It's Time to Plan for Uncle Sam

Stuart W. Margolis, CPA, MT and
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With the end of the year approaching, every business needs tax planning. Unfortunately, many businesses fail to fully deduct eligible expenses. For instance, did you know that an accrual basis corporation can take a deduction for its 2006 tax year for a bonus not actually paid to its employee until 2007 if (1) the employee doesn't 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 2-1/2 months of the following tax year?

In deciding whether to accelerate income into 2006 or defer it to 2007, keep in mind that the income and operating losses of an S corporation are picked up on the personal returns of the corporation's shareholders for the shareholder's tax year that includes the last day of the corporation's tax year. This means that a shareholder of an S corporation must attempt to mesh the income or loss picture of the corporation with his personal income or loss picture for effective year-end tax planning.

Net operating losses (NOL) must be carried back two years (unless election is made) then carried forward twenty years. If the net operating loss is not utilized within these periods, it will expire without providing any tax benefit.

Companies should begin to review their reserve accounts for potential deductions, such as bad debts or inventory write-offs. A deduction for bad debts is only permitted in the year the receivable becomes partially or completely worthless. Similarly, a write down for any excess inventory is only allowed in the year the inventory is actually sold or scrapped.

A special IRS rule allows you to elect to expense up to $108,000 of the cost of long-lived assets that are deemed qualifying property subject

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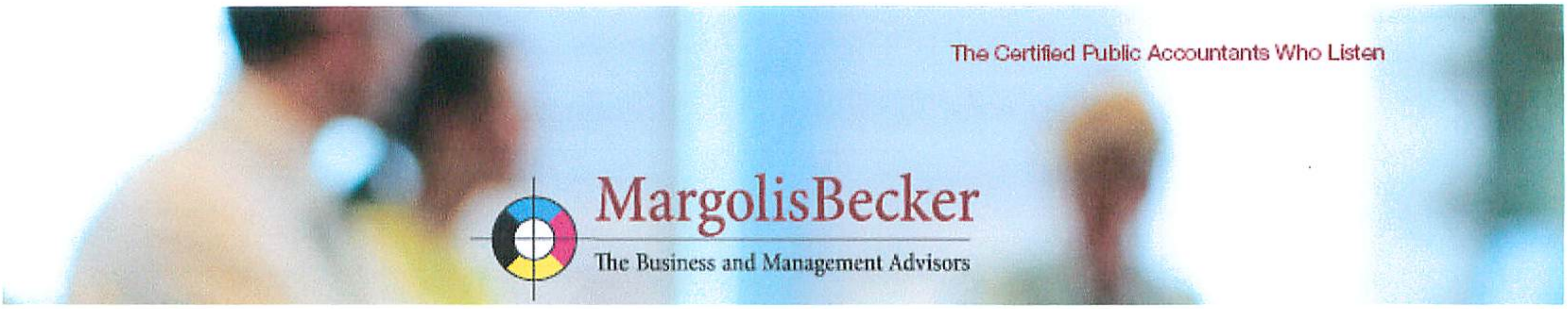

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to phase-out limitations. Normally, you would have to spread the cost of the asset over its useful life and deduct only a percentage of the total cost each year by depreciation. Moreover, you can magnify this benefit by strategically placing qualified property into service up to the last day of the tax year and maybe even avoid the short-year depreciation or mid-quarter convention rules on top of it.

There are other business related deductions that can be claimed on a personal tax return. For instance, if you use part of your home as a home office, you may be entitled to deduct expenses related to the home office based on the percentage of square footage the home office occupies. Related expenses include mortgage interest, property taxes, insurance, utilities, and repairs.

If you used personal funds for business expenses (such as office supplies or meals and entertainment) and were not reimbursed by the business, you may deduct these items on your personal tax return, subject to certain limitations. This includes expenses related to the business use of your regular or mobile phone, Internet fees or mileage from an automobile. Furthermore, if you contributed personal assets, such as a computer, the fair market value of these assets qualify as a business deduction, subject to depreciation limitations, beginning with the date of conversion.

Finally, any self-employed taxpayer may deduct 100 percent of their health insurance premiums.

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