BUSINESS TAX STRATEGIES

Tax strategies

CPAS SAY NOW IS THE TIME TO STRATEGIZE FOR NEXT YEAR GIVEN THE CHANGES IN TAX LAWS, WHICH TYPICALLY AREN'T AROUND FOR MORE THAN A YEAR

BY DEAN ANDERSON

It may be too late for 2006, but local certified public accountants say now is a good time to get a jump on 2007 to reduce business tax liability.

Fred Imel, CPA, works with a select group of larger clients and says it all starts with the setup of your organization.

"The first thing you have to do is see if the company is organized the right way," Imel said. "All businesses have characteristics because of what they do. That decision needs to be made consciously looking at the character of the business, the goals of the owners and realistically what the business can do for the next five years."

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Imel says manufacturing businesses, by and large, get more tax breaks than service businesses because they have a lower gross margin on sales and a lower net profit than service companies.

Given that, manufacturing companies will usually require more capital to get going. More wealth will be built inside a manufacturing company rather than a service company.

With the large buildup, manufacturing businesses will generate equity inside that can't be taken out.

For Joshua Jenson, CPA, each year's baseline starts with determining what a business expects to gross the coming year and what its expenses are.

"I think a lot of small businesses kind of lose sight that they should be including their income taxes as an expense of their business," Jenson said.

For most businesses, Jensen says January is a great time to review what businesses are charging customers.

"You might be underselling yourself and your rate," he said.

The next step would be to look at major changes. Large capital investments and adding additional staff would have a direct affect on taxes.

Jenson says a good rule-of-thumb is that for each new employee, they will save one-third of that salary amount in taxes.

In 2006, up to $108,000 of business equipment purchased can be expensed. From 2007 through 2009, that number will be adjusted for inflation, as set by Congress. In 2010, that number is scheduled to fall to $25,000.

"With Congress, you can never really count on laws being around for more than a year," Jenson said.

Jenson also says one common misconception is that capital purchases can't be expensed until they are paid in full.

"A lot of people don't know that," he said. "A lot of businesses may buy equipment and they may finance it and as long as you purchase it and put it into use in that business year, you get to write it off."

Case in point, Jenson has a client who is a chiropractor. The chiropractor needs to make a $75,000 equipment purchase, which he will do prior to Dec. 31 and will likely only make one payment, but he will still be able to take the full $75,000 deduction.

"You want to just time things," Jenson said. "With some businesses that do a five-year plan and looking at doing an expansion of business in year three or for doing a major purchase, they might consider doing that in 2007 or sooner."

That deduction will adjust the income amount and is not a dollar-for-dollar credit.

Another key area is looking at retirement plans. Changes to existing retirement plans need to be completed by the end of January for it to take effect during that tax year.

"You want to look at those things early in the year so that you don't get mid-year or near the end of the year and wish you could be putting more to retirement than you are able to," Jenson said.

Jenson agrees that the setup of a company can be the key for tax purposes.

"That was one of the first questions I felt I needed to solve myself when I was talking with clients," said Jenson, who started his own practice 10 years ago.

Jenson has broken it down into two types of business. The first is in which the owner is materially participating and one where the owner is not.

The IRS sets a 500-hour minimum limit to define an owner as having material participation in a business.

"If you materially participate in your own business overall, the most beneficial tax set-up is an S-corp," Jenson said. "If you're not going to be materially involved, then I would recommend those individuals set up an LLC taxed as a partnership. That is really what the LLC partnership is designed for, what we call the passive entity."

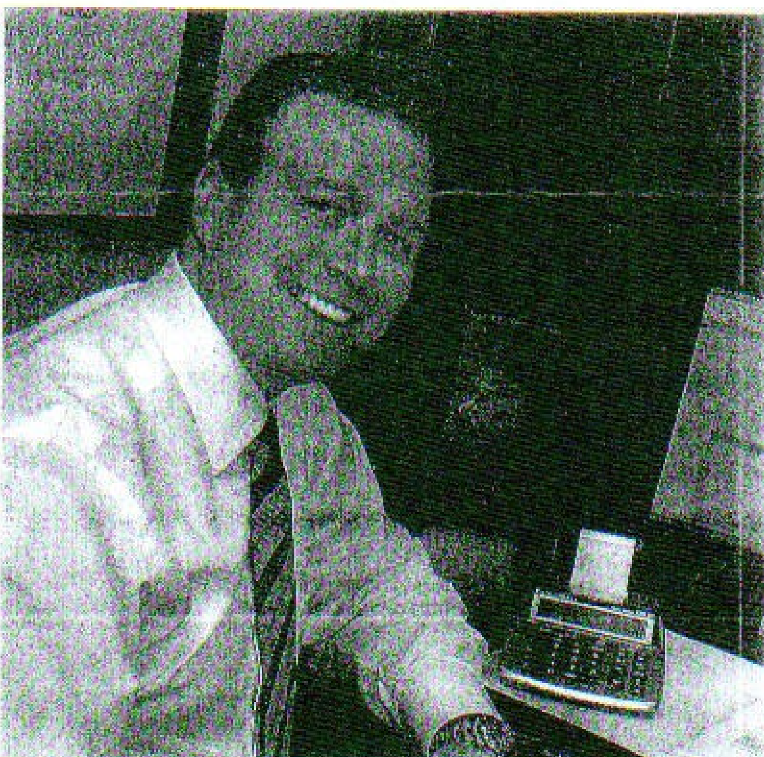
S-corporations allow business owners to save on self-employment tax (Medicare and social security). The net income is not subject to self-employment taxes with the catch being S-corp owners must pay themselves a fair and reasonable rate.

An LLC can be taxed as whatever it chooses. An LLC can elect, through checking a box to be taxed as a C-corporation, S-Corporation, partnership or disregarded entity.

"You want to visit with a CPA," Jenson said. "If you're going to be an S-corp, you only have 75 days from the day you start your business to elect that status. You don't want to wait until the end of the year."

So the correct way to set up your business comes down to three things – how much effort you plan to put in with the business, how much you expect to put in next and how much tax you want to pay.

"With most of my clients, the answer is usually 'No more than I have to,'" Jenson said. "Most people are fair and understand they need to pay their fair share. Most clients don't want to go over the line, they don't want to step over the line, they don't want to step in front of the line, they want to stand on the line." ◆



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