



# 2003 Small Business advisor

TIMELY TALK ABOUT BUSINESS, TAXES, AND TRENDS FALL 2003 Volume IX, Number 3

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Questions & Answers

**Brenda J. McGivern, CPA**

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**Here is your issue of Small Business Advisor. Enjoy!**

### Is Now the Time to Sell Your Business?

As a result of the 2003 tax-cut bill, long-term capital gains rates for capital assets sold after May 5 of this year will be taxed at substantially lower rates: 5% if your marginal tax bracket is 15% or under and 15% for others, down from 10% and 20%, respectively. For most taxpayers, this amounts to as much as a 25% cut in taxes for capital gains on assets owned for more than one year. The new rates are even lower than the old rates (8%/18%) for holding property over five years. [click here for full article](#)



### Are Your Safe Harbor Prepayments in Jeopardy?

Generally, if a taxpayer fails to pay an amount equal to 90% of their tax liability through payroll withholding and estimated tax payments, they could be subject to an underpayment penalty when they file their return, unless they qualify for one of the penalty exceptions. Many taxpayers have investment and self-employed income that is hard to predict. These individuals frequently utilize the exception that allows the taxpayer to prepay an amount equal to 100%, or 110% if adjusted gross income exceeds \$150,000 (\$75,000 for married filing separate taxpayers), of the prior year's tax to avoid a penalty. [click here for full article](#)

### Deducting the Cost of Business Assets

Depreciation is a way of recovering the cost of an item purchased for business use over a period of time. Some assets are depreciated over a specified life. For some assets, the depreciation is straight-line, while for others accelerated methods that front load the deduction may be used. [click here for full article](#)

### Taking Business Equipment Write-Off to the Max



**Brenda J.  
McGivern, CPA**

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please feel free to  
call us at:**

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Whenever property is purchased for business use and that property has a useful life of more than one year, its cost must be deducted over its useful life. This accounting procedure is referred to as depreciation. The number of years the property must be depreciated is largely dependent upon the type of property it is. However, there are exceptions to the depreciation requirement.[click here for full article](#)



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## Tax Calendar (September – December 2003)

### **September 15:**

- Third installment of 2003 Individual Estimated Taxes due.

### **October 15:**

- Last date to timely file 2002 Individual Tax Return (Form 1040) if you are in the United States and filed an extension with Form 2688.

### **September - December:**

- Time for 2003 Year-End and 2004 Tax Planning. Contact this office to schedule a consultation appointment.

- Taxpayers who began their Minimum IRA Distributions before 2003 must withdraw their 2003 Distribution by December 31st.

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If your business is a C corporation organized over five years ago and capitalized for \$50 million or less, you may also qualify for the Small Business Stock Gain Exclusion available to individual taxpayers. Under this special section of the tax code, you can exclude 50% of the gain from qualified Small Business Stock. The annual exclusion is limited to

either \$10 million or 10 times the taxpayer's basis in the stock.

Only stock acquired at original issue is eligible for the exclusion. However, small business stock received as a gift or through inheritance retains its character as small business stock. The transferee picks up the transferor's holding period in the stock. Instead of claiming the exclusion, an investor may roll over any gain from the sale or exchange of qualified small business stock held for more than six months by buying other qualified small business stock within 60 days of the sale. If a rollover is made, no immediate tax is due, and the 50% exclusion can still be used later, when the replacement stock is sold.



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tax payments, they could be subject to an underpayment penalty when they file their return, unless they qualify for one of the penalty exceptions. Many taxpayers have investment and self-employed income that is hard to predict. These individuals frequently utilize the exception that allows the taxpayer to prepay an amount equal to 100%, or 110% if adjusted gross income

exceeds \$150,000 (\$75,000 for married filing separate taxpayers), of the prior year's tax to avoid a penalty. This exception is also used by taxpayers who have large increases in income and want to minimize the amount they pay in advance.

The Federal Government has recently issued new withholding tables that reduce employee withholding to compensate for the new tax cuts.

**Pitfall:** If your planned prepayments include withholding, the reduced withholding could cause the planned prepayments to be less than 100% (or 110%) of your prior year's tax, subjecting you to the underpayment penalty. If you have questions regarding your safe harbor estimates, please call this office as soon as possible.

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Depreciation is a way of recovering the cost of an item purchased for business use over a period of time. Some assets are depreciated over a specified life. For some assets, the depreciation is straight-line, while for others accelerated methods that front load the deduction

may be used. Following are examples of the depreciable life for some commonly encountered business assets. Assets that are used only partially for business must be prorated for business use.

### SAMPLE DEPRECIABLE LIVES

	Depreciable Asset Life		Depreciable Asset Life
Agricultural Equipment	7 Yrs	Office Equipment	5 Yrs
Automobiles <sup>(2)</sup>	5 Yrs	Office Furnishings	7 Yrs
Commercial Real Estate	39 Yrs	Residential Real Estate	27.5 Yrs
Land	Not Depreciable	Trucks	5 Yrs
Land Improvements	15 Yrs		

*(2) Vehicles under 6,000 lbs. gross unladen weight have additional deduction restrictions.*

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## Taking Business Equipment Write-Off to the Max



Whenever property is purchased for business use and that property has a useful life of more than one year, its cost must be deducted over

its useful life. This accounting procedure is referred to as depreciation. The number of years the property must be depreciated is largely dependent upon the type of property it is. However, there are exceptions to the depreciation requirement:

•**Section 179 Expensing** - The tax code contains a special provision that allows certain types of property to be expensed (deducted in the year of purchase) rather than depreciated. This provision is commonly referred to as Section 179 expensing and is limited to a maximum annual amount. The 2003 tax-cut legislation increased that amount from \$24,000 to \$100,000 (1). The maximum annual expensing amount phases out dollar for dollar where the taxpayer places in service during the tax year qualified property in excess of \$400,000. The Section 179 deduction only applies to tangible personal property such as tools, office equipment, machinery, etc., and does

not apply to real estate. Since there are other restrictions, please contact this office for additional details.

*(1) Taxpayers filing married separately are only allowed \$50,000. The expense limit is increased to \$135,000 in qualified enterprise zones.*

•**Special Bonus Depreciation** - For tax years 2001 through 2004, there is also a special bonus depreciation that allows taxpayers to deduct a substantial portion of the cost of the asset in the year purchased. The 2003 tax cut liberalized the bonus first-year depreciation allowance by increasing the allowance from 30% to 50% of the cost of property placed into service before 2005 (was before September 11, 2004). This first-year bonus depreciation deduction is allowed for certain equipment and leasehold improvements for which the business use originated with the taxpayer's business. The taxpayer may elect not to use the 50% deduction and instead use the 30% limit or not use the bonus deduction at all. **Caution:** If you choose not to take the bonus depreciation deduction, you must file a written election with your return.

Sometimes, even repairs may have to be depreciated. If a repair or replacement increases the value of the property, makes it more useful, or lengthens its life, then it must be depreciated. If not, it can be deducted like any other business expense.

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## Auto Deductions-There's a Method to the Madness

When you use a vehicle for business purposes, you can deduct the business portion of the operating expenses on your business. If you use the car for both business and personal purposes, you may deduct only the cost of its business use. You can generally determine the expense for the business use of your car in one of two ways, the standard mileage rate method or the actual expense method.

### • **Standard Mileage Rate Method**

The standard mileage rate takes the place of fuel, oil, insurance, repair, maintenance, and depreciation (or lease) expenses. For 2003, the standard mileage rate is 36 cents per mile. In addition, the cost of business-related parking and tolls is deductible. Caution: If you don't use the standard mileage rate in the first year the vehicle is placed in service, you cannot use it in future years. If in a subsequent year you switch to the actual method, you must use the straight-line method for depreciation. If the car is leased, you must continue to use the standard mileage rate in future years if you choose to use it in the first year.

### • **Actual Expense Method**

To use the actual expense method, determine the entire actual cost of operating the car for the year and then determine the business portion attributable to the business miles



Both methods can include interest paid on the car loan when deducted on business returns. However, the interest deduction is not allowed for employees deducting job-connected car expenses as part of their itemized deductions. Unfortunately, if you deduct actual expenses for the business use of your car, you will probably find your write-offs for depreciation restricted due to so-called luxury car limitations. And most cars (including trucks or vans) fit the IRS definition of a "luxury vehicle," regardless of their cost. If a vehicle is four-wheeled, used mostly on public roads, and has an unloaded gross weight of no more than 6,000 pounds, the car is considered a "luxury vehicle." The otherwise regular allowable luxury auto depreciation limit for 2003 will be increased by \$7,650 with the special 50% bonus depreciation (see article titled "Maximizing Business Equipment Write-off"). The IRS has not yet announced the regular 2003 limits, but the 2002 amount was \$3,060.

*Some SUV vehicles exceed the 6,000-pound limitation and can provide a*

driven. Parking fees and tolls attributable to business use are also deductible.

*substantial first-year write-off when used in business.*

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## But Wait, There's More: Other 2003 Tax Changes

- **Self-Employed Health Insurance Deduction** – For years, this deduction has been allowed for only a portion of the expense. Beginning this year, 100% of the qualified health insurance premium expenses paid for business proprietors and their family members are deductible.

- **Marginal Tax Rates Reduced** – This year's tax cuts expand the 10% bracket for most filing statuses and reduce the marginal tax rates above 15%. The 10% bracket increase is \$1,000 for singles and married persons filing separately and \$2,000 for married persons filing jointly and surviving spouses. The 27% bracket is reduced to 25%, the 30% to 28%, the 35% to 33%, and the 38.6% to 35%, providing most taxpayers with a reduction of 2 percentage points. Knowing your marginal rate is important, because any increase or decrease in your taxable income will affect your tax at the marginal rate. For example, suppose your marginal rate is 25% and you are able to reduce your income \$1,000 by



contributing to a deductible retirement plan. You would save \$250 in Federal tax (\$1,000 x 25%).

- **Traditional IRA Phase Out Levels Increased** – The deductibility of Traditional IRA contributions phases out as a taxpayer's income increases when the taxpayer actively participates in another retirement plan. For 2003, the point at which the phase out begins increased from \$34,000 to \$40,000 for single taxpayers and from \$54,000 to \$60,000 for married taxpayers filing jointly.

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## Questions & Answers

**Q** – I am considering incorporating a small business. I heard that there is a special election I should include in the corporation in case the business fails. Can you elaborate?

**A** – You are probably referring to the "Section 1244 Election." If that election is made, you would be able to deduct any future losses from the sale of the stock as ordinary losses up to \$50,000 (\$100,000 for a married couple filing jointly) as opposed to a capital loss if the election is not made. Capital losses are limited annually to your capital gains plus \$3,000 (\$1,500 for married taxpayers filing separately). As a precaution, it is something you should consider.

**Q** – I own a C-corporation and would like to donate some of my excess inventory to charity. Are there any special rules I need to be aware of?

**A** – When a corporation donates inventory-type property to a charitable organization that will use it for the care of the ill, the needy, or infants, the donor can qualify to deduct more than its basis in the property. The deduction may be as high as the basis plus half the gain that would be realized on the sale of the property (not to exceed twice the basis). Certain restrictions on the transfer of the property apply and there are documentation requirements.

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