

November 2, 2009

Welcome to the business and farm and ranch newsletter!

There's a lot here, please read the entire newsletter. Not so much new for farm and ranch, mainly for sole proprietors. The first section contains information from 2009 and also 2008 legislation that affects 2009. Then you will find issues that are new or updated for 2009. Finally, there are reminders of prior year issues that are still hot topics with the IRS and apply to both farm and ranch and sole proprietors.

American Recovery and Reinvestment Act of 2009

This Act has some interesting provisions:

For months beginning on March 1, 2009, as an employer you can pay \$230 per month for employer-provided transit and vanpool benefits as well as employer-provided parking and it will not be reported as income to your employees. This probably doesn't impact most of you, but some of you might pay for parking in the downtown areas.

The Recovery Act provides a 65% subsidy for COBRA continuation premiums for up to nine months for workers who have been involuntarily terminated. If the worker pays for 35% of the premium, then the employer pays for the remaining 65% of the premium and receives a credit on the Form 941 to reduce the quarterly employment tax liability - or can apply directly to the IRS for a refund.

The Act extends bonus depreciation on NEW property through 12/31/2009. The property must be placed in service prior to 1/1/2010.

Retroactively effective for vehicles bought and placed in service after 2008 and before 2010, the Act increases by \$8,000 the first-year depreciation dollar limit for a passenger auto.

The Section 179 limit is \$250,000. Currently, the limit for 2010 will be \$125,000 and for 2011 will be \$25,000.

TAX PLANNING NOTE: Buy your assets and place them in service before 12/31/09.

The choices for carryback of Net Operating Losses to anywhere from two to six years were restricted to 2008 and have NOT been extended to 2009. NOL's can only be carried back for two years for 2009.

HR 1424

As reported last year, the energy-efficient commercial buildings deduction was extended through 12/31/2013.

The energy-efficient home tax credit was extended through 2009. This is for contractors that build new energy-efficient homes and is a \$2,000 credit.

A new credit begins in 2009 for the purchase of qualified plug-in electric drive motor vehicles. This includes street-legal golf carts, and is only good for 2009 - so if you are interested in this let me know and I will send details.

Here's an interesting note - the FUTA tax rate will drop from 6.2% to 6.0% for 2010.

The 15-year write-off for both qualified leasehold improvement property and qualified restaurant property will end in 2009. Spend this money now!

NEW AND UPDATED SECTIONS FOR 2009

Bookkeeping Items

You must report your business versus your personal use on your cell phone. Cell phones are rarely, if ever, 100% business use and the IRS knows this. Make a determination of the percentage of personal use of your cell phone; we cannot deduct this amount.

Bonus depreciation cannot be taken on used equipment. Please note in the memo section on all asset purchases if the item is new or used at time of purchase.

All meals and entertainment transactions must note in the memo section the name of the client and business purpose or it cannot be deducted.

You cannot deduct checks that are outstanding as of 12/31 if you have a negative balance in your checking account.

Real Estate

DO NOT EVER put real estate in a corporation. Your real estate belongs in an LLC. If you put real estate in a corporation you run a very real danger of double taxation upon the sale of the real estate. This is true for S Corporations as well as C corporations; just don't do it.

Charitable Contributions

You should review your charitable contributions. If your charitable contribution was made with a reasonable expectation of a financial return, i.e. as advertising, then you may be able to re-classify the transaction as advertising.

*****REMINDERS*****

I will need the following documents in order to complete your tax return:

1. Physical count of ending inventory as of 12/31 each year. You must provide me with copies of your physical inventory taken at or about the end of the year. If you do not take a physical inventory at the end of the year, you will have to take a physical inventory prior to preparation of your tax return and I have to perform reasonable calculations to adjust back to year-end. I estimate this will add approximately four hours (\$540) to your tax preparation fee.
2. Automobile mileage logs. I must review your automobile mileage logs for each year.
3. Business policies and procedures. I must have copies of your business policies and procedures on file. See below for some of the policies and procedures you must have on file.

Form W-4 and I-9 reminder:

You must have current Form W-4's and Form I-9's on file for your employees. Your employees must complete these forms annually, as close to January 1st as possible. The Form W-4 is your authorization to legally withhold income tax from

your employee's paychecks. If you withhold income tax without a current year form on file, then you will be subject to severe penalties upon audit by the IRS. The IRS is performing payroll audits at a greater rate than ever; and the penalties can run into the thousands of dollars. Why take the chance? Get those forms completed. And don't forget, the shareholder employees **MUST** complete these forms as well. This is the most forgotten form, and the IRS knows this, and they **WILL** penalize you for not having the form on file for yourself. I know it's ridiculous, but it's a great revenue raiser for the IRS. Do you want to help them raise revenues with your money? NO. Fill out the forms.

One more thing, there is no deduction for payments to illegal aliens. At all. Period. I will not deduct these payments on your tax return and risk a \$5,000 penalty for myself. You can get the Forms by going to my website, saradolpcpa.com, and selecting the Recommended Links button on the left. The 2010 Forms are not available yet, so you need to check for them in late December or early January.

REVISITED FROM LAST YEAR BUT STILL IMPORTANT #### IRS Regulations #### Policies Required ####

Material Participation Rules

The IRS is getting more interested in this area. They like to re-classify the losses you incur in your S Corporation, LLC or partnership as passive losses so you cannot deduct them currently. This can affect you if you have W-2 wages from another job and your S Corporation, LLC or partnership is your second job. So, if you do have other sources of income, this is really important.

The IRS requires "Material Participation" by the taxpayer in order for the taxpayer to classify the activity as a business, farm or ranch, or rental property. If the taxpayer does not materially participate, then the activity is passive and any losses are limited (read "not deductible") and must be carried forward to a year in which they are deductible. The material participation rules are as follows:

1. The individual participates in the activity for more than 500 hours during the year. A spouse's participation counts towards the taxpayer's participation, or
2. The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals for such year; or

3. The individual participates in the activity for more than 100 hours during the taxable year, and nobody else participates in the activity more than the taxpayer; or
4. The individual materially participated in the activity for any five taxable years during the ten previous taxable years; or
5. Based on the facts and circumstances, the individual participates in the activity on a regular, continuous and substantial basis during such year.

You must keep track of your hours if you have another job; especially if you have employees in your business or if someone else also works in the business, such as your spouse.

Manufacturing Deduction

There is a manufacturing deduction for domestic production activities enacted into law by the 2004 American Jobs Creation Act. Although it seems at first that this might not impact you, wait!!! The deduction is for the following five categories of income:

Production of qualifying property, such as tangible personal property, software, sound recordings, etc. (could be you).

Qualified film (may apply).

Electricity, natural gas or potable water (probably doesn't apply).

Construction (lots of you out there in this industry).

Engineering and architectural services (also a bunch here).

Many of you were able to take this credit in prior years, and it turns out that in some cases it was quite substantial. Make sure you keep good records that separate new construction or production from rehab or remodel activities.

Contractors Please Note

Contractors, please remember to create an LLC to hold property. There are tax advantages to this strategy, such as getting capital gain rates upon the sale of the property rather than ordinary income tax rates. If the LLC is owned by a single member, it can be reported on your personal Form 1040 on Schedule E, so a separate tax return need not be required for each LLC.

Recordkeeping for Credit Card Expenses

Business credit cards must be tracked in detail on your books. Each charge must be entered individually and each payment is offset against the credit card balance. At the end of the month, each credit card statement must be reconciled and interest expense recorded at that time. **It is not correct to allocate a payment to various expense categories.** Credit card balances are liabilities and are shown on the balance sheet. You will get into trouble especially at the end of the year when credit card charges from December of the current year show up on the January statement of the following year. These charges must be recorded as prior year expenses - the date the expense was charged. You cannot expense these charges in the following year on the date you make the payment. If you have trouble setting this up please call me. It is critical that you record these expenses correctly.

5-Year Depreciation for Farm Equipment

The Act allows a five year depreciation period for qualifying property used in a farming business if the property is placed in service in 2009.

Self-employed Persons

NOTE: Schedule C's have a higher audit rate than other returns. Beware. Please see my website for a Trade or Business Checklist that you can use to determine if you should be classified as a business or a hobby. Also, I have in my seminar notes in three different places the following: if you are a Schedule C filer you should strongly consider converting to an LLC. You can create a Single-Member LLC (SMLLC) which will provide you with liability protection, but you will still file the Schedule C as usual and keep records as stated in this newsletter.

Gross income means all income you earned. It doesn't mean only that income for which you receive a Form 1099. It means ALL earned income. The gross income is taxable whether received by mistake, limited in use, or illegally received.

If you want to fully deduct your expenses, then you want to qualify as a business. There are nine criteria the IRS uses to determine if you have a business or a hobby. One of the keys is that you **MUST HAVE A SEPARATE BUSINESS CHECKING ACCOUNT.** The IRS wants to know "does the taxpayer maintain complete and accurate books?" In order to comply with this, you must have a

separate bank account for your business. All the recent court cases on this issue, hobby vs. business, have hinged on the businesslike manner in which the taxpayer kept books. By keeping meticulous books and records, you have made a good start on establishing a good foundation for your business.

Bookkeeping

You may use Quickbooks or any other double-entry accounting system you wish. You must record all transactions of the business. All bank accounts and credit card statements must be reconciled monthly. All loan payments must be recorded as to interest paid and principal paid for each payment. You must keep a filing system with all receipts for all expenditures of the company. You should file receipts by vendor or type of expenditure rather than by date.

Mileage Log (written policy required)

Taxpayers should be able to substantiate auto deductions with adequate written records. The records include the following:

1. The amount and date of each expenditure for the vehicle, including purchase documents, vehicle improvements, lease payments, repairs and maintenance, gas and other expenses.
2. The total mileage put on the vehicle each year, substantiated by independent documentation such as oil change receipts.
3. A breakdown of the business, personal and commuting miles by date that includes the business reason for each use of the vehicle.

Records should be maintained in an account book, diary log, trip sheet or similar record. Without a written record of business mileage, the IRS will disallow the mileage deduction. I am required to answer on each tax return prepared whether or not the taxpayer has this written evidence. I can only answer yes if I have copies of the mileage log in my files. Otherwise, I am subject to a preparer penalty if audited. You must maintain these records for ALL vehicles that are used for both business.

Please note: If the company owns the vehicle and you have used the vehicle personally, an amount MUST BE added to your W-2 for 2008 for the value of the personal use.

Meals and Entertainment (written policy required)

In general, 50% of business-related meal and entertainment expenses are deductible. You are required to document each expense with the date, location, amount, specific names of the individuals paid for, and the specific business purpose of the meeting. The expense of providing entertainment to a client, customer or employee can qualify as an ordinary or necessary business expense. Entertainment activities can include the cost of meals (food, beverage, tax, and tip) and be provided at facilities such as nightclubs, social clubs, sports facilities or theaters, or on hunting, fishing, vacation or similar trips.

To qualify for a deduction, the entertainment expenses must be directly related to or associated with the active conduct of a business. For example, business matters are specifically discussed during the meal or entertainment activity and you have more than a general expectation of receiving income or some other specific business benefit in the future. You may also provide a meal or entertainment activity directly before or after a substantial business discussion. You must actively engage in a meeting, discussion or other business transaction to obtain income or some other specific business benefit. Meals with business partners are generally not deductible.

Club dues are not deductible. This includes dues paid to country clubs, golf and athletic clubs, airline clubs, hotel and business luncheon clubs.

Assets and Depreciation

The IRS is taking a harsh stand on which assets must be depreciated. Their position is that any item that has a life of greater than twelve months, no matter what the cost, is an asset and must be depreciated. This definition includes software you buy off the shelf for \$19.95, staplers you purchase for \$10.00, etc.

My continuing education courses are still stating that each business can establish a "materiality" level, such as \$100, to use to determine which items must be expensed versus depreciated. (written policy required)

Please be careful when you are recording your expenses to split out all assets into the fixed asset category.

The good news is that you can deduct up to slightly greater than \$100,000 of assets in the year of purchase. This is the Section 179 rule. So, let's classify these assets correctly and deduct them properly.

Those of you planning to purchase assets prior to the end of the year, please note that the asset purchased must be in your hands and ready to use prior to December 31st in order to be deducted. You cannot sign the purchase agreement, pay for the item, and take delivery after 12/31/08 and deduct the item in 2008.

Gifts to Clients

The deduction for gifts made in the course of business is limited to \$25 to any one individual per year. A gift to a family member of a customer is considered a gift to the customer unless there is a separate and bona fide business relationship with the family member. A married couple is considered one customer regardless of whether they are separately employed or have separate businesses. If a partnership gives gifts to a customer then each partner is considered to have given the gift and cannot give an additional gift.

Hiring Family Members as Employees

Sole proprietors can realize significant tax savings by hiring family members as legitimate employees. If you think this strategy might work for you, call me to schedule an appointment. As usual, there are several rules and regulations that govern this, but if it works for you it can really save some tax.

That's all the fun for now....

Happy Holidays!

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