

Dear Valued Client:

As the end of the year approaches, it is a good time for you to engage in tax planning. A recent flurry of tax legislation may have an impact on your year-end tax planning for 2008. For 2008, the two biggest tax breaks for businesses are the beefed-up expensing option under Code Sec. 179, a 50% bonus first-year depreciation write-off for most new machinery, equipment, and software placed into service this year, and a reinstated research credit.

As the end of the year approaches, it is a good time to think of planning moves that will help lower your tax bill this year and possibly the next. Factors that compound the challenge include the stock market's swoon, the difficult economic climate we're in right now, and the strong possibility that there will be tax changes in the works next year. In fact, there might even be another economic stimulus package carrying tax changes enacted before the end of this year.

We have compiled a checklist of items that may help you to save taxes if you act before year-end. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make:

Boosted Section 179 expensing: Earlier this year, Congress passed the Economic Stimulus Act of 2008 which is intended to jump-start our economy, in part through tax incentives aimed at encouraging businesses to increase their investments in new equipment by the end of 2008. Under the Act, small businesses will be able to write-off up to \$250,000 of qualifying expenses in 2008.

Under pre-Act law, taxpayers can expense up to \$128,000 of qualifying equipment purchases. This annual expensing limit is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the year exceeds \$510,000. The amount of the expensing deduction is limited to the amount of taxable income from any of the taxpayer's active trades or businesses.

Under the Act, for tax years beginning in 2008, the \$128,000 expensing limit is increased to \$250,000, and the overall investment limit is increased from \$510,000 to \$800,000.

As a result of this incentive, most small businesses, and even some moderate-sized businesses with moderate capital equipment needs, will be able to obtain a full deduction for the cost of business machinery and equipment purchased in 2008, thereby reducing their effective cost for those assets. What's more, there is no alternative minimum tax (AMT) adjustment with respect to property expensed under Code Sec. 179.

Bonus depreciation makes a comeback. The Economic Stimulus Act of 2008 provides for bonus (accelerated) depreciation by allowing a bonus first-year depreciation deduction of 50% of the adjusted basis of qualified property placed in service after Dec. 31, 2007, and, generally, before Jan. 1, 2009. The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. The amount of the additional first-year depreciation

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deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

Research tax credit. The good news is that the credit has been restored, retroactively, and applies for amounts paid or incurred through 2009. In addition, some new provisions have been added. Specifically, the option to elect an alternative incremental research credit in lieu of the regular research credit is available through 2008, but is eliminated thereafter. Taxpayers still may elect, in lieu of the regular research credit, an alternative simplified research credit, which for 2009 is increased from 12% to 14% of the excess of the qualified research expenses for the tax year over 50% of the average qualified research expenses for the three earlier tax years.

Domestic Production Deduction. The Code Sec. 199 deduction benefits companies whose activities include manufacturing, construction, engineering, and architectural services. The deduction equals a percentage of the net income from eligible activities— 6% for 2007-2009. However, the amount of the deduction for any tax year may not exceed the taxpayer's taxable income or, in the case of individuals, the taxpayer's adjusted gross income. In addition, the amount of the Code Sec. 199 deduction can't exceed 50% of the "W-2 wages" (wages subject to income tax withholding, and certain deferred compensation) paid to employees for the year that are allocable to the activities eligible for the deduction.

Losses. The difficult economic climate that brought us the depreciation tax breaks may also mean that your business incurs a loss. A loss experienced in an S corporation, partnership, or limited liability company will be passed through to the shareholder(s), partners', or members' personal tax returns.

Even if 2008 will be an unprofitable year for a taxpayer's business, year-end tax planning is necessary since a loss can be turned to advantage by using it to recover taxes paid in other years. This is made possible by carry-back and carry-forward provisions, which generally permit a 2008 net operating loss (NOL) to be taken as an additional deduction for the two (2) preceding years and the twenty (20) following years. (See below for special deductions associated with disaster zones.)

Other, widely applicable tax breaks for business include the following:

- A two year extension through 2009 of enhanced charitable contribution deduction rules for gifts of certain types of food inventory, and corporate gifts of book inventory or computer equipment to schools.
- For property placed in service after Aug. 31, 2008, the new law permits 50% first year bonus depreciation for qualified reuse and recycling property. In general, this is machinery and equipment (not including buildings or real estate), along with associated property, including software necessary to operate the equipment, which is used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials. This break is *not* limited to businesses in the recycling industry.
- A two year extension through 2009 for the tax break that allows expensing of qualified environmental remediation expenses, namely cleanup of hazardous substances (including petroleum products) at qualified contaminated sites.
- The deduction for energy efficient commercial building property has been extended so that it applies through 2013.
- For purchases after 2008 and before 2015, taxpayers will be able to claim a tax credit for electric drive motor vehicles.
- After 2008, companies will be able to give employees who commute by bicycle a \$20 per month tax-free reimbursement for reasonable bicycle

related expenses.

Tax breaks for businesses in disaster areas. The new law creates a new set of tax relief provisions for businesses hit by events such as storms, hurricanes, and floods anywhere in the U.S. that are declared to be federal disasters after 2007 and before 2010. These are of great importance to businesses because many federal disasters have already been declared in numerous states in 2008 and many others are likely to occur before the tax breaks sunset. Here's a summary of the new relief provisions:

- Qualified disaster expenses, such as cleanup (removal of debris, demolition of structures) and repairs, may be expensed.
- A 5-year net operating loss (NOL) carry-back applies instead of the usual 2-year carry-back.
- For qualified Section 179 disaster assistance property placed in service after 2007, with respect to disasters declared after 2007, the maximum expense amount that can otherwise be deducted under Section 179 is increased by \$100,000 and the beginning-of-phase-out amount otherwise in effect for the tax year is increased by \$600,000.
- A 50% first-year bonus depreciation allowance applies to most types of machinery and equipment bought to rehabilitate or replace damaged property. A number of conditions must be met, and certain types of property are excluded.

Tax breaks for specialized industries. There were several tax breaks in the new law that benefit specific industries including financial institutions, farming, real estate, retailers, and restaurants, construction companies, film and TV, motor sports racing, oil and gas, and mining.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Kelley Hardesty Smith and Co.

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