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2011 YEAR-END TAX PLANNING OPPORTUNITIES FOR SMALL BUSINESSES

As the end of 2011 approaches, small businesses should consider taking action that could save them significant amounts of money through targeted tax incentives, some of which expire at the end of the year. Two limited time tax incentives offer small businesses the opportunity to expand their operations thorough purchases of things like new equipment and software as well as improvements to real estate and even purchases of real estate. Another incentive is directed at helping small businesses pay for health insurance for their employees.

179 Deduction. In 2011, businesses are allowed to deduct, rather than capitalize, up to $500,000 of the cost of machinery and business equipment, computers, computer software, office furniture and equipment, and certain business vehicles purchased during the year under Internal Revenue Code Section 179 (the "179 Deduction"). The maximum 179 Deduction is scheduled to drop to $139,000 in 2012. The 179 Deduction is available for used property as well as new property and also (for 2011 only) for off-the-shelf computer software. For 2011 only, the 179 Deduction also can be taken on up to $250,000 (of the $500,000 deduction limit) of certain real estate purchases. This category includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. However, there are important limitations. First, for 2011, the deduction phases-out as a business spends more than $2 million on qualifying purchases. Second, the deductions cannot be used to cause or increase a tax loss (i.e., the business has to be profitable during the year).

Bonus Depreciation. Business are allowed to depreciate 100% of the cost of new property purchased in 2011 (effectively the same as deducting the purchase price). The property must qualify for depreciation under normal depreciation rules and includes things like buildings, machinery, vehicles, furniture, and equipment, as well as "intangible property" like patents, copyrights and computer software. Bonus Depreciation is not subject to the $500,000/$2,000,000 limitations of the 179 Deduction. Bonus Depreciation will be available in 2012 as well, but only at a 50% rate, and then expires in 2013, when the normal depreciation rules go back into effect. Unlike the 179 Deduction, Bonus Depreciation can create a net operating loss which can be carried forward to future years or carried back to prior years (which could result in a refund).

To take advantage of the 179 Deduction or Bonus Depreciation, qualifying property must be placed in service before the end of the year in which the deduction or depreciation is claimed.

The 179 Deduction and Bonus Depreciation may be combined, but there is an ordering rule for applying these incentives. The 179 Deduction is considered first, followed by Bonus Depreciation, and then by regular depreciation. This can be illustrated by an example in which a business buys two pieces of machinery, one new and one used, for a price of $1,000,000 each. The taxpayer can claim 100% Bonus Depreciation for the new machinery, but will be limited to the 179 Deduction for the used machinery. Because the 179 Deduction is limited to $500,000, the remaining $500,000 would be depreciated over a number of years under regular depreciation rules.

Health Care Tax Credits. A small business that pays at least one-half of its employees' health coverage may qualify for a tax credit of up to 35% of the amount spent on those health insurance premiums. Employers with fewer than 25 "full time equivalent" employees and average employee wages of under $50,000 are eligible to receive the tax credit. The number of "full time equivalent" employees is determined based upon the number of hours worked, so an employer with 25 or more employees may still qualify if some of the employees work part-time. However, self-employed individuals, sole proprietors, partners, 2% shareholders of an S corporation and 5% owners ("Owner Employees") and their family members who are employed by the company are not counted as "employees" for purposes of determining the tax credit and their wages do not count for purposes of determined average wages. Premiums paid on behalf of Owners Employees and their family members also are not counted for purposes of determining the amount of the credit. The tax credit phases out as firm size and average wages increase.

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