



November 11, 2008

Dear Business Client:

As 2008 draws to a close, there is still time to reduce your 2008 tax bill and plan ahead for 2009. This letter highlights several potential tax-saving opportunities for you to consider. We would be happy to meet with you to discuss specific strategies for your business.

Business Deductions

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses and dependents as an above-the-line deduction, without regard to the 7.5% of AGI floor.

Equipment Purchases: If you purchase equipment, you may make a "Section 179 Election," which allows you to expense (i.e. currently deduct) otherwise depreciable business property. In general, you may elect to expense up to \$250,000 of equipment costs (with a phase-out for purchases in excess of \$800,000) if the asset was placed in service during 2008. For 2009, these figures will be \$133,000 and \$530,000, respectively. In addition, careful timing of equipment purchases can result in favorable depreciation deductions in 2008. In general, under the "half-year convention," you may deduct six months worth of depreciation for equipment that is placed in service on or before the last day of the tax year. (If more than 40% of the cost of all personal property placed in service occurs during the last quarter of the year, however, a "mid-quarter convention" applies).

Bonus first-year depreciation deduction: Most new machinery and equipment (as well as software) bought and placed in service in 2008 qualifies for a 50% bonus first year depreciation deduction. Property bought and placed in service next year generally won't qualify.

Deduction for bonuses not paid until 2008: An accrual basis corporation can take a deduction for its current tax year for a bonus not actually paid to its employee until the following tax year if (1) the employee does not own more than 50% in value of the corporation's stock, (2) the bonus is properly accrued on its books before the end of the current tax year, and (3) the bonus is actually paid within the first 2 ½ months of the following tax year. For employees on the cash basis, the bonus will not be taxable income until the following year. The 2008 deduction will not be allowed if the bonus is paid by a personal service corporation to an employee-owner, or by an S corporation to any employee-shareholder, or by a C corporation to a direct or indirect majority owner.

NOL Carryback Period: If your business suffers net operating losses in 2008, you may apply those losses against taxable income going back two tax years. Thus, for example, the loss could be used to reduce taxable income—and thus generate tax refunds—for tax years as far back as 2006.

Business Credits

Small Employer Pension Plan Startup Cost Credit: For 2008, certain small business employers that did not have a pension plan for the preceding three years may claim a nonrefundable income tax credit for expenses of establishing and administering a new retirement plan for employees. The credit applies to 50% of the first \$1,000 in administrative and retirement-education expenses for each of the first three plan years.

Employer-Provided Child Care Credit: For 2008, employers may claim a credit of up to \$150,000 for supporting employee childcare or childcare resource and referral services. The credit is allowed for a percentage of "qualified child care expenditures" including expenditures for property to be used as part of a qualified child care facility, for operating costs of a qualified child care facility and for resource and referral expenditures.

Maximize the Deduction for U.S. Production Activities

For 2008, businesses (incorporated or not) can deduct (for both regular and alternative minimum tax) up to 6% of their qualified domestic production activities income. "Qualified domestic production activities income" is the net income from certain business activities, if substantially all the activity takes place in the U.S. (or its possessions). "Production" is somewhat of a misnomer. In addition to traditional manufacturing, the deduction is available for income from selling personal property that the business manufactures, grows, produces or extracts; construction; producing software, film, or videotape; farming; and processing agricultural products and food.

If your business is engaged in one of these qualified activities, the new deduction can be significant. However, there is one catch; the deduction cannot exceed 50% of the wages paid to employees (W-2 wages) for the year. This could be a problem for businesses that pay little or no wages. Many sole proprietorships do not pay the owner a salary. Likewise, S corporations often pay owners relatively small salaries to minimize their payroll taxes. This means that after applying the W-2 wages limit, their deduction for U.S. production activities could be significantly reduced.

Business owners who are eligible for the U.S. production activities deduction should look at their compensation policies and consider increasing owner salaries to ensure their deduction is not scaled back. Also, because the deduction is based on net income from qualifying activities, it would be a good idea to take a look at your accounting system to be sure it will allow you to determine the income from qualifying activities as well as expenses directly related to or allocable to that activity. If not, some tweaking of the accounting system may be in order.

Take Another Look at Electing S Status

Electing S status often saves a substantial amount of tax because it avoids the double taxation experienced by many C corporations. However, S status is only available if the corporation meets several requirements, including a limit on the number of shareholders. Again, for 2008, the maximum number of eligible shareholders allowed in an S corporation is 100. Also, family members (up to six generations) can elect to be treated as one shareholder. Without the election, family members (other than husband and wife) are generally each counted as a shareholder. Making the election then reduces the number of shareholders for the number-of-shareholders limitation. Electing to treat family members as a single shareholder can also be useful for S corporations that otherwise would not be able to admit new shareholders due to the 100-shareholder limit.

Penalties

Be aware the IRS is imposing penalties on employers who issue W-2s without a social security number or an incorrect one. The penalty is \$50 per W-2. It is in your best interest to ensure you have the correct social security number for each of your employees. One way to ensure is to have your employees complete a W-9 certifying their social security number is correct. In addition to W-2s, the same penalty will be imposed for any 1099s issued. Please contact our firm if you have questions about avoiding the imposition of this penalty.

Consider Amending 401(k) Plans to Accept Roth 401(k) Contributions

Earnings on funds in a Roth IRA grow tax-free, as opposed to merely tax-deferred as in a traditional IRA or 401(k) plan. However, higher-income taxpayers are ineligible to make Roth IRA contributions. For 2008, taxpayers covered by a 401(k) plan are able to designate some or all of their 401(k) contributions as Roth 401(k) contribution. Thus, they can take advantage of tax-free growth in their retirement account just like those who are able to contribute to Roth IRAs. Even better, the 2008 contribution limit to Roth 401(k) plans is \$15,500 (\$20,500 if age 50 or older), which is much higher than the \$5,000 (\$6,000 if age 50 or older) limit on Roth IRA contributions.

One Caution: Unlike “regular” 401(k) contributions, contributions that you designate as Roth 401(k) contributions are taxed to you the year they are made. However, the benefit of tax-free earnings on those contributions (provided they are held in the plan for a certain amount of time) will often outweigh the tax-deferral on a regular 401(k) plan contribution. This is especially true if your tax rate is higher when you withdraw the money from your 401(k) plan than it was when the funds were contributed (which could be the case given the current Federal deficit picture). The only “catch” is that an existing 401(k) plan must be amended to accept Roth 401(k) contributions. The plan will have to account for the Roth 401(k) contributions, and earnings thereon, separately from regular contributions.

Mileage Rate News

The business standard mileage rate is 50.5 cents a mile for business miles driven between January 1 and June 30, 2008 and 58.5 cents a mile for business miles driven between July 1 and June 30, 2008.

Spouses' Partnership

Unincorporated businesses owned by a married couple can file as two sole proprietorships instead of a partnership. Each spouse takes into account his or her respective share of the venture's items as if they were attributable to a trade or business conducted by the spouse as a sole proprietor. Thus, a Schedule C will generally be filed for each spouse.

A qualified joint venture is one involving a trade or business if (1) the only members are a husband and wife, (2) both spouses materially participate and (3) both spouses elect to have the provision apply.

Important Information from the Social Security Administration

Effective January 1, 2007, the Social Security Administration no longer accepts any type of physical media; tapes, cartridges, CD ROMs, diskettes, etc. All wage reports must be filed electronically by employers or third-party preparers using the Social Security Administration's Business Services Online.

Michigan Business Tax

In the summer of 2007, Governor Granholm signed into law the Michigan Business Tax (MBT) Act to replace the SBT Act. The effective date for the MBT was January 1, 2008. It is imposed on taxpayers with Michigan business activity and Michigan gross receipts of at least \$350,000.

Please keep in mind that the MBT Act is broad-based, and as a result several issues continue to arise which were not specifically addressed in the Act. In response, the Michigan Department of Treasury has launched a website, www.michigan.gov/taxes, to provide guidance as each issue is resolved. In addition, our staff continues to attend several conferences hosted by the State of Michigan and professional associations to gain valuable knowledge and insight so that we can assist you in successfully incorporating the MBT into your business. Draft forms for the MBT were issued this month by the state with final forms estimated to be released in January 2009.

Planning to Maximize Your Benefits

If you have any questions, please do not hesitate to call us at (269) 321-9200. We would be happy to meet with you at your convenience to discuss the strategies outlined above. There is still time to implement these strategies to minimize your 2008 tax liability.

Very truly yours,

Brink, Key & Chludzinski, P.C.