

Tax Talk

A quarterly publication of Bridges & Dunn-Rankin, LLP

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Dear Clients and Friends,

While the September floods were tragic for many, they actually resulted in some relief for Atlanta-area tax professionals and their clients. Seventeen Georgia counties were declared by the President as disaster areas and, consequently, the IRS and Georgia Department of Revenue extended to December 17 the due date for any tax filings otherwise due between September 18 and December 17 for taxpayers residing in these counties or who have a business in these counties or whose records necessary for tax return preparation were located in these counties. States other than Georgia which we have contacted likewise agreed to extend the deadline.

As we wrap up the tax returns which are now due December 17, it is time to focus on year-end tax planning.

In a continuing effort to stimulate economic

recovery, Congress has recently passed more taxpayer friendly legislation. In this issue we will review highlights of the recent legislation and potential tax legislation on the horizon, discuss year-end tax planning strategies, and, as always, highlight a member of our firm and one of our clients.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges



Kent Bridges,
Managing Partner

The Worker, Homeownership, and Business Assistance Act of 2009

On November 6, 2009, President Obama signed into law *The Worker, Homeownership, and Business Assistance Act of 2009*. Highlights of the tax provisions in this legislation include:

Homebuyer credit – Legislation enacted in 2008 provided for a first-time homebuyer tax credit of up to \$7,500, which had to be repaid over a 15-year period. Legislation enacted in early 2009, increased the maximum credit to \$8,000 and provided that it did not have to be repaid, provided the taxpayer lives in the home for at least 3 years. The credit was available only for homes purchased prior to December 1, 2009, and the credit was phased out for single taxpayers with income between \$75,000 and \$95,000 and for married couples with income between \$150,000 and \$170,000. The new legislation extends the credit for principal residences purchased before May 1, 2010 (or July 1, 2010, if under contract as of May 1, 2010), increases the income levels for which the credit is available (the phaseout will be at income levels of \$125,000 - \$145,000 for singles and \$225,000 - \$245,000 for married couples), and makes the credit available not only for first-time homebuyers (generally defined as those who have not owned a home in the previous 3 years) but also “long-time residents” (generally defined as those who have had the same principal residence for any 5-consecutive year period during the preceding 8 years). For qualifying “long-time residents” the maximum credit is \$6,500. The maximum credit is in all cases limited to 10% of the purchase price, and no credit is available for home purchases in excess of \$800,000. In order to

claim the credit, the taxpayer must be at least 18 years old and cannot be eligible to be claimed as a dependent on another taxpayer’s return. Also, the home cannot be purchased from a relative, and you must attach to your tax return a copy of the closing statement.

Extension and expansion of the 5-year NOL carryback period – Under present law, net operating losses (NOLs) can generally only be carried back 2 years or carried forward 20 years. Under legislation enacted in early 2009, the carryback period for losses incurred in 2008 was extended to 5 years, but only if the loss came from a business with average annual revenue of less than \$15 million. The new legislation extends the 5-year NOL carryback period to cover losses incurred during 2009 (tax years beginning after 12/31/07 and before 1/1/10), and expands it to cover businesses of all sizes (i.e. not limited to those with average annual revenue of less than \$15 million). The amount of the loss which can be carried back to the 5th preceding year cannot exceed 50% of income from that carryback year. Taxpayers which may have elected to forego the NOL carryback for an NOL arising in 2008 (e.g. because they were, under prior law, limited to a 2-year carryback) or who may have filed a carryback claim going back only two years will now have an opportunity to change the election they previously made. Also, the corporate rule which limited use of an

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Scott A. Fincher, CPA

Member in the Spotlight – Scott A. Fincher

Scott Fincher holds a Bachelor of Business Administration degree in Accounting from Georgia State University and a Master of Accountancy from the University of Georgia with a specialization in Taxation. After spending seven years working in industry, Scott returned to school to seek a graduate degree and pursue a career in public accounting.

Prior to joining Bridges & Dunn-Rankin, LLP, Scott worked in the accounting department of a regional homebuilding and land development company located

in the Atlanta area. His areas of specialty were cost accounting, general ledger accounting and management reporting for construction, development and real estate marketing.

Scott, his wife Melissa, a sales representative for a commercial printer, and their two sons reside in the Dunwoody area.

Bridges & Dunn-Rankin is proud to have Scott Fincher as a member of our firm.

The Worker, Homeownership, and Business Assistance Act of 2009 - continued

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alternative minimum tax NOL carryback to 90% of income is suspended for tax years ending after 2002. The extended and expanded NOL provision is expected to yield \$33 billion in refunds.

Increased penalty for late filing of partnership, LLC and S-corp returns – Legislation enacted in 2007 increased the penalty for late

filing of returns for partnerships, LLCs and S-corps to \$85 per partner, member or shareholder per month. The new legislation increases the penalty to \$195 per month per partner, member or shareholder for a maximum of 12 months (i.e. up to \$2,340 per Schedule K-1 filed). Accordingly, a partnership with 100 partners, for example, which fails to timely file its return could be facing a penalty of up to \$234,000.

Tax Legislation on the Horizon

While healthcare reform has occupied center stage in Congress of late, there are tax issues which Congress must deal with as well.

Estate tax – Under current rules, the exemption from estate tax is \$3.5 million and the top tax rate is 45%. The estate tax is scheduled to disappear for 2010, and then reappear in 2011 with an exemption of only \$1 million and a top rate of 55%. This is obviously not palatable, and Congress will almost certainly have to act to reform the estate tax before then. In recent years there has been much talk about the possibility of repealing the estate tax. This now seems highly unlikely. What appears more probable is the exemption remaining at \$3.5 million and the highest rate remaining at 45%.

Alternative minimum tax – Repeal of this highly unpopular tax seems unlikely, but Congress will likely continue to increase the exemption in order to avoid having millions more taxpayers

ensnared by it.

Income tax rates – Currently, the highest Federal rate on ordinary income is 35% and on qualified dividends and long-term capital gains is generally 15%. Absent Congress taking any action to extend these rates, effective January 1, 2011 the highest rate on ordinary income will revert to 39.6% and the rate on long-term capital gains and qualified dividends will revert to 20%. This appears to be the most likely scenario.

Revenue raisers – We will likely again see proposed legislation to tax “carried interests” (type of ownership in partnerships received by managers of hedge funds, private equity funds, and real estate ventures) as ordinary income rather than capital gains. We will also likely see further legislation aimed at preventing the use of offshore financial institutions, foreign trusts and foreign corporations as a means to avoid U.S. tax.

Year-end Tax Planning Strategies

Late November through year end is the time for year-end tax planning. While every client’s situation is unique, here are some of the more common strategies we employ.

Harvesting of capital losses – Capital losses can, for the most part, only be deducted against capital gains. And while capital losses can be carried forward, for individuals they cannot be carried back to previous years. Accordingly, it is generally a good strategy to go ahead and recognize any potential capital losses you have, at least up to the amount of your capital gains for the year. If you have a significant capital gain from earlier in the year (e.g. from the sale of a business), it is important to realize these losses for tax purposes before year end in order to be able to deduct them against the capital gain. You should be aware that under the “wash sale rules” if you buy the same stock within 30 days before or after you sell the stock at a loss, then your tax loss is

disallowed. To the extent that you are concerned that the market may bounce back within the 30 day period and you do not want to risk missing out on the recovery, you can generally buy a similar stock (or similar mutual fund) without violating the wash sale rules.

Timing of payment of state income taxes – There seems to be a commonly-held belief that you should always accelerate the payment of your state income taxes into December in order to get the tax deduction in the current year. While that is sometimes a good strategy, such is not always the case. Individuals in the alternative minimum tax (AMT) posture receive no Federal tax benefit from their payment of state income tax. By running tax projections for the current and upcoming year, you can determine

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Year-end Tax Planning Strategies— continued

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the optimal timing for payment of state income tax, sometimes resulting in a substantial permanent tax savings. This is especially true with respect to a year in which you have a substantial gain, such as from the sale of your business.

Use of tax credits to minimize state income tax – There are various tax credits which can be utilized to minimize or avoid state income tax. Some (e.g. the Georgia jobs, research, and retraining credits) must be generated by a business entity, some can essentially be purchased (e.g. the Georgia low-income housing credit and the film credit), and others are based on taking some sort of action which the government is encouraging (e.g. the Georgia credit for donations to Student Scholarship Organizations). Some of these credits (e.g. the Georgia low-income housing credit) are generally priced in such a way that they really only make sense for individuals if they are in the alternative minimum tax posture.

Timing of charitable donations – It is generally advantageous to time significant charitable donations to coincide with a year in which you have significant income and are in a higher rate bracket. Because of the percentage of income limitations on charitable donation deductions (e.g. 50% of income for cash donations and 30% of income for donations of appreciated property) and the inability to carry the deduction back to earlier years, making a substantial donation in the year after a big gain can potentially result in the permanent loss of a tax benefit versus having made the donation in the same year as the substantial gain. On the other hand, if you have charitable carryforwards that are in danger of expiring, deferring additional donations to the next tax year may be prudent. Likewise, if your charitable deduction would be substantially limited by the percentage of income limitation on itemized deductions in a year of high income or if your income is already offset by other deductions and exemptions in a year of low income, then deferring your deduction may be advantageous.

Estimated tax payments – In order to avoid a penalty, you are generally required to pay in through withholding or quarterly estimated tax payments the lesser of 90% of your current year tax liability or 110% of your prior year tax liability. With respect to estimated tax payments, you get credit the day you actually make the payment. Withholding, however, is generally deemed to have occurred ratably throughout the year, regardless of when actually withheld. Accordingly, if you realize late in the year that you have a shortfall for earlier quarters, you can sometimes avoid the penalty by increasing your withholding late in the year; e.g. having all of a

year-end bonus withheld for taxes.

Acceleration or deferral of income and deductions – Businesses which use the cash basis of accounting for income tax purposes often have a great deal of control over the timing of income and deductions. Shifting income from a high-rate bracket year to a low-rate bracket year can obviously result in a permanent tax savings. And even where your rate bracket will be the same from year to year, deferring income to the next year can result in a time-value-of-money savings.

S-corp and LLC basis and at-risk limitations – In general, you can deduct your share of losses from S-corps, LLCs and partnerships, and distributions from such entities are generally tax-free. However, the ability to deduct losses or receive tax-free distributions is limited by the “basis” and “at-risk” rules. Basically, the amount of loss you can deduct or distributions you can receive tax free is limited to your unreturned investment in the entity (including past undistributed profits and, in the case of partnerships and LLCs, your share of the entity’s liabilities which are either bank debt on a real estate project or debts for which you are personally liable). With respect to flow-through entities in which you own a stake, you should review your basis and at-risk amounts prior to year end to determine whether any tax advantage can be gained by increasing such amounts and whether such is prudent from an economic standpoint.

Exercise of ISOs in year not in AMT – “Incentive stock options” (ISOs) hold out the promise of being able to potentially convert what would otherwise be ordinary income (taxed at the highest rates) into long-term capital gain (taxed at more favorable rates). However, because the bargain element is an “alternative minimum tax” (AMT) adjustment on the date of exercise, the AMT often eliminates much of the hoped for benefit. A tax year in which you will not be in the AMT represents an opportunity to exercise some ISOs at no tax cost, meaning a potential permanent tax savings if you hold the stock for the requisite period of at least one year from date of exercise and two years from date of grant.

Sale of ISO shares that have fallen in value - If you exercise ISOs and sell in the same tax year, then the AMT issue goes away. Accordingly, we typically advise our clients who want to exercise and hold ISOs to do so early in the year, giving us almost a full year to watch the stock price and to sell the stock before year end if necessary in order to cure the AMT problem. If you exercised ISOs earlier this year, you still hold the shares, and the value of the

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Client in the Spotlight – Nor-Ral Plastics, Inc.

Nor-Ral Plastics was formed in 1962 by Norris McWhorter, Sr. and Ralph Sosebee, Jr. as a builder of custom tools for aerospace manufacturers. Norris’ son, Tony, an architect and electrical engineer, joined the company in 1978, and over time the company evolved into the machining, engineering and production of custom tools and parts for customers in the aerospace, automotive, industrial and marine industries.

Today, under Tony’s leadership, the Woodstock-based company manufactures tooling and component parts for the U.S. Military,

Lockheed
Martin, Bell
Helicopter,
The Boeing
Company, Goodrich, Hexcel, Northrop-Grumman, Sikorsky, and many others.



Bridges & Dunn-Rankin is proud to be associated with Nor-Ral Plastics, Inc.

Year-end Tax Planning Strategies - continued

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shares has fallen dramatically, then now may be the time to sell.

Section 179 expense – Small companies (which for these purposes means those which have purchased less than \$800,000 in furniture and equipment) can elect to immediately expense up to \$250,000 of the cost of furniture and equipment against otherwise taxable profit. If your capital expenditures for the year will be less than \$800,000 and you will be in a high rate bracket for the year, then accelerating the purchase of some equipment may be advantageous.

Bonus first-year depreciation – For most new depreciable assets (other than buildings) placed in service during 2009 The American Recovery and Reinvestment Act will permit 50% of the cost to be expensed immediately, with the balance recovered under the regular depreciation rules. This special first-year deduction applies both for regular tax and alternative minimum tax. For autos and light trucks, for which first-year depreciation would otherwise be limited under the so-called “luxury automobile rules”, bonus depreciation of \$8,000 may be taken (bringing the total deduction to approximately \$11,000).

Selection of accounting methods – New businesses can, within certain limitations, select the tax accounting methods (e.g. cash or accrual) which are most beneficial for them. And existing businesses have some latitude to later change their accounting methods. Your situation should be reviewed each year in order to determine which accounting methods are most advantageous for you.

Net operating loss carryback claims – In light of the current economic situation, many businesses will likely report tax losses for 2009. The silver lining in this is that tax operating losses incurred during 2009 can generally be carried back to recover tax paid in any of the previous five years. If you will have a tax loss for the current year and paid tax at a high rate within the past five years, then maximizing your current year tax loss may be advantageous.

Conversion of IRA to Roth status - With a traditional deductible IRA, you get a tax deduction on the front end when you make the contribution, but then are subject to ordinary income tax rates on

any withdrawals (with an additional 10% penalty generally applying if you make withdrawals before age 59 ½). With a nondeductible traditional IRA, you get no tax deduction on the front end and then are subject to ordinary income tax rates on a portion of your withdrawals (the portion representing the income earned by the IRA account). The Taxpayer Relief Act of 1997 introduced a third type of IRA, called the “Roth IRA”, with which you get no front-end tax deduction but the appreciation in value permanently escapes tax. Traditional IRAs can be converted to Roth IRAs, but only if your income for the year of conversion is less than \$100,000 (this rule changes in 2010). The conversion is a taxable event. We sometimes suggest the Roth conversion as a strategy in a tax year in which a client is in a very low tax rate bracket or is in danger of wasting deductions (e.g. a substantial amount of itemized deductions and exemptions, but no income to utilize them against and no ability to create a net operating loss carryback or carryforward). In this situation, you may be able to gain a significant permanent tax benefit at little or no current tax cost.

Utilization of annual gifting exclusion – With respect to the estate and gift tax, there is an annual exclusion which permits you to give up to \$13,000 per year per donee, without incurring any gift tax or eating into your lifetime exemption against such. For married couples electing gift-splitting, this amount is effectively doubled to \$26,000 per year per donee. For those with a significant number of potential heirs, this represents an opportunity to remove a significant amount of value from their taxable estate, especially where gifting assets that may be subject to discounted valuation (e.g. an interest in a family partnership). The annual exclusion is on a use-it-or-lose-it basis with no carryover, so if you haven’t maximized your annual exclusion gifts yet for 2009, consider doing so before year end.

Setting expectations and avoiding surprises – One of the key advantages to engaging in year-end planning is that it enables you to appropriately plan your required cash outlay for taxes and avoid any unpleasant surprises at April 15 or any regrets as to actions that could have been taken by year-end but weren’t.

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Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth families.



IRS Decreases Standard Mileage Rate

The IRS has announced that, effective January 1, 2010, the allowable business mileage rate will decrease from the current 55 cents per mile to 50 cents per mile.

The information provided in this newsletter is presented for educational and informational purposes only, and is not intended to constitute legal, tax or accounting advice. The articles provide only a very general summary of complex rules. For advice on how these rules may apply to your specific situation, contact a professional tax advisor.