

Tax Planning Strategies for Contractors



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Agenda

2

- Current Law

- Proposed Legislation
 - ▣ Temporary Extension of Tax Relief
 - ▣ AMT Relief - Two-Year Alternative Minimum Tax Patch
 - ▣ Estate Tax Relief
 - ▣ Temporary Extension and Enhancement of Investment Incentives
 - ▣ Temporary Employee Payroll Tax Cut
 - ▣ Individual Tax Relief
 - ▣ Business Tax Relief

- Tax Planning Considerations





Current Law

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Employment Incentives

4

- Work Opportunity Credit
 - Credit against first year wages up to \$6,000 per employee in certain targeted groups

- Retained Worker Credit from HIRE ACT of 2010
 - Up to \$1,000 per eligible employee

- 2010 Payroll Tax Holiday
 - A limited social security tax “holiday” for the employer share of social security tax on wages paid to a previously unemployed new hire



Credits

5

- New Markets Credit
- Energy Credit
 - 30% of cost credit for purchase of solar, wind, geothermal, and other qualified energy property.
- Credit for Federal Tax Paid on Fuel
 - Credit for the tax paid on off highway business use of gasoline, diesel, and other qualified fuels.
- Credit for Hybrid Vehicles
 - 50% or 25% credit for certain brand new hybrid vehicles



Depreciation/Capital Improvements

6

- 2010 Bonus Depreciation
 - 50 % up front deduction on qualified new property if the deduction is utilized

- Section 179 Deduction
 - Up to \$500,000 in deduction in 2010 & 2011 for qualified property subject to income and asset placed in service limitations

- Energy Efficient Commercial Building Property Deduction
 - \$1.80 per square footage of building, basis is reduced in property if the deduction is utilized



Fringe Benefit Incentives

7

- Accountable Plan - Tools
 - Accountable plan status to a tool reimbursement arrangement allowing tax free reimbursements to employees for purchase of tools

- Small Business Healthcare Credit
 - Up to 50% of the cost of employee health insurance paid by a small employer (generally only for those with 25 or less employees)



Accountable Plans

8

Employees must meet all of 3 rules:

- Incurred expense while performing services
- Account to employer within a reasonable time (60 days)
- Returned amounts in excess of expense within a reasonable time (120 days)



Non Accountable vs. Accountable

9

	<u>Non- Acct.</u>	<u>Acct.</u>
<u>Expense Allowance</u>	\$3,600	\$3,600
□ Amount Substantiated	<u>0</u>	<u>2,400</u>
□ W-2 Amount	\$3,600	\$1,200

Note: W-2 Amount Subject to FICA,
Medicare and Income Taxes



Types of Reimbursements

10

For Use Of Employee's Auto:

- Mileage, Tolls, Parking:

2010

50.0

2011

50.0 (As of now)

- Travel (Airfare, Cabs)
- Meals, Lodging



Tax Rates

11

Income Type	Tax Rate resulting from Bush tax cuts	Tax Rate upon Expiration of Bush Tax Cuts
Ordinary Income	35%	39.6%
Ordinary Income	33%	36%
Ordinary Income	28%	31%
Ordinary Income	25%	28%
Ordinary Income	15%	15%
Ordinary Income	10%	15%
Qualified Dividends	0%- 15%	Ordinary Income Rates
Long-term Capital Gain Income	0%-15%	20%



State Capital Incentives

12

- Massachusetts:
 - Investment Tax Credits for Manufacturing and M&D Corporations
 - 3% of the cost of qualifying tangible personal property
 - Workforce Training Grants
 - Express, general grant, and hiring incentives training grants
 - Grants as much as \$30,000-\$250,000 available
 - Abandoned Building Property Deduction
 - A one time 10% deduction for purchase of certain abandoned property.



State Employment Incentives

13

- Rhode Island
 - ▣ Apprenticeship Credit
 - ▣ Jobs Training Credit
 - ▣ Enterprise Zone Credit
 - ▣ Adult Education Credit
 - ▣ Jobs Training Grant



Roth Conversions

14

- Pre-2010 AGI Limitation on Roth Conversion: \$100,000

- 2010 AGI Limitation on Roth Conversion: \$0

- Benefits of Roth IRA/Reasons to Convert
 - Tax free accumulation of earnings
 - No requirement to distribute at age 70 ½
 - Reduces value of estate



Roth Conversions

15

- Disadvantages of Conversion
 - Must pay tax on pre-tax contributions and earnings in year of conversion
 - Special exception for 2010 conversions: Pay tax 50% in 2012 and 50% in 2013 subject to tax rates in 2011 and 2012



Roth Conversion

16

- Ideal Candidates to Convert
 - Several years until needing access to funds
 - Desire to pass retirement assets to heirs through estate
 - Ability to pay taxes on conversion with non-retirement plan assets
 - Lower current tax bracket than projected future tax bracket.
 - Significant contributions to non-deductible IRA





Estate Planning

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Estate Tax

18

2009 Estate Tax Rate:	35%
2009 Exclusion:	\$3,500,000
Basis to beneficiary:	FMV on date of death
2010 Estate Tax Rate:	0%
2010 Exclusion:	N/A
Basis to beneficiary:	Carryover basis
2011 & Beyond Estate Tax Rate:	up to 55%
2011 & Beyond Exclusion:	as low as \$1,000,000



Estate Planning Strategies

19

- ❑ Gifting Strategies
- ❑ Irrevocable Life Insurance Trust
- ❑ Generation Skipping Trust
- ❑ Property Ownership
- ❑ Credit Shelter Trust
- ❑ Marital Trust
- ❑ Grantor Retained Annuity Trust (GRAT)
- ❑ Qualified Personal Residence Trust (QPRT)
- ❑ Defective Grantor Trust (DGT)
- ❑ Family Limited Partnership
- ❑ Charitable Lead Trust
- ❑ Charitable Remainder Trust
- ❑ Charitable Foundation



Generation Skipping Transfer Tax

20

- Generation skipping transfer tax rates are linked to the estate tax which are currently zero percent
- Possible benefit for 2010 gifts to second generation
- Gift would need to be made before 12/31/2010



Employee vs. Independent Contractor

21

- Control vs. Independence
 - Make sure there is a written plan.

- Consistent Treatment

- Massachusetts Differences



Independent Contractor

22

- Form 1099-MISC.:
 - \$600 or more in calendar year payment for services
 - Reimbursed expenses of independent contractor included on 1099

- Incorporation exception not applicable to attorneys



Substantiation of Business Expenses

23

- Complete Monthly Expense Report and require inclusion of receipts





Proposed Legislation

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Temporary Extension of Tax Relief

25

- Tax Rates:
 - Current law - top rate increases from 2010 to 2011:
 - Ordinary income - 35% in 2010; 39.6% in 2011
 - Dividends - 15% in 2010; 39.6% in 2011
 - Long-term capital gains - 15% in 2010; 20% in 2011
 - Proposed legislation - retains 2010 tax rates through 2012



Temporary Extension of Tax Relief

26

- Personal Exemption Phase-Out:
 - Current law - full personal exemption deduction in 2010; phased out beginning 2011 based on AGI
 - Proposed legislation - no phase out through 2012



Temporary Extension of Tax Relief

27

- Itemized Deduction Reduction
 - Current law - no reduction in 2010; reduction beginning in 2011
 - Proposed legislation - no reduction through 2012



Temporary Extension of Tax Relief

28

AMT Relief

Exemption:

<u>2010</u>		<u>2011</u>	
IND	MFJ	IND	MFJ
\$47,450	\$72,450	\$48,450	\$74,450

Nonrefundable personal credits - allowed (e.g., child tax credit)



Estate Tax Relief

29

Current Law:

	2009	2010	2011
Exemption	\$3.5	NA	\$1.0
Rate	35%	NA	55%

Proposed legislation:

	2009	2010	2011
Exemption		Note	\$5.0
Rate			35%

Note:

- ▣ Estate tax rate for 2010 - 35% and \$5 million exemption
- ▣ Executor may elect to opt out of estate tax in 2010 with modified carryover basis.



Estate Tax Relief

30

- Portability
 - Executor of deceased spouse may elect to transfer unused exemption of deceased spouse.
 - Avoids "wasted exemption" and complicated estate planning to claim entire exemption (currently \$7 million for a couple).

- Reunification
 - Estate and gift tax exemption and rates unified - effective for gifts made after 2010.



Temporary Extension & Enhancement of Investment Incentives

31

- Bonus depreciation
 - Current law - 50% bonus depreciation - new assets placed in service through December 31, 2010

- Proposed legislation
 - 100% bonus depreciation - new assets placed in service after September 8, 2010, and before January 1, 2012.

 - 50% bonus depreciation - new assets placed in service after December 31, 2011, and before January 1, 2013.



Temporary Extension & Enhancement of Investment Incentives

32

- 179 deduction
 - Current law - \$500,000 deductible with phase out beginning at \$2,000,000 for assets placed in service in tax years beginning in 2010 and 2011 reverting to \$25,000/\$200,000 for tax years beginning in 2012.
 - Proposed legislation - provides for a limitation of \$125,000 and phase out beginning at \$500,000 for assets placed in service in tax years beginning after December 31, 2011. Limitation is \$25,000/\$200,000 for tax years beginning after December 31, 2012.



Temporary Employee Payroll Tax Cut

33

- Current law - employees pay a 6.2% Social Security tax on wages earned up to \$106,800 (in 2011) and self-employed individuals pay a 12.4% Social Security self-employment tax on self-employment income earned up to the same amount.
- Proposed legislation - reduces both taxes by 2% on income earned during 2011.



Individual Tax Relief

34

- Extends certain deductions and credits through 2011 including:
 - State and local general sales taxes
 - Above-the-line deduction for qualified tuition and related expenses
 - Tax-free distributions from IRAs for charitable purposes (\$100,000 per taxpayer aged 70½ or older)
 - Tax credit for energy-efficient U.S.-based manufactured clothes washers, dishwashers and refrigerators
 - Tax credit for energy-efficient improvements to existing homes



Business Tax Relief

35

- R&D credit - extended for two years through 2011.
- New Markets Tax Credit - extended for two years through 2011
- 15-year cost recovery period for certain leasehold improvements, restaurant buildings and improvements, and retail improvements - extended for two years through 2011
- Work opportunity tax credit (WOTC) - 40% of first \$6,000 of wages paid to new hires of one of nine targeted groups. Currently set to expire August 31, 2011 - extended through December 31, 2011.
- Exclusion of small business capital gains - Stock acquired after September





Tax Planning Considerations

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Tax Planning Considerations

37

- Scenario:
 - ▣ S corporation with C corporation earnings and profits
 - ▣ S corporation generating losses in excess of shareholders' basis
 - ▣ Result - suspended losses

- Possible solution:
 - ▣ Election to treat S corporation as distributing C corporation dividends

- Result:
 - ▣ Shareholders stock basis increases
 - ▣ Shareholders deduct suspended losses to extent of stock basis increase - tax benefit at 35%
 - ▣ Shareholders pay tax on dividends at 15%
 - ▣ Net tax rate benefit to shareholders - 20% (35% tax benefit - 15% tax cost)



Tax Planning Considerations

38

- Scenario:
 - Sale of a business qualifying for capital gains in 2010 - partial payment by note
 - Sale qualifies for installment sale treatment
 - Assumption - capital gains rates increase subsequent to 2010

- Possible solution:
 - Elect out of installment sale treatment - accelerate taxable gain on the note 15% in 2010 vs. 20% in subsequent year



Roth Conversions

39

- Undo strategy - put different asset classes into separate Roth accounts with plan to undo conversion for those accounts that have lost value

- Split conversions
 - Report 1/2 in 2011 and 1/2 in 2012 - tax based on 2011 and 2012 rates
 - Tax deferred to 2012 and 2013

- Conversion can be undone by extended due date of return
 - E.g., if conversion is in January 2011 - can be reversed as late as 10/15/2012.

- If no deductible IRAs - contribute to non deductible IRA and convert to Roth



Accelerate gifts to 2010

40

- Gift tax rates at historical low of 35%

- Skip generations without incurring generation skipping transfer tax

- Property at low values (e.g., real estate, stocks) with high appreciation potential
 - Subsequent appreciation transferred tax free



Transfer Tools

41

Transfer tools - effective in low interest rate environment

- Grantor Retained Annuity Trusts:
 - Grantor receives annuity at low rates
 - Present value of remainder interest minimized - low gift tax
 - Actual return exceeds annuity rate
 - Result - excess value transferred to remainderman free of transfer tax



Transfer Tools

42

Transfer tools - effective in low interest rate environment

- Charitable Lead Annuity Trusts:
 - Grantor receives charitable contribution deduction for annuity present value
 - Grantor makes taxable gift for principal contributed less annuity present value
 - Actual return exceeds annuity rate
 - Result - excess value transferred to remainderman free of transfer tax



Transfer Tools

43

Transfer Tools - effective in low interest rate environment

- Qualified Residential Property Trust:
 - Grantor transfers residence to trust and retains use for a period of years
 - Gift based on current (depressed) real estate value and low interest rate
 - Result - excess value transferred to remainderman free of transfer tax



Alternative Minimum Tax

44

- Projection - AMT position
- Minimize expenses deductible for regular tax but not for AMT purposes e.g. state tax deductions to equalize regular taxable income and tentative minimum taxable income.



Tax Planning Considerations

45

- S vs. C corporate structure



Accounting Method Changes

46

- S corporations - change to overall cash method of accounting:
 - Large contractors - limited to non long-term construction contracts
 - Small contractors - possible to change for all contracts



Investments

47

- Harvesting capital losses:
 - Apply against short term capital gains - up to 35% tax benefit
 - Apply against ordinary income (up to \$3,000) - up to 35% tax benefit
 - Apply against long term capital gain - 15% tax benefit



ANY QUESTIONS?



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