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2011 Year-End Income Tax Planning
For Businesses

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We have reached that time of year when businesses need to consider year-end tax planning. This year is particularly challenging because Congress has enacted a series of tax breaks which are generally scheduled to expire after 2011. For example, unless Congress acts to extend these provisions, the following business tax breaks will generally ***expire (or become less beneficial) after 2011:***

1) 100% §168(k) bonus depreciation;
2) Larger and expanded §179 deduction;
3) 100% gain exclusion for "qualified small business stock;"
4) Relaxation of the S corporation built-in gains tax rules.

There have also been recent IRS releases and court cases that address: the ability of self-employed individuals, partners, and S corporation shareholders to deduct health insurance premiums (including Medicare premiums); whether compensation paid to S corporation shareholders is "reasonable"; and the S/E tax exposure of owners of a limited liability partnership.

We are sending you this letter to help you navigate the many *new* tax planning opportunities available to businesses because of recent law changes and other current tax developments, while also reminding you of the *traditional* year-end tax planning strategies for businesses (including regular "C" corporations, "S" corporations, partnerships, LLCs, and self-employed individuals).

Caution! Since several significant new tax breaks **expire after 2011,** you may have to act promptly to take advantage of these short-lived provisions! So, please pay close attention to the ***expiration dates*** for the various provisions discussed in this letter, which we ***highlight prominently*** in each section.

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

- Taking Maximum Advantage Of The 100% §168(k) Bonus Depreciation Deduction And §179 Deduction p. 2
- Other "Business" Tax Breaks Expiring After 2011 p. 5
- Other Recent Developments Impacting Business Planning p. 6
- Traditional Year-End Planning for "S" Corporations p. 7
- Traditional Year-End General Business Planning p. 8

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.*

TAKING MAXIMUM ADVANTAGE OF THE 100% §168(k) BONUS DEPRECIATION DEDUCTION AND THE EXPANDED §179 DEDUCTION

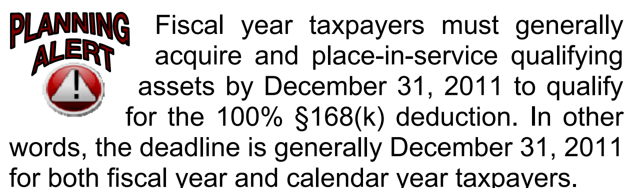
The two most significant business tax breaks ***expiring after 2011*** are:

1) the 100% §168(k) bonus depreciation deduction, and

2) the expanded §179 deduction. These two provisions offer unprecedented up-front deduction opportunities for businesses considering significant capital expenditures.

The 100% §168(k) Bonus Depreciation Deduction Generally Expires After 2011

For *qualifying* new business property placed-in-service from **2008 through September 8, 2010,** businesses were allowed a 50% first-year §168(k) bonus depreciation deduction. The Tax Relief Act of 2010 increased this deduction to 100% for "qualifying business property" ***acquired*** and ***placed-in-service*** after **September 8, 2010 and through December 31, 2011** (through December 31, 2012 for certain long-production-period property and qualifying noncommercial aircraft). In other words, for §168(k) property acquired and placed-in-service during this period, the *entire cost* of the property can be fully deducted. For qualifying §168(k) property placed-in-service ***during 2012,*** the §168(k) bonus depreciation deduction reverts back to **50%,** and generally ***expires*** altogether for property placed-in-service ***after 2012.***



Fiscal year taxpayers must generally acquire and place-in-service qualifying assets by December 31, 2011 to qualify for the 100% §168(k) deduction. In other words, the deadline is generally December 31, 2011 for both fiscal year and calendar year taxpayers.

The following paragraphs summarize the rules for determining if an asset qualifies for the §168(k) deduction:

♦ ***Qualifying 50%/100% §168(k) Bonus Depreciation Property***

Property qualifying for the §168(k) bonus depreciation deduction is generally *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, modern golf course greens, depreciable computer software, farm buildings, qualified motor fuels facilities and "qualified leasehold improvements").

Make sure you properly classify "land improvements" as "15-year property" (and not as part of the building) since land improvements qualify for the 100% bonus depreciation deduction, and buildings (other than "qualified leasehold improvements," farm buildings, and qualified motor fuels facilities) generally do not.

These are only *examples* of qualifying property. If you have a question about property that we have not mentioned, call us and we will help you determine if it qualifies.

♦ ***Reconditioning Used Property***

Although §168(k) bonus depreciation property must generally be "new," the IRS regulations provide that capital expenditures incurred to recondition or rebuild used property may qualify. **For example,** lets assume that your business purchases a *used* machine during 2011 for $50,000. Also during 2011, you incur $20,000 to recondition the machine. The $50,000 cost of the used machine does not qualify for the §168(k) bonus depreciation deduction. However, the $20,000 expenditure to "recondition" the machine would qualify for the deduction.

♦ ***Qualified Leasehold Improvement Property***

Even though improvements to a commercial building *generally* do not qualify for the §168(k) bonus depreciation deduction, "qualified leasehold improvement property" (QLHIP) does qualify. Furthermore, QLHIP qualifies for the 100% deduction if it is "acquired and placed-in-service" after **September 8, 2010** and **before 2012.** *QLIP* is generally any capital improvement to an interior portion of a building that is used for nonresidential commercial purposes, provided that **1)** the improvement is made under or pursuant to a lease either by the lessee, sublessee or lessor of that interior building portion; **2)** the interior building portion is to be occupied exclusively by the lessee or sublessee; **and 3)** the improvement is placed-in-service **more than 3 years** after the date the building was first placed-in-service.

QLIP **does not include** any improvement attributable to: the enlargement of the building; any elevator or escalator; any structural component benefitting a common area; or the internal structural framework of the building. **Caution!** Leasehold improvements made to property leased between certain *related persons* **will not qualify.**

♦ ***Newly-Constructed Or Renovated Buildings And Cost Segregation Studies***

Depreciable components of newly-constructed or newly-renovated buildings that are properly classified as depreciable *personal* property under a ***cost segregation study*** are generally depreciated over 5 to 7 years. Since these non-structural components have a depreciable life of 20 years or less, they should qualify for the 100% 168(k) bonus depreciation if "acquired and placed-in-service" **after September 8, 2010 and before 2012.**

In certain situations, these components of the building might qualify for the 100% bonus depreciation deduction even if the construction or renovation of the building itself began ***before*** *September 9, 2010*, provided you make a timely election to apply the 100% §168(k) acquisition rules separately to each component.

♦ ***100% 168(k) Bonus Depreciation Property Generally Must Be "Placed-In-Service" By December 31, 2011***

Whether your business has a "calendar" or "fiscal" tax year, in order to get the ***100% §168(k)*** bonus depreciation deduction, you must place the property in service ***no later than December 31, 2011*** (before the end of 2012 for certain long-production-period property and qualifying noncommercial aircraft). Generally, if you are purchasing "personal property" (equipment, computer, vehicles, etc.) "placed-in-service" means the property is **ready and available for use.** To be safe, qualifying property should be ***set up and tested*** on or before the ***last day of 2011.*** On the other hand, if you are dealing with building improvements (e.g., qualified leasehold improvement property, non-structural components of a building), a certificate of occupancy will generally constitute placing the building or improvement in service.

The §168(k) bonus depreciation deduction reverts **to 50%** for qualifying property **placed-in-service in 2012** (except for certain long-production-period property and qualifying noncommercial aircraft).

§168(k) Bonus Depreciation For Passenger Automobiles, Trucks, And SUVs.

The maximum annual depreciation deduction (including the §179 deduction, discussed below) for most *business automobiles* is capped at certain dollar amounts. For a business auto first placed-in-service in **calendar year 2011,** the maximum first-year depreciation deduction is generally capped at $3,060 ($3,260 for trucks and vans not weighing over 6,000 lbs). However, Congress previously increased the first-year depreciation cap for vehicles qualifying for the §168(k) up-front bonus depreciation deduction by $8,000 for 2008 and 2009. The Tax Relief Act of 2010 **extended this $8,000 increase through 2012 for new vehicles otherwise qualifying for the §168(k) bonus depreciation deduction.**

For example let's say your business is planning to purchase a *new* vehicle weighing 6,000 lbs or less that will be used 100% for business purposes. If you buy the new car and place it in service during 2011, your first-year depreciation deduction will be $11,060. **Heavy Vehicles.** "Heavy Vehicles" (i.e., trucks, vans, and SUVs with loaded vehicle weights over 6,000 lbs.) are generally exempt from the passenger auto annual depreciation caps discussed above. Therefore, if you buy a new "heavy" truck or SUV and use it 100% for business **in 2011,** you could deduct the "entire cost" **for 2011** using the §168(k) deduction.

If you purchase a passenger auto, truck, or SUV in 2011, to qualify for the 100% §168(k) bonus depreciation deduction, your business mileage **through December 31, 2011** must ***exceed 50% of*** the total mileage. By keeping your personal use to a minimum, you will maximize your business percentage for 2011 which could dramatically increase your 2011 depreciation deduction.

If your business use percentage drops to ***less than 51%*** after 2011, you generally will be required to bring into income a significant portion of the depreciation that was originally taken. Therefore, it is important that the business use of the vehicle ***exceeds 50%*** for subsequent years.

Expanded §179 Deduction

For the last several years, Congress has temporarily increased the maximum §179 up-front deduction for the cost of qualifying "new" or "used" depreciable business property (e.g., business equipment, computers, etc.). For **property placed-in-service in tax years beginning in 2010 and 2011,** the overall cap was increased from **$250,000** to **$500,000,** and the beginning of the deduction phase-out threshold was increased from **$800,000** to **$2,000,000.** In addition, for **2010 and 2011 purchases,** a taxpayer may elect for "qualified real property" to be §179 property. Prior to this change, real property generally did not qualify for the §179 deduction.

Caution! For tax years **beginning after 2011,** the maximum §179 deduction is currently scheduled to drop **back to $139,000** and there will be no §179 deduction for "qualified real property."

♦ ***Up To $250,000 Of "Qualified Real Property" Temporarily Qualifies As §179 Property***

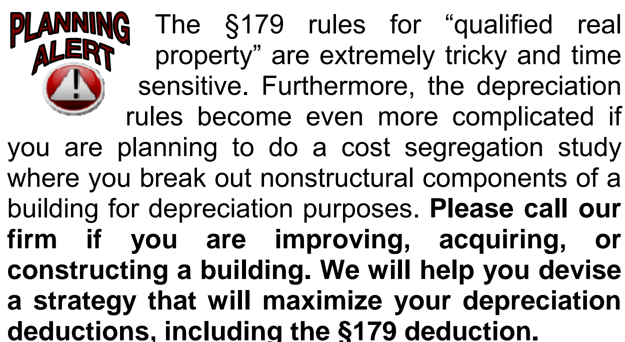
Traditionally, the §179 deduction has been limited to depreciable, tangible, "personal" property, such as equipment, computers, vehicles, etc. However, businesses may **"elect"** to treat qualified "real" property as §179 property, for property **placed-in-service in tax years beginning in 2010 or 2011.** 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 more than 3 years old and that are used for nonresidential commercial purposes);

2) Qualified Retail Improvement Property (generally capital improvements made to certain buildings that are more than 3 years old and 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 a building, 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).

Caution! If you want to take the §179 write-off **for "qualified real property" for your tax year beginning in 2011,** you must place the building (or improvements) in service by the ***end of your 2011*** tax year. If you are a calendar year taxpayer, this means that the property must be placed-in-service ***no later than December 31, 2011.*** A certificate of occupancy will generally constitute placing the building or an improvement to a building in service.



The §179 rules for "qualified real property" are extremely tricky and time sensitive. 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 your depreciation deductions, including the §179 deduction.**

What If The §179 Deduction And The 100% §168(k) Bonus Depreciation Deduction Apply To The Same Property?

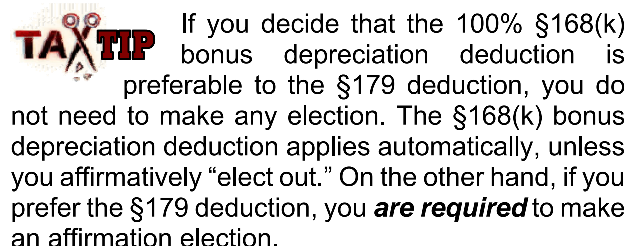
For qualifying property purchased and placed-in-service ***in 2011,*** in many cases both the §179 deduction and the 100% §168(k) bonus depreciation will apply to the same property. For example, both provisions would apply to new depreciable, tangible, "personal" property (e.g., new business equipment, computers, vehicles, etc). The 100% §168(k) bonus depreciation deduction may be preferable to the §179 deduction where the §179 deduction is limited by your business income. The 100% §168(k) bonus depreciation deduction is not limited by your business income and can generate an overall tax loss (i.e., "net operating loss"). You can use a *net operating loss* to offset income in the preceding 2 years as well as up to 20 future years. However, in other situations, the §179 deduction may actually be preferable where:

1) your business is purchasing "used" business property (§168(k) bonus depreciation only applies to "new" property);

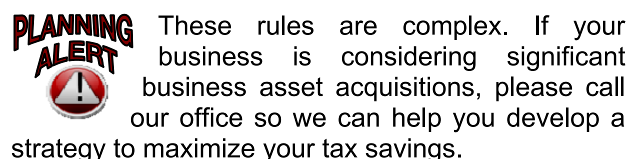
2) your business is purchasing ***"qualified restaurant property"*** or ***"qualified retail improvement property"*** which, as described above, temporarily qualifies for the §179 deduction but not for the §168(k) bonus depreciation deduction;

3) your business is located in a state that allows some or all of the §179 deduction for state income tax purposes, while the state does not allow any or as much of the §168(k) bonus depreciation deduction; or

4) your business is subject to the uniform capitalization (UNICAP) rules (the §179 deduction is not required to be capitalized into the cost of inventory while the §168(k) bonus depreciation deduction is not exempt from the UNICAP rules).



If you decide that the 100% §168(k) bonus depreciation deduction is preferable to the §179 deduction, you do not need to make any election. The §168(k) bonus depreciation deduction applies automatically, unless you affirmatively "elect out." On the other hand, if you prefer the §179 deduction, you ***are required*** to make an affirmation election.



These rules are complex. If your business is considering significant business asset acquisitions, please call our office so we can help you develop a strategy to maximize your tax savings.

OTHER "BUSINESS" TAX BREAKS EXPIRING AFTER 2011

In addition to the 100% §168(k) bonus depreciation deduction and the expanded §179 deduction, there are several other important business tax breaks currently scheduled to expire at the ***end of 2011.***

Although Congress has traditionally extended many expiring tax breaks, there is no guarantee that Congress will do so in the future.

Whether or not Congress ultimately extends these expiring tax breaks, there are real tax savings to be obtained if you take advantage of these provisions **before the end of 2011.** The following are some of the more important expiring provisions that your business should consider utilizing ***before the end of 2011:***

Two Percent Social Security Tax Holiday For "2011"

For **2011 only,** there is *a* ***2%*** reduction in Social Security taxes for both employees and self-employed individuals. Therefore, **if you are an employee,** your take-home pay for 2011 is generally being increased by 2% of each dollar of compensation that you earn. However, since Social Security taxes apply only to the first $106,800 of compensation in 2011, your maximum savings will generally be $2,136 (i.e., $106,800 x 2%). Likewise, if you are self-employed, your Social Security taxes are reduced by 2% of your self-employment income for 2011 (up to $106,800). Therefore, if your self-employment income is $106,800 or more, your self-employment taxes will be reduced by $2,136.

Accelerating 2012 compensation or self-employed income ***into 2011*** will save you 2% on your Social Security tax to the extent the income acceleration does not cause you to exceed the $106,800 earned income cap.

100% Exclusion For "Qualified Small Business Stock"

If you sell "qualified small business stock" (QSBS) **acquired after September 27, 2010 and before January 1, 2012,** you may be able to exclude the **entire gain** from taxable income if you hold the stock for more than 5 years (the gain will also be exempt from the alternative minimum tax). QSBS is generally stock of a non-publicly traded domestic "C" corporation engaged in a qualifying business, purchased directly from the corporation, and **held for more than 5 years;** where the issuing corporation meets certain active business requirements and has assets at the time the stock is issued of $50 million or less. Businesses engaged in a professional service, banking, insurance, financing, leasing, investing, hotel, motel, restaurant, mining, or farming activity generally *do not* qualify.

If you are considering investing in or starting a new business, we will gladly help you evaluate whether structuring your investment as QSBS will work to your overall tax advantage. However, you must act promptly to take advantage of this narrow window of opportunity to qualify for the 100% exclusion. Only stock acquired **from September 28, 2010 through December 31, 2011** qualifies for the 100% exclusion (after it has been held over five years). Also, to qualify, you must purchase the stock directly from the corporation that is issuing the stock or from an underwriter of the stock (stock purchased from other third parties does not qualify).

Don't Overlook The "Retention Credit" For Qualified Unemployed Workers

If your business:

1) hired a *qualified unemployed worker* **after February 3, 2010 and before January 1, 2011,**

2) the worker signed a ***IRS Form W-11*** ("HIRE Act Employee Affidavit"), and

3) you retained the worker on your payroll for at least 52 **consecutive** weeks, you may be entitled to an "income tax" credit of up to $1,000 for each qualifying worker **on your 2011 return.** If you think your business qualifies for this credit, we will gladly help you determine the exact amount of credit available.

S Corp 10-Year Built-In Gain "Waiting" Period Temporarily Shortened To 5 Years

If a "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 gain from the sale of any built-in gain asset (up to the amount of appreciation in that asset on the effective date of the S election), if the asset is sold during the first 10 years following the S election. 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 *has temporarily* reduced the 10-year waiting period *to 5 years* **for S Corp tax**

years beginning in 2011. That is, the Jobs Act provides that there will be no 35% built-in gains tax on the net recognized built-in gain of an S corporation for any taxable year **beginning in 2011,** if the 5th year in the waiting period (i.e., "recognition period") preceded such taxable year.

For sales of "built-in gain" assets that occur in tax years beginning ***after 2011,*** the waiting period to avoid the *built-in gains tax* is scheduled to revert to 10 years. **Caution!** We have just summarized these extremely complicated rules in this letter. If your S corporation plans to sell a built-in gain asset, please call us. We will gladly help you determine if the S corporation qualifies under this special 5-year rule.

Other Selected "Business" Tax Breaks Scheduled To Expire After 2011

A host of other current tax breaks for businesses are scheduled to expire unless Congress takes action to extend these provisions. The following business tax breaks expire **at the end of 2011:**

1) 15-year (instead of 39-year) depreciation period for qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property;

2) 7-year depreciation period for certain motor sports racetrack property;

3) research and development credit;

4) employer differential wage credit for payments to military personnel;

5) various tax incentives for investing in the District of Columbia;

6) favorable S corporation charitable contribution provisions;

7) several tax benefits for qualified energy-efficient expenditures;

8) enhanced charitable contribution rules for qualifying business entities contributing computer equipment, book, and food inventory; and

9) work opportunity tax credit for qualified employees.

OTHER RECENT DEVELOPMENTS IMPACTING BUSINESS PLANNING

Relief From Stringent 1099 And W-2 Reporting Requirements

Over the past 18 months, Congress enacted new information reporting requirements for businesses. After much pressure from the business community, both Congress and the IRS have recently provided the following relief from some of these new reporting requirements:

♦ ***Congress Repeals Recently-Enacted 1099 Reporting Rules***

New rules enacted in 2010 expanded the 1099 reporting rules to include payments aggregating $600 or more made to "corporations" (previously, payments to corporate payees, other than attorneys and certain health care providers, were exempt from the 1099 reporting rules). These changes also expanded the 1099 reporting requirements to include payments of $600 or more for "property" (previously, the 1099 reporting rules applied predominantly to payments for "services"). Both of these changes were effective for payments made after 2011. In addition, effective for payments made after 2010, Congress imposed 1099 reporting requirements on taxpayers receiving real estate rental income, whether or not the taxpayers were in the rental real estate "trade or business." The *Comprehensive 1099 Taxpayer Protection Act of 2011* has now retroactively repealed all three of these provisions as if they had never been enacted.

Practice Alert! If you are considered to be in the *"trade or business"* of renting real estate (traditionally a *facts & circumstances* determination), you may still be required to file a Form 1099 for payments of $600 or more to a service provider (e.g., payments to a plumber or painter). Also, the 1099 reporting requirements continue to apply to payments made to corporations for ***attorneys' fees,*** and to corporations providing ***medical or health care services.***

♦ ***IRS Provides Relief From Reporting Cost Of Employer-Provided Health Insurance On W-2s***

Beginning with 2011 W-2s, employers were generally required to report the cost of employer-provided health insurance coverage on Forms W-2. In 2010, the IRS announced that this reporting would be "optional" for ***all employers*** for ***2011 Forms W-2*** (generally given to employees in January, 2012). The IRS recently extended this interim relief by making the reporting of the health insurance cost *"voluntary"* for "2012 Forms W-2" for employers that file less than 250 2011 W-2s. Therefore, if your business ***files less than 250 2011 W-2s (i.e.,for compensation paid to employees in 2011),*** it will ***not be required*** to report the health insurance cost on the ***2012 W-2s*** (generally filed in January 2013).

Practice Alert! Reporting the health insurance cost on the W-2 is for information purposes only, it does not cause the premiums to be taxable to the employee.

- ***The IRS Announces That More Small Tax-Exempt Organizations May File A Simplified Annual Information Return***

For tax years beginning on or ***after January 1, 2010,*** tax-exempt organizations with ***annual gross receipts of $50,000*** or less can file ***Form 990-N*** ("Electronic Notification e-Postcard"). The threshold previously was $25,000 in annual gross receipts.

TRADITIONAL YEAR-END PLANNING FOR "S" CORPORATIONS

Properly Account For Health Insurance Premiums For S Corporation Shareholders - Including Medicare Premiums

Generally, if you own S corporation stock and the S corporation pays for your health insurance premiums, IRS says you can take an *"above-the-line"* deduction (i.e., unrestricted by the 7½% subtraction as an itemized medical expense deduction) for the premiums on your personal tax return if the S corporation timely reports the cost of the premiums paid on your W-2 as wages. However, if the medical insurance policy is your personal policy, the IRS says that your S corporation must pay the premiums directly, or reimburse you for the premiums ***before the end of the year and*** timely report the payment (or reimbursement) on your W-2 as wages for you to take an *"above-the-line"* deduction on your personal return.

Make sure your S corporation complies with these rules (including reimbursing any premiums you paid during 2011 by 12/31/11 and including any premiums the S corporation paid for you or reimbursed you on your 2011 W-2) so you will not be limited to a deduction only for the premiums in excess of 7½% of your AGI**.**

The above rules apply to premiums paid or reimbursed for you, your spouse, your dependents, and any of your children **under age 27 at the end of the year** (even if the child does not qualify as your dependent). In addition, the IRS has clarified that Medicare premiums qualify as medical insurance premiums. Therefore, the above rules also apply if the S corporation reimburses or pays **your Medicare premiums.**

Check Your Stock And Debt Basis Before Year End

If you think your S corporation will have a taxable loss this year, you should contact us as soon as possible. These losses will not be deductible on your personal return unless and until you have adequate "basis" in your S corporation. Any pass-through loss that exceeds your "basis" in the S corporation will carry over to succeeding years. You 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.

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.**

Making sure that you have sufficient basis is particularly important **in 2011** if your S corporation anticipates generating losses from the 100% §168(k) bonus depreciation deduction. The rules for restructuring existing loans to an S corporation to ensure 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 corporation operations with funds borrowed directly from related entities or from other shareholders.

Salaries For S Corporation Stockholder/Employees

For 2011, an employer must pay FICA taxes of 7.65% of an employee's wages up to $106,800 and FICA taxes of 1.45% on wages in excess of $106,800. In addition, for 2011, an employer must withhold FICA taxes from an employee's wages of 5.65% on wages up to $106,800 (normally 7.65%, but reduced to 5.65% for 2011 only) and 1.45% of wages in excess of $106,800. If you are a stockholder/employee of an S corporation, this FICA tax is generally applied only to your W-2 income from your S corporation. Other income that passes through to you or is distributed on your stock is generally not subject to FICA taxes or to self-employment taxes.

If the IRS determines that you have taken an unreasonably "low" salary from your S corporation, the Service will generally argue that other amounts you have received from your S corporation (e.g., distributions) are disguised "compensation" and should be subject to FICA taxes. Determining "reasonable salaries" for S corporation shareholder/employees is a hot audit issue, and the IRS has a winning record on taking taxpayers to Court on this issue. The IRS has been particularly successful where S corporation owners pay themselves no salary even though they provided significant services to the corporation. However, in a recent case, the IRS took a CPA to Court who had paid himself $24,000 of salary from his S corporation, while receiving additional cash "distributions" from the S corporation of approximately $200,000. The Court concluded that his salary (subject to payroll taxes) should be $91,000 rather than $24,000. Therefore, the Court treated $67,000 of the $200,000 of distributions from the S corporation as additional wages. **Caution!** Determining a "reasonable" salary for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is "reasonable." However, this case makes it clear that salaries to S corporation shareholders should be supported by independent data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation.

Keeping salaries low and minimizing your FICA tax could also reduce your Social Security benefits when you retire. Furthermore, if your S corporation has a qualified retirement plan, reducing your salary may reduce the amount of contributions made to the plan on your behalf since contributions to the plan are based upon your "wages."

TRADITIONAL YEAR-END GENERAL BUSINESS PLANNING

Self-Employed Business Income

If you are self-employed, it continues to be a good idea to defer as much income into 2012 as possible, if you believe that your marginal tax rate for 2012 will be equal to or less than your 2011 marginal tax rate. If you think that deferring 2011 income to 2012 will save you overall taxes, and you use the cash method of accounting, consider delaying year-end billings until 2012.

If you have already received the check in 2011, 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.

Self-Employed Individuals, Partners, And S Corp Owners Should Take Maximum Advantage Of Deduction For Health Insurance Premiums

Generally, if you are self-employed, a partner in a partnership, or a more than 2% shareholder of an S corporation, you may qualify for an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums you pay for yourself, your spouse, your dependents or your children under 27 at the end of the year (even if the child is not your dependent). Until recently, there was confusion as to whether Medicare premiums paid by a self-employed individual, a partner in a partnership, or a more than 2% shareholder of and S corporation, qualified for this treatment. The IRS has now confirmed that if you otherwise qualify for an *above-the-line* deduction for health insurance premiums, you may be able to deduct your Medicare premiums.

The IRS also says that if you are self-employed and failed to take this deduction for Medicare premiums in prior years for which the statute of limitations is still open (generally, three years back), we may be able to amend those returns and take the deduction. **Please contact us if you think this applies to you and we will assist in determining if you may amend prior year returns and take the deduction.**

If you are a partner in a partnership or a more than 2% shareholder in an S corporation and you are paying health insurance premiums on a personal medical policy during 2011 (including Medicare premiums), the IRS says that the partnership or the S corporation must reimburse you for those premiums ***before the end of 2011*** and include the reimbursement in your 2011 W-2 income for you to qualify for the *above-the-line* deduction. If you are in this situation, please call our office and we will help you structure the reimbursement of the premiums to maximize your deduction. **Note!** Please also see the section of this letter that addresses the tax treatment of health insurance premiums for S corporation shareholders for additional information for those individuals.

Establishing A New Retirement Plan For 2011

Calendar-year taxpayers wishing to establish a qualified retirement plan for 2011 (e.g. profit-sharing, 401(k), or defined benefit plan) *generally* must adopt the plan **no later than December 31, 2011.** However, a SEP may be established by the due date of the tax return (including extensions), and a SIMPLE plan must have been established no later than October 1, 2011.

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. In addition, 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.

***Circular 230 Disclaimer*:** Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of **1)** avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions, or **2)** promoting, marketing, or recommending to another party any transaction or matter addressed herein.

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