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## **Year end tax planning opportunities for business and individuals... It's not too late!**

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"Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose the pattern which best pays the Treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands." - Judge Learned Hand, U.S. Court of Appeals

Now that 2007 is fast coming to a close, it is the time to heed Judge Learned Hand's advice and review your financial situation to minimize your tax burden for 2007. Tax planning strategies do not come in a one-size-fits-all package and every plan must account for the particular needs and circumstances of each business. The primary objective for tax planning strategies involve timing your income so that it will be taxed at a lower rate, structure your deductible expenses so that they may be claimed in years when you are in a higher tax bracket and postpone tax whenever possible.

### **Income Shifting**

Business and individuals can benefit from shifting taxable income and accelerating or deferring deductions between 2007 and 2008 by controlling the receipt of income and payment of expenses. Businesses expecting to be in the same or lower tax bracket in 2008 should consider deferring income until next year and accelerating deductible expenses in 2007. Alternatively, if a substantial increase in income is anticipated in 2008, income should be accelerated in 2007 and deductions deferred until next year.

### **Accounting methods**

The accounting method used by a business determines when income must be recognized and expenses are deductible for tax purposes. Cash based businesses can shift income to next year by not billing notices for services or products until 2008.

### **Â§179 Expensing**

For 2007, a business can immediately deduct up to \$125,000 for qualifying equipment purchases, including computers and software. To take the deduction, qualified equipment must be placed in service by December 31, 2007. The Â§179 deduction begins to phase out when more than \$500,000 in fixed assets are placed in service for the tax year.

### **Manufacturing deduction**

The Â§199 deduction for qualifying domestic production activities benefits a broad array of businesses, including construction, engineering, architecture and farming. For 2007, the deduction equals 6% of the lesser of (1) qualified production activities income for the tax year, or (2) taxable income that does not take the deduction into account for the tax year. This deduction applies for

both regular and alternative minimum tax liability.

### Cost Segregation Study

Do a cost segregation study when a building has been purchased, built or remodeled. The study will maximize depreciation deductions. Although real property must be depreciated over 27.5, 31.5 or 39 years using the straight line method, certain parts of the building can qualify for a shorter depreciable life.

### Compensation and bonuses

Businesses should also consider maximizing 2007 contributions to qualified retirement plans since contributions are tax deductible. Moreover, paying year end bonuses in December or January can also add or defer a significant compensation based business deduction. For example, businesses can deduct in 2007 a bonus paid in 2008, as long as the obligation is paid within two and one-half months of the close of the tax year.

### Losses

Business losses can be taken for bad debts. Businesses should review their accounts receivable to determine if there are any accounts which have become worthless and uncollectible over the past year.

### Alternative Minimum Tax

The 2007 AMT exemption amount for corporations is \$40,000, subject to an income based phase out. A flat 20% AMT income rate applies to businesses. Small corporations that meet a gross receipts test are exempt from the AMT.

Planning for the AMT is more difficult for individuals. Without further action from Congress, the AMT exemption for individuals will decrease. For 2007, the AMT exemption amounts have decreased to \$33,750 for individuals and \$45,000 for married couples filing jointly. This decrease will result in more than one-third of taxpayers earning \$75,000 and \$100,000 a year and more than 70% of taxpayers earning between \$100,000 and \$200,000 per year will be subject to the AMT. Congress has enacted temporary AMT relief in prior years but has enacted no such relief yet.

To start planning, individuals should project their income for the rest of 2007 and 2008. The AMT calculation includes certain items of income otherwise excluded under the regular rules. Items of particular significance, because they become tax preferences not deductible under the AMT, include

- \* Personal exemptions
- \* Deductions for state and local taxes
- \* Home equity loans and other mortgage interest not incurred in buying, building or improving your principal residence;
- \* Incentive stock options
- \* Large capital gains
- \* Private activity bonds
- \* Deductions of unreimbursed business expenses

### Income smoothing

Year end tax planning for individuals involves shifting income between 2007 and 2008 by

accelerating transactions that either produce income or yield deductible expenses. Individuals who anticipate being in a higher tax bracket in 2007 than in 2008 should consider delaying receipt of taxable income until next year.

#### Deductions

Accelerating or deferring income from one year to another impacts individuals' ability to take deductions; as income level rises, the ability to claim deductions is reduced or eliminated. Individuals who itemize deductions should consider bunching deductible expenses into one of the years, or whether the adjusted gross income limits for medical or miscellaneous itemized deductions may be more easily met.

#### Kiddie tax

The kiddie tax rules are much less generous today than they were less than two years ago. The 2007 Small Business Tax Act extends the reach of the kiddie tax by raising the age limit to include all children under age 19 and students under age 24.

#### Gift Giving

Individuals should consider making gifts that maximize the annual and lifetime gift-giving limits to reduce income and estate tax liabilities. For 2007 and 2008, individuals can transfer \$12,000 per person tax free. Married couples can gift \$24,000 per family tax free.

#### Retirement Contributions

Individuals should review their 401(k) contributions to ensure that they will receive the maximum matching contribution from their employer. An individual is also allowed to contribute up to \$15,000 to their 401(k) plan. Individuals who will be at least 50 years of age by the end of the year may make an additional "catch-up" contribution. For 2007 the catch-up contribution is \$5,000.

It's never too early to begin thinking about tax planning strategies. Individuals and businesses should integrate current year tax planning with long term tax strategies. The earlier you consult your tax advisor when a significant transaction approaches, the more likely the transaction can be structured to minimize income tax liabilities. A little tax planning now can go a long way.

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