2008

Small Business advisor

TIMELY TALK ABOUT BUSINESS, TAXES AND TRENDS

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Buying a Vehicle? Expect Bigger Deductions in 2008

When you use a vehicle for business purposes, the business portion of the operating expenses can be deducted on your self-employed business or, if you are an employee, as a miscellaneous itemized deduction. The tax code provides two possible options: using the standard mileage rate or using actual expenses. For vehicles purchased and placed into service during 2008, the recent Economic Stimulus legislation and inflation adjustments substantially increase the first-year write-offs for business use. The following is a summary of these changes for vehicles purchased in 2008.

Standard Mileage Rate Method – The standard mileage rate takes the place of fuel, oil, insurance, repair, maintenance, and depreciation (or lease) expenses. The rate varies from year to year; for 2008, the standard mileage rate is 50.5 cents per mile. In addition, the cost of business-related parking and tolls is deductible. **Caution:** If the standard mileage rate is not used in the first year in which the vehicle is placed into service, it cannot be used in future years. If, in a subsequent year, there is a switch to the actual method, the straight-line method for depreciation must be used. If the car is leased, the standard mileage rate must be used in future years.

Actual Expenses Method – To use the actual expense method, determine the entire actual cost of operating the car for the year first and then the business portion attributable to the business miles driven. Vehicle depreciation is included as part of the operating costs of a vehicle. Until this year, the depreciation was limited to about $3,000 for the first year. However, for 2008, the 50% bonus depreciation is back, which boosts the first-year allowable depreciation limit by $8,000, increasing the limit for passenger vehicles to $10,960 ($11,160 for small trucks and vans).

SUV Special Limits – Vehicles with a gross unladen weight of more than 6,000 pounds are not subject to the limitations that apply to passenger vehicles, small trucks and vans. Instead, their business portion can be depreciated like any other type of business property, except that they are limited to $25,000 of the Section 179 expense deduction. However, by combining the Section 179 deduction with the new 50% bonus depreciation that applies to 2008, the purchase of an SUV for business can produce a substantial first-year write-off. The following is a representative example (assuming 100% business use) of the write-off for a newly-purchased vehicle placed into service in 2008.

		Write-Off
Heavy SUV Total Cost	$50,000	
Sec.179 Deduction (must be applied first)	<25,000>	25,000
Balance	25,000	
50% Bonus Depreciation	<12,500>	12,500
Balance	12,500	
Reg. First-Year Depreciation (20% of Balance)	< 2,500>	2,500
Total First-Year Write-Off		$40,000

Caution: There has been some discussion in Congress about limiting the write-offs for heavy SUVs. However, Congress is sensitive to the negative effect that such a decision would have on U.S. car makers. So, we must wait and see! For those of you planning to purchase an SUV based upon this big write-off, be sure to call first to see the current status of the deduction and pending legislation.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

Your Rebate Checks Are in…But What Does This Mean for 2009?

By the time you read this article, the IRS has already started sending out the stimulus rebates. A new schedule was released, accelerating the distribution of the payments. Payments were direct deposited into qualifying individuals' bank accounts starting April 28 instead of May 2, and paper checks were mailed starting May 9 instead of May 16. The schedule that was released in March remains the same, with payments either direct deposited or put in the mail by the dates listed on the schedule.

These rebates are actually advance payments for a new refundable tax credit called the "Recovery Rebate Credit" that is claimed on your 2008 tax return and must be accounted for when you file the 2008 tax return. So the government can get the money into people's hands quickly and not wait for the 2008 returns to be filed in 2009, the IRS will calculate and mail out advance payments of this 2008 credit based upon the information included on a taxpayer's 2007 tax return. The IRS will make a direct deposit of the advance payment into a taxpayer's account if direct deposit was requested for the 2007 return refund. When the taxpayer files his or her 2008 return, the Recovery Rebate Credit will be reduced by the amount of the advance payment. Should the advance payment exceed the amount of the credit, the taxpayer will not be required to make up the difference!

Since these advance payments (cash rebates) are computed based on the data from the 2007 return, a 2007 return must be filed to obtain a cash rebate. Thus, some taxpayers (such as those receiving SS income and who are not otherwise required to file a return and otherwise qualify for the rebate) must file one to qualify for the advance payment. However, if a taxpayer does not file a 2007 return, he or she still would qualify for the Recovery Rebate Credit when a 2008 return is filed. This also applies to taxpayers who file late. They do not lose the Recovery Rebate Credit; they just do not receive it in advance and will have to wait for the benefit when their 2008 return is filed. The IRS is prohibited from issuing advance payments after December 31, 2008.

How much will your rebate be? The rebates are broken into two categories, the basic credit rebate and the qualifying child rebate credit. For the basic credit rebate, a single person with no qualifying children gets a maximum rebate of $600 or a minimum rebate of $300. A married couple filing jointly with no qualifying children gets a maximum rebate of $1,200 or a minimum rebate of $600. To receive the maximum, your 2007 tax (figured in a special way) must be $600 or more for a single person and $1,200 or more for a married couple filing jointly. To get the minimum, you must have at least $3,000 of qualifying income (explained above) or owe tax (figured in a special way) of at least $1. Your rebate amount will fall in between the minimum and maximum if your tax is more than $300 but less than the maximum rebate for your filing status. In that case, your rebate will be equal to your tax. Let's say that you are single and that your tax is $500. In this scenario, your rebate will be $500.

An eligible individual who is entitled to any amount of the basic credit is also allowed a credit equal to $300 for each qualifying child of the individual in addition to the basic credit. "Qualifying child" has the same meaning for this purpose as it has for purposes of the child tax credit. Thus, for each child who qualifies for the child tax credit, a taxpayer qualifies for an additional $300 rebate.

For example, a married couple filing jointly with one qualifying child could be eligible for a maximum rebate of $1,500 ($1,200 + $300).

Phase-out for higher-income taxpayers: The amount of the rebate (both the basic and the child amount) is reduced by 5% of a taxpayer's adjusted gross income (AGI) above $75,000 ($150,000 for joint returns). For example, a married couple filing jointly with one child has an AGI of $170,000 and a net tax liability of over $1,200. Their rebate is $500: [$1,200 basic rebate plus $300 qualifying child rebate – $1,000 phase-out (i.e., 5% x ($170,000 - $150,000))].

Do all qualified individuals get rebates? No. Each individual must qualify for the rebates in one of two ways, and the rebates and the credit in 2008 is phased out for higher-income taxpayers. To qualify, a taxpayer must (1) owe tax, as computed in a special way, or (2) have at least $3,000 of qualifying income. Qualifying income generally includes earned income, social security benefits, and veterans' disability payments (including payments to survivors of disabled veterans).

If you think that you might qualify for the rebate and have not yet filed a return, please call this office for assistance.

2008 Brings Big Write-Offs to Businesses

Section 179 of the tax code allows taxpayers to elect to treat any portion of the cost of qualified business property as an expense deduction for the tax year in which the Section 179 property is placed in service - instead of having to capitalize the expense and recover the cost over several years.

Generally, Section 179 property is acquired by purchase for use in the active conduct of a trade or business and is either:

- tangible property such as machinery, equipment, office furnishings, computer systems, certain vehicles (within special limits), or
- off-the-shelf computer software. (Off-the-shelf software qualifies for the Section 179 deduction only through 2011.)

Under the Economic Stimulus legislation passed earlier this year, the Section 179 expensing deduction has been increased to $250,000, almost double the prior $128,000 limit. For property placed in service by an enterprise zone company, the expense deduction limit increased to $35,000.

For 2008, the Section 179 expense deduction limit has been phased out for larger companies by the amount by which the cost of Section 179 property placed in service during the tax year exceeds $800,000 ($510,000 before the new legislation).

Example: *A small business acquires and places in service, during the 2008 tax year, $200,000 of machinery. Under the Economic Stimulus legislation, the small business can deduct the entire $200,000 cost of the machinery in 2008.*

One potentially negative aspect of taking the Section 179 expense deduction is that recapture is necessary if the property is removed from business service (or not used more than 50% for business) at any time before the end of its recovery life. The recapture is the excess of the Section 179 amount over the normal depreciation deduction that would have been allowed.

If recapture is a potential problem, the Economic Stimulus legislation also reinstated the 50% bonus depreciation (which applies to most tangible property, purchased computer software, and qualified leasehold improvement property) for 2008 only. This provision allows a deduction of up to 50% of the cost of the property within the first year with the balance depreciated in the normal manner. There are no recapture issues associated with the 50% bonus depreciation.

The Section 179 deduction and the 50% bonus depreciation also can be combined to provide your business with virtually any write-off (up to the cost of the property) needed for 2008. Another benefit is that there are no alternative minimum tax (AMT) issues, since both are deductible when computing the regular tax and the alternative minimum tax.

2008 offers some interesting opportunities if you are acquiring certain business property. Please give our office a call if we can assist you in planning your acquisitions to provide the greatest tax benefits.

Is a Real Estate Rental an Investment Opportunity For You?

Does the decline in real estate values present a business opportunity? Real estate rentals historically have been a popular long-term investment, and if you believe that this market eventually will rebound from its current slump, this may be the time to consider such an investment. This material will explain some of the tax ramifications of renting both residential and commercial real estate.

One of the biggest benefits of owning rental property is that the tenants, over time, buy the property for you. In addition, if structured properly, the allowable depreciation deduction will shelter the rental income. Another historical benefit of real estate rentals is capital appreciation. Before acquiring a rental property, there are several things to consider, including:

- after-tax cash flow,
- potential for long- or short-term appreciation,
- property condition (with an eye on when you might get stuck with a large repair bill),
- debt reduction,
- type of tenants,
- potential for rent increases or re-zoning, and
- whether there is community rent control, etc.

Although most of the considerations are subjective, the after-tax cash flow can be estimated fairly easily, as illustrated in the example below.

	Cash Flow	Tax P&L
Rental Income	12,000	12,000
Debt Payment	- 10,000	
Mortgage Interest		-9,000
Property Taxes	- 1,500	-1,500
Insurance	-600	-600
Homeowners Association	-300	-300
Repairs and Maintenance	-900	-900
Depreciation		- 4,250
Total	**-1,300**	**- 4,550**
Tax Savings at 25%	1,138 ←	**4,550 x 25%**
After-Tax Cash Flow	**- 162**	

In this example, there is a column for actual cash flow (after taxes) and another for reportable tax profit or loss. For actual cash flow purposes, we must consider the entire mortgage payment (interest and principal), while for the rental tax P&L, only the interest is deductible, but an allowance for depreciation is included. As a result, in the example, there is a negative cash flow of $1,300. However, for tax purposes, the rental shows a loss of $4,550, primarily because of the depreciation allowance. Assuming that the taxpayer is in the 25% tax bracket, that $4,550 loss yields a $1,138 savings in taxes for the year. Thus, our after-tax cash flow is negative only by $162. You also will need to consider whether your loss deduction is limited by the passive loss rules. Generally, you can deduct virtually all expenses incurred to operate and maintain (not improve) the rental. Improvements must be capitalized and depreciated.

Rental real estate income is business income but is not subject to Social Security taxes. Real estate rentals are also considered passive activities. Generally, passive activity losses are deductible only to the extent of passive activity income. However, where there is active participation by the taxpayer in managing the rental, the taxpayer can deduct up to $25,000 of losses each year as long as his or her Adjusted Gross Income (AGI) for the year is less than $100,000. For higher-income taxpayers, the $25,000 loss exception is ratably phased out between an AGI of $100,000 and $150,000. There is also a special allowance for real estate professionals. Any losses not allowed under these two exceptions are not lost but suspended and carried forward indefinitely to tax years in which your passive activities generate enough income to absorb the losses. To the extent your passive losses from an activity are not used up in this fashion, you will be allowed to use those losses in the tax year in which you dispose of your entire interest in the passive activity in a fully taxable transaction.

When a rental is sold, it is treated as a capital asset, and the gain, except for depreciation recapture, is taxed at capital gains rates. Recaptured depreciation, depending upon your tax bracket, can be taxed up to 25%. Besides outright selling of a rental, there are a number of options such as exchanging the existing rental for another while deferring the gain and avoiding current taxes, selling the property in an installment sale (which spreads the taxable gain over multiple years), or even converting the property to personal use (which forestalls the taxable gain until the property ultimately is sold).

Buying, operating, and selling a rental property can have profound tax ramifications and provide some interesting options not available to other investments. Please contact this office prior to the purchase or disposition of a rental property so that the tax impact can be analyzed prior to making a financial commitment.

QUESTION: My wife and I jointly own a business and have been filing a partnership return for several years. We understand that there is a new rule that allows us to avoid filing the partnership return. Can you explain?

ANSWER: Beginning in 2007, a married couple who owns a joint business venture in which they both participate can elect to file two self-employed business schedules (Schedule C or Schedule F) on their personal income tax return, dividing the income and expenses instead of filing a partnership return. However, this special provision does not apply to state law entities such as general or limited partnerships or limited liability companies. If you are interested in pursuing this option for 2008 and currently have employees, are also required to file other types of tax returns, or simply have questions about this option, please give this office a call.

QUESTION: I often spend the day calling on customers at their business locations. Can I deduct the cost of my lunch while I'm away from my office?

ANSWER: The answer is generally no. You can deduct the cost of your meals only when you are away from home overnight. However, you may be able to deduct the cost of your lunch as business-related entertainment if you take one of your customers to lunch with you. In any case, even when the meals are allowed, they are only 50% deductible.

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Tax Calendar
June – September 2008

June 16, 2008

– U.S. citizens living abroad on April 15, 2008 must file a 2007 income tax return (if not already filed) or file for an extension.

– The second installment of your 2008 individual estimated taxes is due. If your income or deductions have significantly changed, you should call this office to determine if any adjustment in estimates is appropriate.

July 2008

– Time to review your 2008 year-to-date income and expenses to ensure that your estimated tax payments and withholding are adequate to avoid underpayment penalties. There have been a significant number of tax changes for 2008 that can impact your estimated taxes for 2008.

July 31, 2008

– This is the due date for self-employed individuals and employers to file 5500 series returns for 2007 calendar year benefit plans (including Keogh/HR-10 plans).

September 15, 2008

– The third installment of your 2008 individual estimated taxes is due.