.

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note:** The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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