

FALL 2010

Management



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Driving down the 199

Manufacturers' deduction could lead to a tax-saving destination

With year end fast approaching, now is a good time for business owners to start thinking about what direction to take in their tax planning. If you're involved in "qualified production activities" and looking for a smart route to potentially lowering your 2010 tax bill, you may want to take a drive down the 199 — the Section 199 deduction, that is.

This tax break, popularly known as "the manufacturers' deduction," hits its peak level of percentage power this year and is available to more than just manufacturers. And though the 199 has its share of twists and turns, it could lead you — and your company's cash flow — to a tax-saving destination.

A familiar road

If the manufacturers' deduction sounds familiar, it may be because the tax break was first introduced with the American Jobs Creation Act way back in 2004.

As you can probably tell by the name, it was intended to primarily benefit America's struggling manufacturing industry. But, helpfully, lawmakers made the tax break broad enough to include many

other types of businesses — such as companies that work in architecture, film production, software, engineering and construction.

“The manufacturers' deduction was first introduced with the American Jobs Creation Act way back in 2004.”

One of the main requirements for the deduction is that your company regularly perform the aforementioned "qualified production activities." These are generally defined as tasks related to manufacturing, producing, growing or extracting property "in significant part" within the United States.

How to get rolling

To get rolling on the 199, you'll need to document your qualified production activities and determine how much income you've derived from them. This will require gathering gross receipts from the lease, rental, exchange or other transfer of qualifying production property minus out-of-pocket expenses, such as materials costs.



Possibility of rising tax rates puts tax strategy at risk

Considering whether you can take a drive down the 199 (see main article) will have you looking hard at your taxable income. While doing so, and assuming your company has had a relatively decent year, you may want to consider the tried-and-true tax planning strategy of deferring income.

This will defer tax, which generally is beneficial. For instance, assuming you use the cash basis method of accounting and expect to be in the same or lower tax bracket in 2011, you might defer billing for products or services until after Dec. 31. If you use the accrual method of accounting, you might hold off on shipping products or delivering services until 2011 (if your customers won't mind the delay).

But keep in mind that, as of this writing, tax rates are scheduled to go up in 2011, so deferred income could end up being taxed at a higher rate. Check with your tax advisor for the latest information.

Having done all of this, you may then be able to claim a deduction equal to 9% of the lesser of either your net income derived from your qualified production activities or your entire taxable income for the year. This is up from 6% in 2009.

There is, however, an important caveat: The deduction can't exceed 50% of the W-2 wages paid to employees during the calendar year that are allocable to domestic production gross receipts.

Taking a ride

Let's take a hypothetical cruise down the 199 and see where it might take you. Say your company nets \$800,000 in taxable income on \$4 million in gross receipts in 2010, entirely from qualified production activities. Assuming your W-2 wages paid are adequately substantial, the deduction at the new 9% rate will be \$72,000, for a federal tax savings of over \$25,000 based on a 35% rate. That would presumably be a nice cash flow boost.

Perhaps the biggest challenge of the manufacturers' deduction, and one that many companies underestimate, is the administrative burden that may be associated with claiming it. You'll need to meticulously track and maintain documentation for your business's qualifying production activities.

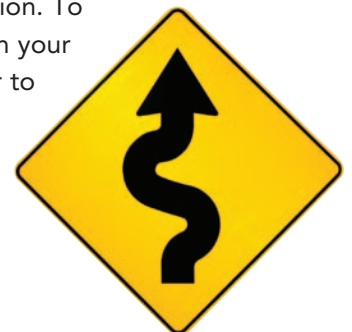
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Your company's taxable income plays a key role in whether you can take a ride down the 199. But what if you have no taxable income for the year? In this case, you can't claim the manufacturers' deduction.

Unfortunately, many companies have struggled in the uncertain economy of late, so winding up with a distinct lack of taxable income isn't unheard of. The net operating loss (NOL) deduction allows you to use an NOL to offset income you've earned in previous years or income you'll earn in future years. But the tax code doesn't allow you to use the manufacturers' deduction to create or increase an NOL.

The passenger's seat

The 199 isn't a road every company can drive down. But, if you can and you're able to navigate its administrative twists and turns, you'll likely be better off when you arrive at your final tax destination. Bear in mind, this discussion has been a greatly simplified explanation. To see whether this trip is worth your while, invite your tax advisor to sit in the passenger's seat and help you see how far you can get. ♦



To cope with a calamity ...

Deducting casualty and theft losses

Sadly, from the oil spill affecting the Gulf Coast to tornadoes in the Midwest to wildfires out West, 2010 has brought its fair share of disasters. And that's not even to mention the always-prevalent acts of thievery that have cost innocent victims thousands.

Although calamities like these are certainly no fun, you can get at least some payback from a tax perspective. That is, in qualifying instances, you may be able to deduct a casualty (disaster) or theft loss on your federal income tax return.

What qualifies

The IRS defines a casualty loss as damage to a residence or other personal property caused by a "sudden, unexpected and unusual event." Examples include a fire, earthquake, flood, automobile accident or vandalism. Normal wear-and-tear on your residence or property and other age-related deterioration don't count. Neither do termites.

“You may generally deduct losses only in the year they occurred or, in the case of theft, the year it was discovered.”

The agency defines theft as "the taking and removing of property or money with the intent to deprive the owner of it." As you might expect, lost property doesn't qualify for a deduction.

How to claim it

If you believe you've suffered a qualifying casualty or theft loss this past year, you'll need to file Form 4684, "Casualties and Thefts," with your



return. Be forewarned that a few more limitations apply, however.

First, each loss is reduced by the full amount of any insurance reimbursements you received. Second, assuming you held the property for personal use, each loss must be reduced by \$100. Once your aggregate losses for the year (reduced by the amounts mentioned) have been calculated, you can deduct only the amount that exceeds 10% of your adjusted gross income (AGI).

Last, you may generally deduct these losses only in the year they occurred or, in the case of theft, the year it was discovered. But if you've already filed your return for a given year, you may still be able to claim the loss by filing an amended return.

If you experience a casualty or theft loss related to a business or income-producing property,

such as a rental home, the rules are largely the same, except there's no requirement that the loss exceed 10% of your AGI to qualify for a deduction. If the property is completely destroyed, your loss will equal your adjusted basis in the property less any salvage value as well as any insurance reimbursements you received.

Where to turn

One way to at least bring a little positivity to an unexpected disaster or theft is by gaining some tax benefit as you recover from the event. Work with your tax advisor to ensure you get all you can from this tax break. ♦

Long-term care policies offer security ... for a price

Medicare and standard health insurance can protect individuals from home-care, nursing-home or other care-related costs while *recovering* from surgery, an injury, an illness or another health issue. But they don't cover such care long-term. If you worry about how you'd afford care beyond those limits — or that such costs could deplete your estate, leaving little or nothing for your loved ones after you're gone — you might want to look into long-term care (LTC) insurance.

What it will do (and won't)

LTC insurance covers services that help people with activities of daily living (ADLs), which will be specifically defined by the policy. These activities typically include eating, bathing, dressing, using the bathroom and, if applicable, transferring from a wheelchair as necessary. These services may be provided by a skilled nursing facility, an assisted living facility or a home care provider.

LTC insurance won't pay your medical bills or replace lost income — those are jobs for health and disability insurance — and an LTC policy isn't a substitute for those types of insurance. Also, LTC insurance won't pay the cost of a retirement facility that provides a residence and activities for people who are able to live independently.

How it's structured

Each LTC policy is different, so before purchasing coverage familiarize yourself with the terms, conditions and features of several policies. Be sure you know a policy's benefit amounts, covered services and term. Most LTC policies are reimbursement arrangements, meaning the benefits are based on your actual expenses. Less common indemnity or "per diem" policies provide you with a stated amount per day regardless of your actual expenses.

“Be sure you know a policy's benefit amounts, covered services and term.”

An LTC policy defines the conditions that trigger the payment of benefits. If a policy's definition is based on an inability to perform certain ADLs without substantial assistance, for example, consider questions such as the following:

- How are ADLs defined?
- How many ADLs must be impaired before you're entitled to benefits?
- How does the policy define "substantial assistance"?

○ Is a physician's certificate required?

Most policies have an elimination period, which requires you to wait a specified amount of time after care begins (30, 60, 90 or 120 days, for example) before benefits are paid. Electing a longer elimination period will help lower the policy's cost.

The tax treatment

To minimize the cost of LTC insurance, you may buy a tax-qualified policy. If a policy is tax qualified, a portion of your premium payments is, at least potentially, tax deductible. And, any benefits you receive are tax free.

To qualify for tax-favorable treatment, the policy must be guaranteed renewable and noncancelable regardless of your health (provided you pay the premiums). It also must require you to obtain a certification from a licensed health care practitioner stating that either you're unable to perform at least

two of six ADLs or you have a severe cognitive impairment and that this disability has lasted or is expected to last at least 90 days.

The income tax deduction is limited. You may deduct your premiums as medical expenses, but only up to a specified amount based on your age. Whether there is a tax benefit from the deduction depends on a number of factors.

“To qualify for tax-favorable treatment, the policy must be guaranteed renewable and noncancelable regardless of your health.”

For instance, if you're self-employed, you'll generally be able to deduct the allowable amount in full, whereas if you're not self-employed (or if your self-employment earnings aren't sufficient), you'll need to aggregate the allowable amount with your other deductible medical expenses, which will provide a benefit only to the extent that you itemize and the medical expenses exceed 7.5% of your adjusted gross income.

If, however, you purchase the policy through your C corporation (or an S corporation of which you own less than 2%), the company is eligible to deduct 100% of the premiums.

Careful decision warranted

As you can see, LTC policies aren't for everyone. They can be expensive and you may find the eligibility requirements rigorous. And in a time when the economy has made us all extra careful about how our money is spent, a careful decision is all the more warranted. Nonetheless, the investment now could give you peace of mind that, should you need long-term care, the costs will be covered. ♦



4 ways to get — and keep — your business data in order

Is this still the information age? For business owners, it may seem more like the *hyperinformation* age. With so much data flying around, it's easy for something to fall through the cracks — something that could come back later to haunt management, such as an important contract or outstanding bill. Here are four ways to get — and keep — your business data in order:

1. Simplify, simplify, simplify. Look at your data, both electronic and paper, in broad categories and see whether and how you can simplify things. Sometimes refileing documents under basic designations such as “vendors,” “leases” and “employee contracts” can help you get better perspective on your information. In other cases, you may need to realign your network or file storage to more closely follow how your company operates today.

2. Write an overall data storage policy. A formal effort toward getting organized can help you target what's wrong and determine what to do about it. In creating this policy, spell out which information you must back up, how much money you'll spend on this effort, how often backups must occur and where you'll store backups.

Also, decide who should be granted access to what data. You may need to delineate several levels of security clearance to protect your most sensitive data.

3. Consider the cloud. Web-based data storage has been around for years. It allows you to store files on a secure remote server. Doing so is an excellent way to back up your data off-site, protecting it from a local disaster and enabling you to access it from any Internet-ready computer.

But you may want to take it a step further. To not only store your data but also provide and maintain the software on which you generate and process it, consider cloud computing. This is a fast-rising technology option under which a company buys or leases its software from an off-site provider that runs the application on its server and provides access via the Internet.

4. Don't forget about e-mail. Much of your company's precious data may not be in a file or spreadsheet at all but rather in an e-mail. And this communications medium has taken on a greater significance in recent years as e-mails have played key roles in legal proceedings.

Because of this, it may be a wise move to establish an e-mail retention policy. This formal document should specify each department's (or employee's) responsibilities and procedures when it comes to e-mail. It should also include a retention schedule that sets timeframes for all types of records that staff members might store. ♦



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