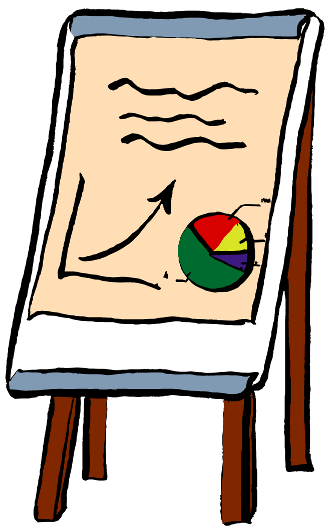
The Business Net LTD
New and Small Business Development Solutions



A WORKBOOK
FOR
YEAR END TAX PLANNING
And Beyond

$150.00

The Purpose of this Workshop

The Business Net, Ltd. has developed this workshop to assist you with the year-end tax planning process.

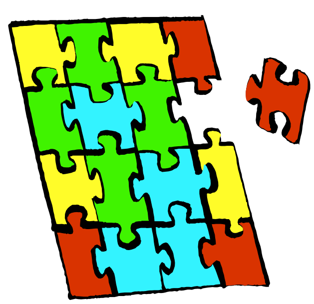
Some financial information can only be known at the end or close to the end of each business year. Company business activities may have changed and may require changing tax tactics.

Year-end tax planning is an attempt to accommodate these unexpected business results. You may have overlooked some tactics and need to add them in.

Concise tax planning must include all your financial activities. This workshop concentrates on tax planning for your business, but there will be references to your overall tax planning.

Tax planning is most effective if done during your company's budgeting and planning processes. These processes use available information to predict and incorporate tax strategies into the budget for the coming year.

Individuals who also own and operate a business must work their plan to include both the business and their personal tax plan.



The structure of this workbook

Part 1 – The arena of the tax game

The objectives of tax planning and implementation

a) The three primary objectives

The arenas of inclusion to be included in the process

a) All financial activities and holdings (Your financial world)
b) Sources of incoming cash or trades for value of all kinds
c) All debts, trade outs and contingencies
d) All government agencies and entities: federal, state and local
e) All processes available to control taxable incomes

How the tax management process works

a. Planning determines who gets your earnings
b. The objectives of tax management
c. How you play to win
d. Financial and tax management terms

Your relationship to the tax game

a) You are in the game
b) Play to win
c) Levels of tax strategies and tactics
d) What your potential results depend on

Tax game terms

A Financial World Graphic

Part 2 – The tax game playing field

First. **Starting Your Tax Planning**

a. Identifying where you are today
b. Tax planning key points
c. The levels of tactics
d. Tax management strategies
e. Tax preparer qualifications

Second

Outline of the planning process

a) Finances and financial determination
b) Future projections
c) Strategy needs
d) Selecting possible tactics
e) Identifying financial adjustments
f) Developing your plan

Third **Find Your Planning Situation**

f. Situation 1 – Big profits – much cash
g. Situation 2 – Good profits – some cash
h. Situation 3 – Profit – little cash
i. Situation 4 – Loss – no cash

Fourth **Using projections**

j. Projecting income and expenses
k. Possible asset acquisitions and cash available
l. Other projections and options

Fifth **Managing Income**

m. The affect of accounting method
n. Positioning "income"
o. Income character and timing

Sixth **Managing Expenses**

p. Accelerating current year expenses
q. Deferring expenses to next year
r. Expenses that must be allocated
s. Working with non-cash expenses

Seventh **Depreciation**

t. What is depreciation and depreciable lives
u. Bonus depreciation
v. Code Section 179 deductions
w. Carryovers

Eighth **Deferred Compensation/Pension plans**

x. Definition and Types of deferred compensation
y. Who is eligible and timing of set up
z. Timing of the funding
aa. Changing plans year by year

Ninth **Operating Losses**

bb. What are "net operating" losses (NOL's) & how/when are they created
cc. Carrying NOL's back
dd. Carrying NOL's forward
ee. What about corporate capital losses

Tenth **Tax Credits**

ff. Business credits
gg. Refundable
hh. Non-refundable
ii. Individual credits

What's Next?

REFERANCE MATERIALS

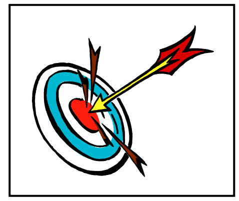
Part One

The Tax Game Playing Field

Part 1
Playing Field of the Tax Game

Objectives of tax planning

- The three primary objectives of the tax management are to:
  - **Reduce**
  - **Delay**
  - **Or Eliminate taxes**.



Managing the size of your tax costs

- Tax management determines who gets a large part of your earnings, the government or you. Management of tax is so important because they (taxes) may be one of the highest costs to the business. ***This plan must include both the individual and their business.***

The arena in which the game is played

- The playing field for this game includes all your financial activities and holdings.
- Sources of incoming cash or trades for value of all kinds.
- All debts, trade outs and contingencies.
- All government entities; federal, state and local
- All processes available to control incomes

Your relationship to the "Tax Game"

- Like it or not you are in the game. ***Taxes are forced extractions***, so they need to be managed.
  - Business and its taxes are deeply related in a dynamic relationship. Both change over time often in dramatic fashion.
  - All business financial decisions involve tax consequences.
  - Tax is a negotiated cost to a business.
  - Amount of taxes due is always based on the "net" profit of the business (gross income minus the allowable expenses).

- Play to win: Don't be at effect, be aggressive.
  - Choose your level of play.
  - Know and use the rules, or team up with someone who does.
  - Have clear objectives in your financial world and for your business.
  - Have a clear and comprehensive tax strategy.
  - The tax plan must include the rest of your financial world

What you need to know

- The tax rules are complex. Finding the least tax cost is a complex process involves many elements of a business. While not absolutely essential, to the success of a business, handling tax proficiently does produce a healthier bottom line.

The Tax Game Terms

Your Financial World – the financial world consists of all of your financial activities and holdings

Financial World Players –The "**Players**" in this game are all your financial activities. They may affect the outcome of your final tax cost. Players include yourself and any of your business or investment activities. Player structure is how the transactions, holdings or entities are set up and how they choose to be or are taxed.

Strategies – Strategies are the plan of play. You need to develop your strategy based on your plans and goals. An effective tax strategy must account for: player structure and the quantity, character and timing of taxable income.

Tax Strategy Requirements:

- **Transaction player structuring** – player entity structure is critically important to a tax cost management strategy including the legal structure of player entities, and legal relationships between entities.
- **Transaction Timing** - many tax tactics are time sensitive.
- **Choice of taxation** – certain legal entities have the option to elect how they will be taxed.

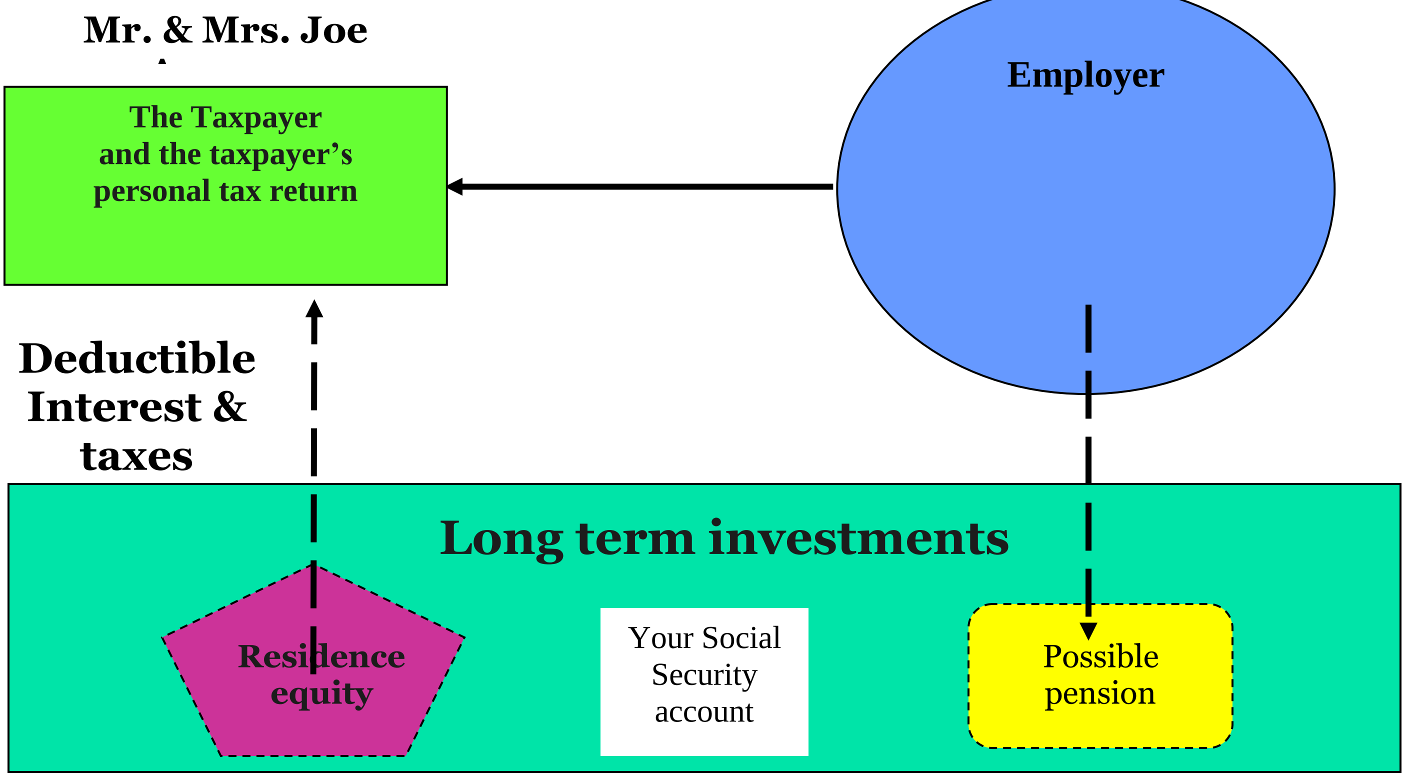
The factors that affect income taxability – the amount of tax on income is dependent on three factors:

- **Quantity -** The amount of taxable profit.
- **Character -** Which types of taxes will apply to taxable amount.
- **Timing -** When income is taxable.

Compliance with rules and Measuring Tax Related Financial Activities

Quantity, character, and timing are measured and positioned by your **financial tracking system** - A primary tool in determination of taxability of cash flows. A major cause of overpayment of tax costs is a tracking system that is inaccurate or incomplete.

A Financial World Graphic – a vary sample version



What the Financial World Graphic Tells You

- The "Graphic" shows all players
- The "Graphic" shows relationships between players.
- Each player has some financial activities.
- Each player is unique and is some type of entity
- Each type of player has its own unique set of tax tactics – that may affect other

How the financial world relates to tax planning

- All players in your financial world will or may impact your final tax return
- The overall tax strategy for all your financial activities should be coordinated
- Tax related activities not directly related to your business may impact the choice and value of your business tax strategies
- Tax tactics that may be used in your business plan may require financing from another part of your financial world
- The results of your business tax plan may add to or require a change in that tactic during the year
- Non-business financial activities may require input from your business
- The financial world map may point to requirements for cash management
- their tax results that may require changes or operational activities
- The relations of players and their tax tactics are critical to overall tax planning.

Part Two

The Tax Planning Process

Starting your tax planning process

Identify Where You Are

- List your short and long-term financial goals.
- Identify each of your players and their impact on your tax and non-tax objectives.
- Create a "Game Graphic" of your current situation.

Tax Planning Key Points

- Must play to win.
- Plan is based on your financial goals.
- There are strategy levels.
- Each game graphic is unique.
- Players are not fixed as to number or attributes.

Levels of tax strategies and tactics apply at different times

- A first level tax strategy is the selection of the type of business or holding entity to be taxed.
- A second level strategy is to determine what type of tax is going apply to the type of activity. (a business activity profits, capital gains from investment, and more).
- A third level strategy is to allow profits to be divided between payroll taxes and pass-through income not subject to payroll taxes.
- A fourth level strategy is to determine when the tax will apply. (at the corporate level or as pass through to owners).
- A fifth level strategy is a tactic that applies to individual functions.
-

A Key Point with "Level Five" Strategies

The Tax Management Game is the only game in which you can add or subtract players at any time or rearrange player activities to match IRS or planning requirements.

Tax Management Strategies Depend On

- Your level of aggressiveness
- You and your team's knowledge of game strategy
- Knowledge of your opponent
- Clarity of your objectives – both financial and tax

Individual tax tactics that are available because you have a business:

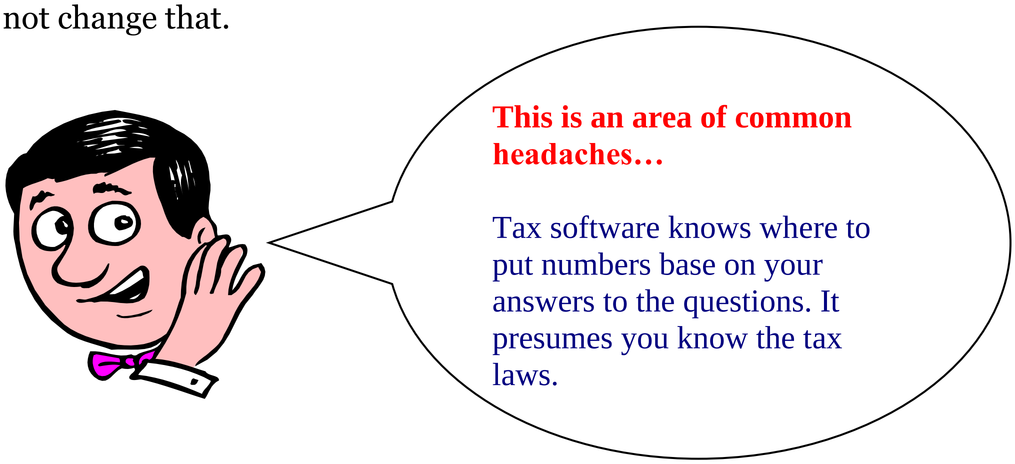
- Mileage reimbursements for business use of your personal vehicle
- Medical insurance reimbursements – business must have a profit – not available to S corporation owners
- Medical savings account annual contributions
- Reimbursement for education costs

TAX STRATEGIES AND PREPARER QUALIFICATION LEVELS

If you believe that filing tax returns is only an after the fact exercise to determine the amount of tax due and report that information to the government, we believe that you may be paying more than your fair share.

Is handling taxes only a chore or is something else possible? We both know it is a chore by its nature. But doing taxes is something else. For a lot of us, doing taxes is the first time we sit down and reflect on what we did with money over the year. It is like reviewing a picture album. We earned money, we bought things, we sold things, we changed jobs, people moved in and out of our lives. It was event filled year. Some events were happy and some not. Some were mundane and some exciting. It was a year of our lives. When you prepare your income taxes you should not just be putting numbers in boxes on a form. Even though you did not plan your strategy, you may still have opportunities to minimize those taxes. You should be very careful to select a preparer who has your best interests in mind, has adequate knowledge and skills and is not just looking to transfer numbers to the forms for a fee.

Why not just buy software like TurboTax and do it yourself? Now we would never say that the software will not do a good tax return. It will. A lot of the tax software and books like J.K. Lasser's <u>Taxes Made Easy</u> are good. It is not the books or software that makes mistakes. If you know what you are asking of the book or software it will turn out a good return. The problem lies with the complexity of the rules. It is amazing how many things people simply overlook. People regularly pay more than they should pay simply because they did not know how to categorize their money life in tax thinking. A book or software will not change that.



Outline of the planning process

(See the Resource for more details)

The tax planning starting point

The process begins by determining the current status of your overall tax strategy and to identify which tax tactics you are using. This process may require you to visit with your tax advisor or tax preparer to outline the main tactics you are using.

Here are some tools and processes that will help this process:

Financial. Determine your current business and personal financial situation. We have included in this workbook the description of the four most likely business situations that may apply to your business. You should also determine your overall financial situation.

The Future. Using current available information make some projections as to the expected results of financial activities for the balance of the year and into next year. Your financial tracking system can provide information for this process.

Strategy Needs. Using the included questionnaire assemble information that may be available to input into the strategy moving forward.

Select possible tactics. Begin with the suggested tactics included with the four possible business situations to select one or more of possible activities that may work. Consult with your tax advisor or preparer for possible tactics.

Financial adjustments. Review the descriptions of the activities you may be able to enact to change your tax status to determine if any of the changes will work for you.

Develop a plan. Based on your choices begin to make required changes to your business to comply with the tax laws requirements.

Your Tax Strategy Needs

A lot of information needs to be considered in selecting your tactics. The following questions are types of information you will need. This list is not the only information that may exist, each situation is unique and may have other facts.

- **Did your business have a profit last year? Yes ____ No ____**
  - **If no, what was the amount of your loss $ __________**
- **Did you have a business loss this year? Yes ____ No ____**
- **What do you expect the business to do next year?**
  - **Increase ____ Decrease ____ Same ____**
- **Do you have a budget for the coming year? Yes ____ No ____**
- **Do you invoice your customers? Yes ____ No ____**
- **Do you usually have payables? Yes ____ No ____**
- **Does your business operate from your home? Yes ____ No ____**
- **Does the business have cash available? Yes ____ No ____**
  - **How much? $ __________**
- **Did your business sell any assets? Yes ____ No ____**
- **Did the business acquire new assets? Yes ____ No ____**
- **Does your business have a pension plan? Yes ____ No ____**
- **Does your business need new equipment? Yes ____ No ____**
- **Did you have non-business tax events this year?**
  - **Yes ____ No ____**
- **Do you have business use of vehicle not owned by the business?**
  - **Yes ____ No ____**

Answers to these questions will have an impact on your 2021 tax costs. Now is the time to get with your tax advisor.

Choose the situation you believe best describes your business for the current year

Here are the 4 most likely tax planning situations

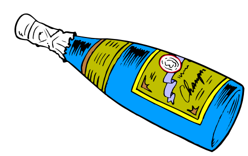
These tactics are very general. They can give you and your tax advisor an idea of where to start and what else may be needed to develop a tax plan.

Situation 1. This is the place we would all like to find our business. The business has had a banner year, profits were high, expenses were under control and have all been paid, the business is in expansion, and there is lots of cash in the bank.

In this situation the planning process should include:

- to make sure that the business, and its owner(s), will be paying only the taxes that are necessary
- new asset acquisitions are needed, and the timing can be defined
- that payroll/pension deferrals are maximized
- that you understand for how long this situation will last and have taken that information into account in your plan
- that the future cash needs for the business can be met from reserves and not from borrowing
- Is it time to sell?

Is this your situation? Yes _____ No _____

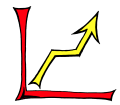


Situation 1.

Planning possibilities are:

1. Modify taxable income
2. Acquisition of fixed assets that will be needed to expand the business, and determination of when they should be acquired and placed in service.
3. Pay differed salaries to owner/managers for years when they were underpaid.
4. Pay bonuses to key employees, and institute future performance based bonus plan.
5. Maximize payroll.
6. Pay out tax favored dividends to owners.
7. Pay off standing liabilities or loans.
8. Establish business savings and cash management programs and accounts.
9. Defer part of the income due to next year if it will be lower profits and not increase next year's profits.
10. Accelerate expenses to current year, if this will not have a negative impact on the next year.

11. Contribute additional to State unemployment fund to reduce rate.
12. Look for opportunities to fund new business activities, expand the business market share, expand the company product/service mix.
13. Prepay state estimates for next year.
14. Design taxes to avoid the alternative minimum tax.
15. Increase or add charitable donations.
16. Complete deferred maintenance projects.
17. Establish and fund a pension deferred compensation programs.
18. Check for available credits.
19. If you have receivables, are they good or doubtful? Activate an allowance for doubtful receivables.
20. Prepay expenses that are for less than a year.
21. Check about using bonus depreciation on newly acquired business assets.
22. Don’t forget NOL carryovers from prior years.



Situation 2. This is likely to be the more normal place for your business. The business has had a typical year with good cash flows, expenses have been under control and are paid current, and the business has a reasonable amount of cash in the bank.

In this situation the planning process should include:

- that taxes for the business, and its owner(s) be minimized
- asset acquisitions be scheduled to meet needs and new assets be placed in service before year end, if that does not reduce cash availability to critical
- that payroll/pension deferrals be used at appropriate levels
- that cash requirements through year end are not exceeded to the extent possible
- that some future cash needs may be met as well
- Is it time to grow?

Is this your situation? Yes _____ No _____

Situation 2.

Planning possibilities are:

1. Acquisition of fixed assets for the business before year end.
2. Bonuses to key employees.
3. Maximize or add payroll.
4. Maximize depreciation options to reduce taxes.
5. Defer income to following year, if that will not negatively impact the next year.
6. Accelerate expenses to reduce taxes, if this will not negatively impact next year.
7. Pay tax deferred dividends.
8. Contribute additional to State unemployment fund to reduce rate.
9. Re-structure payments to owner(s) to tax favored forms.
10. Increase owner compensation to make up for prior low years.
11. Increase or add charitable donations.
12. Complete deferred maintenance projects.
13. Establish and fund a pension deferred compensation programs.
14. Check for available credits.
15. If you have receivables, are they good or doubtful? Activate an allowance for doubtful receivables.
16. Prepay expenses that are for less than a year.
17. Check about using bonus depreciation on newly acquired business assets.
18. Don’t forget NOL carryovers from prior years.

Situation 3. The business has had a typical year with average cash flows, expenses have been average and have been mostly paid, the business appears to have a taxable profit, however, there is a minimum of cash available, or there are no currently available cash but some possible cash receipts within the first quarter of the new year.

In this situation the planning process should include:

- that taxes be minimized to the extent possible, for both the business and the owner(s)
- that payroll/pension deferrals be used where possible especially if you can use delayed payment, and the cash flows will improve by payment time
- needed assets be placed in service before year end and payment be delayed
- incomes to owner(s) be used that will result in minimizing their taxes for the year and that the transfer of income to the next year be manageable in that year and not increase the problem into the new year where possible
- that expenses be accelerated where possible and cash allows
- What is the best way to increase marketing and incomes?

Is this your situation? Yes _____ No _____

Situation 3.

Planning possibilities are:

1. Acquisition of fixed assets for the business before year-end, using primarily financed acquisitions with differed payments.
2. Maximize depreciation options to minimize taxes.
3. Defer income to following year, if this will not negatively impact next year.
4. Re-structure payments to owner(s) to tax favored forms.
5. Develop a budget for next year to better control cash.
6. Re-evaluate marketing and customer relations procedures.
7. Determine your most profitable products or services and concentrate efforts to develop those markets.
8. Establish and fund a pension deferred compensation programs.
9. Check for available credits.
10. If you have receivables, are they good or doubtful? Activate an allowance for doubtful receivables.
11. Prepay expenses that are for less than a year.
12. Check about using bonus depreciation on newly acquired business assets.
13. Don't forget NOL carryovers from prior years.

Situation 4. The business has had a minimal or poor year. It will be showing a loss for the year and cash availability is minimal or non-existent. The expenses have been managed to the extent possible and some of the bills remain unpaid. Prospects for the next year are better or about the same.

In this situation the planning process should include:

- important here is to look at the possibility of decreasing the apparent income to the owner(s) to reduce their tax liabilities
- generation of possible tax refunds from prior years, or the pass forward of losses and credits for future years to minimize taxes in those years
- to make plans to improve the business going forward
- Is this business going to make it?

Is this your situation? Yes _____ No _____

Situation 4.

Planning possibilities are:

1. Accelerate income into current year.
2. Postpone expenses to following year.
3. Reduce owner(s) compensation.
4. Use NOL carry-back to generate tax refund cash.
5. Sell appreciated fixed assets not needed for current operations.
6. Aggressively pursue receivables, make deals for cash.
7. Establish and fund a pension deferred compensation programs.
8. Check for available credits.

TOOLS TO ACTIVATE YOUR TAX PLAN

Using Projections

Projections are estimates made from the best available information. They are used to “guess” at the most likely situation for the near future. Each projected situation will dictate a different set of tactics that may be used to arrive at the best possible tax cost results.

Projections are required to choose the proper strategy. Tax tactics will require the proper structure to be in place before the tactic is needed or used. Tax tactics are usually time sensitive.

Here are some of the projections you should have:

- Income probable – This year and next
- Expense projections – This year and next
- Possible asset acquisitions – When is the best time to acquire?
- Cash availability – To pay for tax reducing actions
- Possibilities to delay payments – Will funds be available early next year?
- Other – Add or delete products, services and/or business assets.

Managing income

Taxable income for a business may be dependent on the accounting method used to track business financial activities.

The two accounting methods are: accrual or cash.

Accrual accounting adds income when invoiced. Under the accrual method: income may be increased by billing earlier; income may be decreased by billing later.

Cash accounting adds income when received. Income can sometimes be delayed by delaying the receipt of checks. This is achieved by delaying the actual collection of income. It may be accelerated by aggressive collections and early deposits.

The basic question is "When do you want income to be "income"?" Keep it legal.

Income management objectives depend upon the current tax situation. Usually in situations 1 and 2 (see the 4 variations below) you would be looking to postpone the receipt of income in the current year; in situations 3 and you may be looking to increase income into the current year. In each of these cases it is important to realize that changing the year income is recognized will change the income of some other year, and the process must not be artificially created.

Delay receipt of income by delaying the invoicing or delaying the mailing of invoices. Accelerate income by invoicing early or mailing earlier.

Ensure that you do not cause unwanted results in the following year. Poor planning can push income into the following year when that year will have higher income or accelerate income into the current year if the following year will produce less income.

Managing Expenses

Managing expenses is basically the reverse of managing income.

Increasing current year expenses. Keep it legal.

Accelerate expenses of an accrual business by causing billings to be made during the current year. Accelerate expenses in a cash basis business by prepaying for products or services in the current year, even if those products or services will not be delivered or completed until the following year.

How not to accelerate expenses

Prepaying for certain products or services is not a workable tactic if the service or product has a useful life of more than one year. Such as the prepayment of a liability insurance policy for the next two years does not produce an expense in the current year for the entire payment. Only one year's premium is currently deductible.

Deferring expenses

Current year expenses that will create a loss may be deferrable. Your cash basis business can withhold payment until the following year.

Non-cash expenses

Depreciation is a non-cash expense. Increase this expense using the special elections below. Decrease this expense by not using accelerated methods.

Using Depreciation

Depreciation

The depreciation is a most confusing tax rule. Looking at the most common depreciation rules. *Look before you leap.*

Depreciation is a tax accounting tactic created by the tax code. It allows a business to expense (write off) the cost of asset acquisitions that have useful lives of more than one year. Depreciation is an artificial (paper) expense that does not require additional cash outlays, and yet reduces taxable income. It is a legal tax reduction device.

The IRS depreciation rules allow cost recovery of assets over their “normal” life. The Service has determined the useful life of every type of fixed asset. The life for depreciation is based on the IRS class life system. Property other than real property has lives of 3, 5, 7, 10, or 15 years. Real property has a life of 27 ½ or 39 years.

Under the current MACRS depreciation system, an asset placed in service will be entitled to 200% of the first ½ year of its cost divided by its useful life. So, for an asset with a five year life the depreciation available in the first year of service will work out to 20% (the cost of the asset divided by 5 [years] divided by 2 [one half year] times 2 for 200% declining balance) The second year will work out to 40% or twice the first year, each year thereafter the amount will be less, 26% year three, 14% year four, and 10% year five.

Even as confusing as the above seems, there are even more confusing rule for autos.

Code Section 179 Deductions

Besides the regular depreciation rules there is an additional fast write off election. Code Section 179 deductions, the expensing of all or some portion of the cost in the year it is placed into service.

Bonus Depreciation

Current tax regulations allow for “bonus depreciation.” Under there rules a business may deduct 100% of the cost of newly acquired business assets. This bonus depreciation is automatic unless the business elects out of the 100% deduction or chooses a smaller percentage of bonus depreciation.

Code Section 179 allows a business to expense (write off) up to $1,040,000 of the cost of “personal property” assets acquired and placed in service during the tax year. The allowable deduction is limited by the total amount spent in the year. The limitation begins to reduce the 179 deduction once total purchased reached $2,590,000.

Certain SUV’s have a maximum allowable 179 deduction of $25,000.

Carryovers

It should be kept in mind that the 179 deduction cannot be used to create an NOL carryover. However, any unused 179 deduction will be carried forward into the next tax year.

Bonus depreciation

In an effort to support business acquisition of business assets the congress enacted a new “bonus” depreciation different and in conjunction with Code Section 179 accelerated depreciation. Bonus depreciation has had different rate over the years but for 2021 is 100% of the cost of assets placed in service. You do not have to take this 100% bonus depreciation which is automatic unless you elect out.

All of these depreciations have an ordering rule that must be used in determination of allowable depreciation in any given year. The order of use is: first 179, then bonus, then regular depreciation if there is any undepreciated basis left..

Large Possible Tax Savings

Deferred Compensation

What the heck is deferred compensation? Deferred compensation is compensation paid to, or payable to, an employee for services rendered that does not constitute a part of that person's current year taxable income. This includes amounts contributed into a pension plan for the employee.

Types of deferred compensation

Deferred compensation falls into two basic types; payments into some form of pension or retirement plan, and accruals of compensation to be paid at some future date, or non-qualified deferred compensation plans (i.e., some stock option plans.). Accrued compensation may or may not be a current deductible expense depending upon the length of deferral, the type of employee, and the accounting method used by the business. Pension contributions are generally current expenses to the business.

Pension plans fall into three types; those funded fully by the employer, those that are funded fully by the employee electing to reduce their take home wages by a predetermined amount that is contributed to the plan and usually has a company matching contribution, and those that have both contributions.

Eligibility

In most cases, all "full time" employees will be eligible to participate in a business's pension program. Qualified pension programs fall under very strict federal guidelines regarding contributions, management and distributions.

Some types of business pension programs are:

- Traditional 401-k
- Simple or solo 401-k
- SEP – Simplified Employee Pension
- Simple –IRA
- Defined benefit plan
- Defined contribution plan
- Non-qualified deferred compensation plans

Each type of plan has deadlines by which the plan must be in effect;

Simple-IRA plans must be established by 9/30 of the year contributions will begin. (This plan will not be useful for late tax planning)

All other plans must be established before 12/31 except the SEP. Sep plans can be established and funded up until the filing of the business tax return, including extensions.

Timing of the funding of pension plans

The actual funding of pension contributions varies with the type of plan and whether there are withholdings from the employee. When amounts have been withheld from an employee for pension purposes the business must remit those amounts to the plan trustee within 45 days of the withholding.

Company contributions to pension plans can generally be delayed for up to 45 days after the end of the business's fiscal year end. So pension expenses used on a business calendar year return can be paid up through February 14 of the year following.

Changing from year to year

Changes may be made to the type of pension plan for the business each year. All rules for discontinuing a plan and establishing a plan must be followed to avoid problems.

Operating Losses

Creating a net operating loss

"Net Operating Losses" (NOL) can be created in several ways:

1. Expenses including allowable depreciation* exceed income for the year.
2. Loss from sale of non-capital assets causes net loss.
3. Carry over of prior year NOL creates a current year loss.

*A section 179 expense deduction can never produce an NOL, however the special bonus depreciation can create an NOL.

Carrying NOL's Back

An NOL for the current year may be carried back five years (current tax law) and used to reduce taxable income in those years. This could result in a refund of taxes paid in that or those years. If the taxpayer does not elect to carry the NOL forward only on the current tax return the loss must be carried back first.

Careful consideration must be given to the carry back of losses as the carry forward might result in a greater tax savings even though the savings is delayed.

Carrying the NOL Forward

You may elect to carry the current year NOL be carried forward only. In cases where there are no profits in previous years it only makes sense to elect to carry forward only. If the current loss results from an NOL brought forward, there is no choice but to elect forward only.

Excess 179 deductions

Since a 179 deduction may not be used to create a loss for the business, what happens to the disallowed amount of the 179? It carries forward and will be allowed in a succeeding year if the other deduction rules apply, and it is not an NOL. This is a planning tool to be considered. If you do not need the 179 deduction in the current year and you do not expect to acquire additional assets in the following year but are expecting profits the carryover deduction will prove valuable.

What about capital losses?

Capital losses would not affect business incomes for sole proprietorships and partnerships. In the corporate tax world capital losses receive special treatment. Capital losses may only be used to offset capital gains, no $3000 write-off as in the personal tax world. Special care needs to be taken if capital losses will be generated.

Tax Credits (Highly Complex)

Congress in efforts at economic stimulation has always allowed certain types of tax credits for business. Tax credits are more valuable than write-offs as the do not just reduce taxable income but reduce tax, dollar for dollar.

Two types of Tax Credits

Tax credits fall into two basic categories: Non-refundable and refundable. Most tax credits for business are of the non-refundable variety.

Non-refundable credits

Non-refundable tax credits can be used to eliminate any income tax due from the business. Should the credit exceed the income tax due for the year in which the credit is generated, the excess credit may be lost or may carry forward for some period of time before being lost.

Refundable credits

A refundable credit can also be used to offset the income tax and some penalties, any excess credit will be refunded to the taxpayer.

As there are a wide variety of these tax credits and many situations in which there are even more credits based on the location of your business, you should work with your tax professional to determine your eligibility for these credits.

Some types of credits:

- Employee retention credit
- Small employer health insurance credit
- Pension plan startup credit
- Work opportunity credit
- Welfare to Work credits require the input of a State agency to generate the credit.

Where Do You Go from Here?

It is important to constantly work on your tax plan. The short time until the end of this calendar year will allow implementing some tax tactics, but time is of the essence.

The planning process necessarily begins with you, the business owner/operator and their Financial World Map. You should gather as much information as you are able, write down what you hope to accomplish and get with your advisor as soon as possible.

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REFERENCE MATERIALS

SAMPLE TACTIC DESCRIPTIONS

Using the Corporate Vehicle Personally

A business may own a vehicle that is used in the business. When the vehicle is owned by the business 100% of the cost of operating that vehicle is paid by the business. This is available to corporations and partnerships but not to sole proprietors. Generally the vehicle is considered a legitimate business expense as long as the use is more than 50 % business. If an employee- the business owner or any other employee-uses a company vehicle for personal activities that employee will receive additional wages or compensation if a partner in the amount or the value of that usage. The value is determined by first calculating the percentage of personal use- personal miles divided by total miles. The personal use percentage is applied to the fair rental value, taken from the IRS table, and this result is increased by 5.5 cents times the personal mileage. The result increases the employee's wages. The additional income is still less than the actual cost to operate that vehicle for the personal miles.

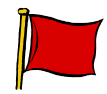
Tactic Description: The fact that the corporation owns a vehicle that is also available for use of an employee or owner does not mean that the personal use is free to the employee or owner. In fact the Code provides rules to be followed to determine and report that use as income to the employee. The cost to the employee is still a bargain over the cost to operate that vehicle. The actual personal use must be tracked and logged.

Tax Benefit: The ownership of the vehicle means that the company pays 100% of the costs of operating the vehicle making that part of the process easier to track. The income to the employee becomes a part of their W-2 income and is a benefit to the employee because they have not paid the actual cost of having a vehicle.

Pitfalls and problems: The company must not ignore this pass through of income to the employee especially the owner. To do so could mean that the entire vehicle expense may be disallowed or assigned as income to the employee.

The 179 Deduction Trap

The code section 179 deduction is a fast way to recover the cost of newly acquired business assets. Careful planning must be done before electing to take the 179 deduction. The 179 deduction is an election, you must choose to use that deduction.
The general rule is that each business is eligible to expense up to $1,050, 000 in new personal property equipment placed in service in any tax year. Total maximum investment limitation is $2,590,000.
The 179 accelerated depreciation is the first of the two “bonus” depreciation which can be used in each year. The second bonus depreciation is only available after the 179 deduction us used up.



IRS Caution

Tactic Description: This tactic is an opportunity to reduce taxable income by taking this accelerated depreciation. Under the current law if your company has newly acquired assets eligible for “bonus” depreciation you must take the 179 deduction before the more generous bonus depreciation at 100%. If the available 179 deduction matches or exceeds the total new assets then the other bonus depreciation will not be used. The part of the 179 deduction that exceeds the cost of the assets may be carried over to the following year.

Tax Benefit: The ability to reduce taxable income using the 179 expensing deduction can result in substantial tax reduction. The 179 deduction is an election, you are not required to take that deduction. Electing not to take the 179 deduction will bar you from using the 100% bonus depreciation.

Pitfalls and problems: The use of the 179 deduction could be a problem in the near future if you need to sell or transfer the asset before the full life expectation for that asset. Any part of the 79 deduction that exceeds the strait line depreciation would need to be recaptured as ordinary income to your company.

Template For Creation of a Tax Strategy

Section 1. Gathering information about the big picture.

Description of participants in the strategy.

First--The personal situation: Since all planning is designed to enhance the financial situation for you, it is necessary to understand what you is seeking. If you know your goals, then your strategies can be pointed in that direction.

a. **Identify income sources –** sources of income can take many forms: employee earnings, investment earnings, or distributions from the Client's business. Timing of income receipts is always a part of the strategy.
b. **Identify investments** – the investments we will be considering are those that contribute to the overall tax situation of the Client, both currently and in the future. Therefore, they can take the form of active portfolio investments to generate interest or dividends, passive investments to produce either income or losses that must be factored into the current tax situation, long-term investments such as the current business as an asset or a pension program that will contribute to income during retirement, and growth investments such as the expected exit benefits from the business or long-term gains from active and passive investments.
c. **Assets owned, being purchased, financed** – these assets include such items as their residence and other real properties purchased for whatever reasons. If these items have been financed some or all the interest may be deducted from current income or added to the basis of the investment. Included here are other types of investments such as collectables, art, and other appreciating personal property.
d. **Family configuration and cash requirements** – this information includes spouses, children, and dependent parents. This should include their ages, relationships, financial requirements for education or care, living locations, comings in and goings out, and other expectations.

Second--The Primary Business: This is the business that currently is your major source of cash flow, tax tactics structuring, primary source of personal income, and possibly the most likely source of future income from wages, other current income transfers, and sale proceeds.

e. **Description of business purpose** – what the business does to generate its revenues, as well as where you expect the business to go in the future. This includes what the business will look like when it has reached your vision for the business. It also describes how it generates its customers, who are its workers, and how it relates to its industry and market. It includes how long the business has existed and when the owner plans to exit.
f. **Description of entity being used for the business** – what type of legal entity is the business? What income tax return does the business file each year? How is the entity related to you and to any other business or investment you have?
g. **Type of income received from the business** – how do you receive income, other cash, or other benefits from the business. When do you receive

such cash distributions or benefits? Who else, related to the owner, receives cash or benefits from the business?

Third --Additional Business: What other business do you have that is operating or pending which will impact your tax strategy.

Description of any other business purpose – here we are looking for what the business does to generate its revenues. Other questions are:

- Where the owner expects the business to go in the future?
- What the business will look like when it has reached your vision for the business?
- How it generates its customers, who are its workers, how does it relate to its industry and market?
- How long has the business been in existence and when does the owner plan to exit?

h. **Description of the entity being used for the business –** under what type of legal entity is the business operated? What income tax return does the business file each year. How is the entity related to you and to any of your other business or investment activities.

i. **Type of income received from the business** – how you receive income, other cash, or other benefits from the business. When do you receive such cash distributions or benefits? Who else related to you receives cash or benefits from the business?

Fourth --Investments that produce annual taxable income (loss) – a more complete description of the various investments and their current information, including distribution documents with expectations and reasons for acquisition. This may include trusts or possible inheritances.

j. **Description of investment purpose** – description of the investment, how it was acquired, why it was acquired, what are your objectives and expectations for the investment, when the investment is expected to be divested.

k. **Description of entity being used for the investment** – what is the nature of the investment vehicle – liquid bank type vehicle (CD, money market, cash value life insurance), equity investment vehicle (stocks, limited partnership interests), direct ownerships (LLC, corporation, partnership).

l. **Type of income tax form received** – 1099-Int, 1099-Div, K-1, other.

Fifth – Your financial objectives – where do you and your family currently wish to achieve, when do they expect to reach their optimum position, and what will happen then?

Section 2. Defining relationships between participants and the possible tax tactics that could be applied:

Relationships between you and your primary business

First --Define the possibilities of cash transfers between the primary business and you. Determine quantity, character, and taxability. Identify tax benefits.

Second—What is the relationship between your primary business and any secondary business?

Third--Define any possible cash transfers between the businesses and their tax consequences. Determine their quantity, character and taxability, and identify tax benefits.

Fourth—Identify the relationship between the second business and you.

Fifth--Define the possibilities of cash transfers between the second business and you. Determine their quantity, character and taxability. Identify tax benefits.

Sixth--Define the possibilities of tax-free benefits to you and the requirements to apply these to other business employees.

Seventh--Define the possibilities of tax preferred benefits to you and their requirements to apply to other business employees.

Eighth--Choose tax tactics that present themselves and determine how they should be activated.

Ninth--Analyze the relative tax advantages of each tactic

Matching Strategy levels to preparers.

Tax preparers like strategies can fall into one of five levels.

Preparer A Level One Preparer may have a bookkeeping background and use it as a basis to do taxes. It is not their primary source of income. They may have taken a tax course from H & R Block or a similar company. They only transfer your numbers to the IRS forms. These preparers use inexpensive tax software or work part time for one of the national preparation companies.

Strategy level. At Level 1 the preparer transfers your numbers to the tax forms.

Preparer The Level Two Preparer has worked in tax preparation for several years. They have learned more complex tax forms. They are still just moving your information to the forms with no thought to any possible alternative ways to deal with your specific situations. They are likely to still be using off-the-shelf tax software or be working part time for a national company. They are not fully aware of the rules around the more complex tax tactics. The idea of a tax strategy does not come into play.

Strategy level. At Level 2 the preparer selects the latest "hot" tax device(s) – electing tax tactics at random with little or no coordination.

Preparer The Level Three Preparer is an experienced full-time preparer. They have been through several tax seasons. They are familiar with most of the tax forms and procedures. They take tax update courses each year to increase knowledge and skill. These preparers understand how to use tax tactics. Preparers at this level have professional grade tax software. These preparers may understand the idea of a tax strategy though they do not address your return from that point of view.

Strategy level. At Level 3 the preparer uses limited coordinated tax planning considering only your business - and ignore the rest of your financial world.

Preparer The Level Four Preparer is a seasoned preparer with a combination of tax knowledge and business training and/or experience. This preparer has one or more college degrees and work full time in business tax and accounting areas. They understand client's financial statements and how they are created. They usually belong to professional associations. These associations have Continuing Professional Education (CPE) requirements to help their members maintain their skills. These CPE courses usually include tax update courses. They use professional grade tax software. These professionals will usually develop a tax strategy, but generally limit that strategy to the part of your financial world that they see when doing the interview before preparation. They seldom recommend changes in your operations to take advantage of additional tactics.

Strategy level. At Level 4 the preparer includes and coordinates tax tactics for your entire *existing* financial world based on your activities, but rarely recommends operating changes to activate additional tactics.

Preparer The Level Five Preparer is a “Master Tax Strategist.” This person will usually have graduate level education in tax and/or business. They fully understand the many intricacies of the tax code at both the federal and state levels, and how to structure activities to take advantage of various tactics. They have an active relationship with their clients and make suggestions to the clients on how to structure their activities to take advantage of more tactics. They are proactive with their clients and do not rely on the after the fact results to develop the strategy. This person will always begin the preparation process with the development of a tax strategy that includes your entire financial world. Their goal is to minimize your tax costs effectively and legally.

Strategy level. At Level 5 tax preparation includes all Levels 1, 2, 3, and 4 activities, recommends additional tactics for consideration and will have you - add or delete players and modify entity actions to achieve your goals.

The level of tax strategy you will be able to accomplish will depend heavily on the type of preparer that you choose. Higher level preparers are more costly but will usually be able to save much more in direct tax savings than their fees. The strategy process also means that you must work at activating more tactics throughout the year. You cannot expect the best results when you bring your information to the preparer after the year is over.

Details of the management of a business' taxes

The Business Net stresses the need for current, accurate, and detailed financial information

Planning for tax

We deeply believe that many small business owners are paying too much in income taxes on the cash flows of their businesses. The principal reason for this situation is that the business owner does not deal with their income taxes in the same way as they deal with their other costs of doing business. Income taxes, and other taxes, are a cost of doing business just as much as production costs or costs of goods sold. Income taxes are no more a fixed amount that is the cost of materials used to produce product for sale to customers.

Dealing with taxes

The main reason, we believe, that most business owners do not approach taxes this way is three-fold. First, they may not know beyond a few "tax" tactics the things that can be done, second, that they have no practical way to determine what can be done and do not have enough money to hire a big tax firm to guide them in management of the tax on business cash flows, and third they do not have a formal accounting system to track financial activities.

It is true that tax consultants who know the rules well enough to apply them to small businesses may be hard to find. Additionally, many tax preparers have so little business knowledge to understand how to arrange financial transactions for the business to take advantage of the tax breaks.

The problem comes down to the misconception that most if not all tax tactics can be accessed at the time of preparation of the income tax returns. This is simply not true. In fact, it is often the case that some tax reducing tactics are simply not available to a business just because of how it is set up, or they waited too long to structure for the taxable advantage.

So, making the most of the available tax tactics that are available begins at the time the business is set up and continues for the life of the business. Tax planning must be attended to along with other business management activities. All financial and many legal transactions have tax consequences. Those tax consequences need to be addressed as the decisions are being made for the business and how the business is operated.

Tax rules and regulations are very complex. Sometimes an available tax benefit is lost because the transaction was structured wrong, or the timing was wrong. A competent tax advisor should be able to advise you of the consequences of a financial action and may be able to help structure the action to take advantage of the tax break then available. This is not something you should try to determine on your own or based on advice from a non-tax savvy person. As a business owner you have enough to do without trying to understand tax law too.

Tracking and backup for tax tactics

Our approach to this problem is very different from most tax preparation and accounting firms. We believe that the only way to get maximum bang for the buck is to set up a continuous ongoing process of information gathering and conversation with the business owner on what is happening with the business, especially in the areas of: business legal structure, contracting, and transactions between related parties including the business owner; and **financial tracking of business activities.**

The tax advisor should be included in the decision process from the inception of the business through the building phase, the operations phase and including the exit phase. It is important that the tax advisor be aware of the goals and expectations of the owners at all phases of the business. A tax tactic used this year could have very dire consequences next year, so it could be prudent to forego the immediate savings for a larger long-term savings. *It is also important that your advisor be informed about all your other financial activities to allow for coordination of strategies*.

Making the management of tax costs a central theme for the business will also determine what kinds of support services your business should have. Although the financial activities tracking function is needed to provide operating information it is equally needed to support the minimization of the tax cost. The legal services are needed to obtain adequate legal structure for the business and proper contracts with interested parties. The tax consequences should be addressed when these documents are created.

Compliance issues are a fact of life in business. Payroll reporting, sales tax reporting, income tax forms, and other compliance issues must be completed and filed timely and accurately and have adequate underlying records. However, many of these compliance activities can impact the cost of income taxes positively or negatively.

We begin our business owner support system from the design of a tax management standpoint and then design the support services to feed into the basic plan and to be adaptable to its changing requirements. Attention to the income tax costs of operating the business is managed as closely as any of the other costs.

The process starts by determining the desires and expectations of the owner/creator of the business. This is developed into the basic strategy for keeping funds in the company, not paid out as taxes. Using basic strategy as a basis we recommend the business entity for best control of all aspects of the business operation. This requires examination of the relationships between the business and related businesses or the owners.

Financial tracking for business purposes

The business financial activities must be tracked. The system needs to make sure that management is receiving adequate information to track the health of the business and make appropriate business decisions. The system must provide suitable information for taking advantage of any possible tax tactics.

Compliance activities can be quite complex and should be completed by competent individuals. Most of these reports are periodic and need not be done at the business office. Care should be taken to ensure timely completion and filing of these reports as they usually incur penalties if filed late or incorrectly. Penalties are a separate kind of tax on the business and should be avoided.

A tax strategy is developed at the outset of the business and is modified each year based on the business activities of the current year and the projections for the next year.

This strategy is modified as circumstances warrant. Other services – legal, financial activity tracking, and compliance activities – are used to modify and adjust the strategy to insure the least legal income tax cost to the business. All tax savings fall directly to the bottom line of the business.

By constantly knowing what is happening with the business there is little likelihood that a tax saving tactic will be missed. No one will be required to remember what happened many months in the past that could have made a difference in the tax results. Financial and legal transactions can be structured to take full advantage of the tax tactics and rules for maximum benefit to the business.

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