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Stu's View

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Business Taxes 2011: Uncertainty to Opportunity

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You know the old adage: "The only certainty in life is death and taxes." Although the many unresolved tax issues during 2010 may have made this seem questionable, Congress finally passed the Tax Relief Act of 2010. This legislation offers numerous advantages for both businesses and individuals. Some are extensions of existing legislation you may already be employing in your tax strategies, while others offer new tax opportunities.

The 2010 tax bill includes multiple beneficial provisions for Businesses, including:

- 100% Bonus Depreciation
- Section 179 Asset Expensing Election
- Loss Carry Backs & Carry Forwards
- Leasehold Improvements deduction
- Research & Development (R&D) Tax Credit
- DPAD - Domestic Production Activities Deduction
- School Contributions: Used Computers
- Energy Tax Credit

<u>Bonus Depreciation</u>

Bonus depreciation is the big winner for businesses in the new tax legislation. This provision allows for immediate write off of <u>new</u> (not used) equipment. To qualify, the new equipment must be purchased from September 9, 2010 through December 31, 2011 and placed into service during this specified time frame. It should be noted that "bonus" depreciation is really a misnomer for this benefit, as it is actually an acceleration of the actual depreciation into the first year or early years, and not a "bonus". As such, it means there will be no write off for your business in future years.

Section 179 Asset Expensing Election

Great as it is, the bonus depreciation provision only applies to new equipment. For other asset purchases, there is the Section 179 Election. This is an accelerated depreciation that can be used by small businesses for both new and used assets, allowing you to expense up to $500,000 of assets purchased in 2010 and 2011. For example, if you purchased an asset for $450,000, the whole asset could be expensed. If you purchased equipment of $1,000,000, the maximum amount of $500,000 would apply. Of course, there is always a limitation – i.e., if you exceed $2,000,000 a year in total assets purchased, the $500,000 maximum deduction is lowered dollar for dollar to $0 at $2,500,000 of annual total purchases. Beginning in 2012, the expensing option reverts back to $125,000.

The printing industry has always had an issue with limitations on the 179 because of the high cost of printing presses. Therefore, bonus depreciation is now the better deal for new assets since there is no limitation.

An additional perk of the 179 election may apply in acquisition situations. There is a tremendous amount of consolidation in the industry now, and sometimes specific assets (furniture, software, equipment, etc.) are being acquired as well as the customer list. When acquiring another company as an asset purchase (where you buy the assets, versus a stock purchase), that list of equipment you are purchasing is just like buying any used equipment. It is considered used, so it does come under the 179 expensing option with its $500,000 expensing benefit. Keep in mind, though, that if your equipment or furniture purchases in an annual period exceed the $2,000,000 limit, then you can't utilize the expensing option for used equipment.

Loss Carry Back / Carry Forward

As a result of accelerating the depreciation write-offs of equipment purchases, carrying back the losses to the prior two years can provide significant refund opportunities. For example, if you buy a large press in the specified bonus depreciation time frame and it creates a loss, you may carry back that loss on your C Corporation to the two prior years. Carry backs can also apply to S Corps and LLCs, although the losses pass through to your individual tax returns. If you haven't had profits for a few years, then you can carry it forward instead of back.

Carrying back a current loss can free up cash. Since we have long advocated that "Cash is King," we are recommending that our clients take advantage of this option. One note of caution here, however -- Do pay attention to the varying state tax laws in planning your carry back. Many states only allow a small amount (only $25,000 in many states) in first year write offs of new assets, as opposed to the federal government's full 100%. That can be a big difference on a state tax return!

Leasehold Improvements Deduction

Depreciation rules for leasehold improvements have also favorably changed under the recent tax laws. Until recently, the depreciation for leasehold improvements on business facilities had to be taken over 39 years by whoever was paying for the leasehold improvement – the facility owner or the lessee. The tax rules now allow a deduction of up to $250,000 of interior leasehold improvements (interior walls, a bathroom or kitchen improvement, etc.) in any given year.

R&D Tax Credit

In the last several years, the IRS has simplified the methodology of calculating the Research & Development (R&D) credit. The R&D Credit is a boon to printers because it is an actual reduction in taxes, rather than a deduction reducing your taxable income. It is also simpler than ever to compute, using a straight 6% of your qualified R&D expenditures. For example, if you incurred $100,000 in R&D costs, you could get a $6,000 R&D credit. Furthermore, most credits like this can generally be carried forward.

For printing companies, eligible R&D expenses may include such items as costs incurred to improve processes and procedures, quality assurance, or scheduling; testing new inks or plates; hiring consultants to streamline your procedures; or activities which create the ability to do new business. Based on how you are going to use it, even a new MIS system may qualify, if you are careful to provide appropriate documentation. This should include records of the individuals dedicated to this project and the time they incurred. You can generally use gross salary, but not benefits or taxes in this computation. You can justify R&D for quality control or scheduling, or benefits to be able to provide future sales and revenue, but be careful. Once you start billing customers for those types of expenditures, it no longer qualifies for R&D.

DPAD -- Domestic Production Activities Deduction

The DPAD regulation has also been extended under the new tax law. This is a deduction against taxable income. Once as low as 3%, it's been increased now to 9%. It applies for manufacturers, developers of software, construction companies, etc. To claim this deduction on your taxable income, simply fill out the applicable form on your return that says you are a manufacturer (and printing companies are, by government definition, manufacturers). Converting (cutting web rolls to sheets) also falls into this category. Binders are eligible under federal guidelines, but may not qualify under individual state guidelines, so be sure your tax preparer does the research. Just remember that if you qualify, you have to fill out the form because the IRS is not going to just give the deduction to you.

Note that you can still take this deduction if you are an S Corp, but the process is a bit different. The deduction will flow through to the individual, and the individual will receive that 9% DPAD deduction. It won't show up on the tax return of the corporation, but is passed on to the individual, who fills out the appropriate form for the deduction.

School Contributions: Used Computers

The new tax law has also provides an increased benefit to businesses who donate their used computers to public schools. Exact regulations have not yet been written and the forms aren't even out at this writing, but just be aware of this pending contribution opportunity.

Energy Tax Credit

It's not a cheap or simple process to convert to solar, wind or geothermal energy, but businesses can almost recover all their costs – in some cases in the first year -- through the energy tax credit and loss carry backs. An energy tax credit of 30% can be claimed, based on the cost of system installation, in addition to write offs for the cost of the equipment under the bonus depreciation provision. Some states also allow significant credits.

Uncertainties still remain on many tax issues, making long range business tax planning a challenge. For the next few years, however, the business tax atmosphere appears friendly; so now is the time to work with a tax professional knowledgeable in the industry to make sure you get all the tax relief you deserve.

Stu's View is contributed by Stuart Margolis, CPA and Partner of MargolisBecker LLC to provide information that helps firms operate profitably. More information can be found at www.margolisbecker.com.

About MargolisBecker

MargolisBecker has long been recognized as the financial expert for the printing and allied graphic communications industry, assisting thousands of companies with strategic and financial management, valuation, mergers/acquisitions, accounting, audit and tax services. The firm is noted for its expertise in enabling printing companies to optimize profits. Proudly, it is the purveyor of the industry's *Cash is King*, and *Value-Added Principles of Management*, and compiles the annual Printing Industries of America Ratios, the industry's premier financial benchmarking tool.