# Keep More Cash!

## 4 KEY TAX STRATEGIES

## 1. Profit From Losses
## 2. Accelerate Write-Offs
## 3. Put Unsold Inventory to Work
## 4. Keep It in the Family

**By Justin Martin** *Photographs by Peter Yang*

WHEN YOUR ACCOUNTANT PREPARES YOUR BUSINESS TAX return, you may feel a bit like Bill Murray's character in *Groundhog Day,* only this time forced to relive the indignities of 2008 again and again. Yes, last year was a bummer for many American entrepreneurs. But like Murray's cynical weatherman, you have an opportunity to improve upon the past.

With smart tax moves, you may be able to recover some of the money you lost in a bruising 2008. *FSB* talked with a dozen tax

experts, who identified such savvy strategies as carrying a loss back to previous years, accelerating write-offs for equipment purchases and claiming deductions for unsold inventory. We also found small business owners who have effectively used each strategy to preserve much-needed cash rather than forking it over to the feds.

**Are you worried that your taxes will increase under the new administration?**

**Yes: 60%**
**No: 37%**
**Not sure: 4%**

PERCENTAGES ARE ROUNDED. SOURCE: *FSB*/ZOGBY INTERNATIONAL POLL OF U.S. SMALL BUSINESS OWNERS, CONDUCTED LATE JANUARY

## Profit From Losses

FOXFIRE PRINTING HAD A ROUGH 2008. BASED IN Newark, Del., Foxfire creates in-store signage for clients such as Pep Boys and Supervalu. Last year many of its other retail customers closed stores and slashed marketing budgets—one valued client even went bankrupt. As a result, Foxfire's revenues fell from $25 million in 2007 to $23 million in 2008, and the company posted its first loss since 2000. But founder John Ferretti plans to recoup some of that money by executing what's called a net operating loss (NOL) carryback. "Bankers aren't lending," he says. "So I'm grateful there's a piece of the tax code that will put some capital into my business."

Here's how the carryback works. Say you lost $1 million in 2008 after turning a $500,000 profit in each of the previous two years. You carry the loss backward by having your accountant amend your 2007 tax return to offset the entire profit for that year. You would then be due a refund on any federal taxes you paid on that profit—and state taxes in roughly a third of the states. You would still show a loss balance of $500,000, which you could carry back to 2006 and offset your profit for that year as well.

Generally you can carry a loss back for only two years. (In light of last year's red ink tsunami, legislation before Congress at press time proposes to extend the carryback to five years.) Some companies may still have a loss balance even after amending two years' worth of tax returns. Luckily you can also carry a NOL forward to offset profits for up to 20 years.

Be aware that the IRS can take up to a year to refund money from a NOL carryback. But there's an expedited form (IRS 1139) that will get cash into your hands twice as fast, though it can be used only by businesses that are organized as C corporations.

## Accelerate Write-Offs

ORDINARILY YOU WOULD DEPRECIATE PURCHASES OF, for example, equipment and machinery, both of which are treated in IRS form 946. The list is broad and allows plenty of wiggle room—it includes everything from drill presses and desk chairs to landscaping shrubs. The IRS sets depreciation schedules for these sundry items, typically ranging from three to 15 years.

Depreciation helps you recoup your money, but often in small increments over more than a decade. There's also a cunning and perfectly legal strategy that you can use to take a large write-off in a single year; it's called a Section 179 deduction. "The name is dull," says Blake Christian, a C.P.A. with Holthouse Carlin & Van Trigt in Long Beach, Calif. "But Section 179 can really supercharge your deductions."

Taking a large onetime deduction makes sense, especially in the current economy. You get a bigger chunk of change to plow back into your business right now. And you won't lose ground to inflation, which happens when you depreciate a purchase over many years.

# Keep It in the Family

### Business losses can help with estate planning.

**IF YOUR FAMILY BUSINESS** declined in value last year, now is the ideal time to pass some of it along to the next generation.

Estate planning is all about tax policy, which makes for uncertain planning given that the estate tax is slated for a one-year suspension in 2010. But it appears that Congress will act this year to freeze the estate tax at its current level. At death a person can pass along $3.5 million tax-free, but anything above that is taxed at rates as high as 45%.

By transferring as much of your business as possible to your heirs while you're still alive, you minimize any estate tax they may have to pay after you're gone. As of 2009 you can give $1 million worth of gifts during your lifetime, tax-free. The amount is cumulative, so you can make the gifts incrementally or all at once. You can also make tax-free gifts of up to $13,000 each to as many individuals as you choose in 2009. That's up from $12,000 last year.

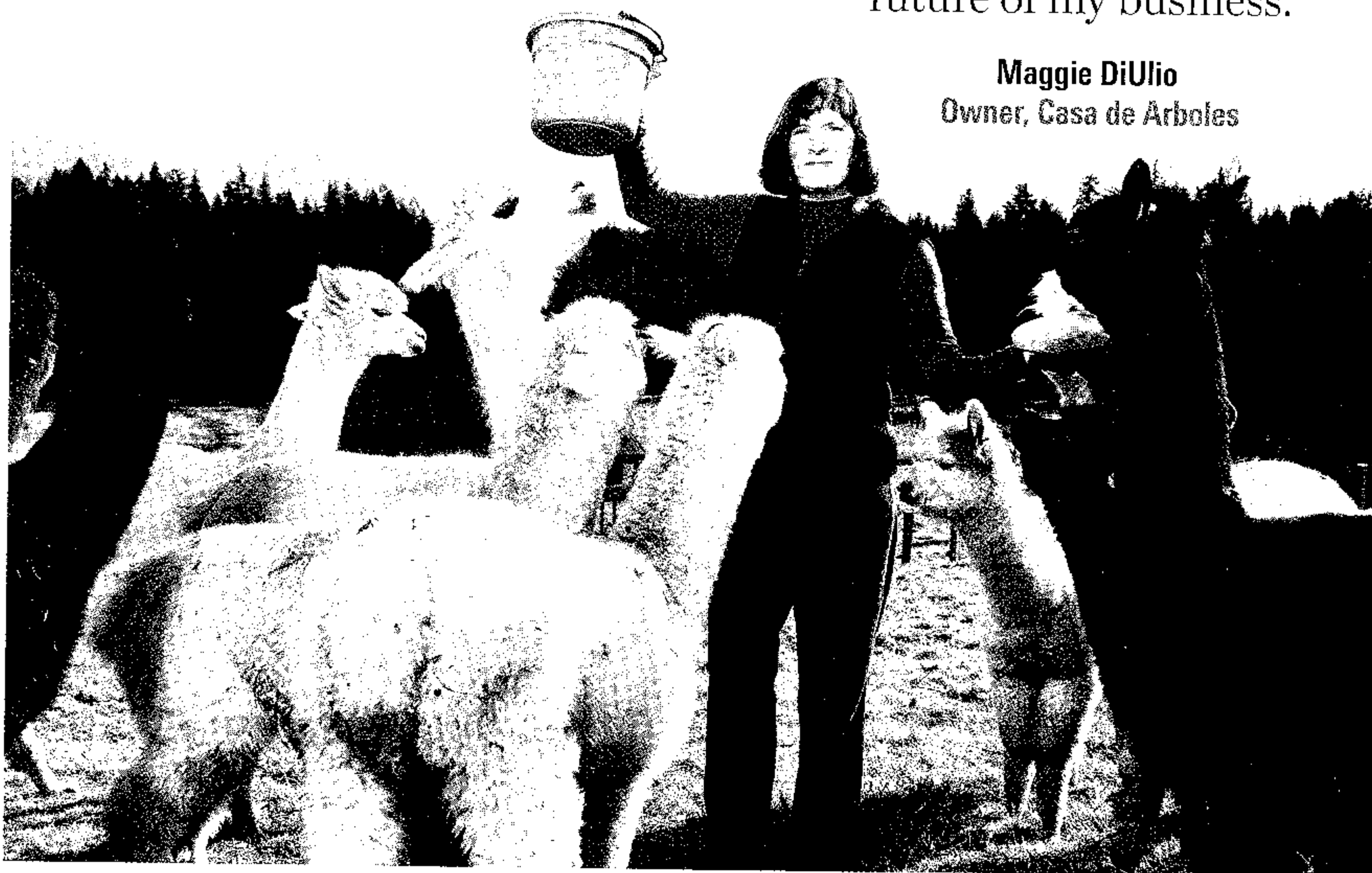
So how does a family business that has declined in value take advantage of the gift-tax rules? It's simple. Right now you can give larger blocks of ownership shares to your children and still stay within the limits. Say your business is worth half what it was a year ago. That means a stock gift worth $13,000 equals twice as many shares as last year's.

If the business appreciates in the future, you'll have picked the perfect time to transfer some or all of the ownership. Your kids will think you're brilliant.

Of course, the IRS imposes detailed rules on these gifts. Tax experts advise having your business assessed by an independent valuation firm before transferring shares. —J.M.

"Taxes have a huge impact on the growth, health and future of my business."

**Maggie DiUlio**
Owner, Casa de Arboles



# A Taxing Future?

## Small business may be safe—for now.

**WITH A NEW ADMINISTRATION AND** an economy that continues to slip, Maggie DiUlio is nervous. DiUlio owns Casa de Arboles, a 30-acre alpaca farm in Monroe, Wash. She and her husband (who helps with the alpaca operation but also works as a veterinarian) had a combined 2008 income of $340,000. DiUlio worries that President Obama will make good on a campaign pledge to raise taxes on couples with incomes above $250,000 ($200,000 for single filers).

DiUlio also worries about business tax hikes. For example, she says she might sell her alpaca farm one day, which would require her to pay capital gains taxes. Currently the federal capital gains rate is 15%, but that too could change. "I'm apprehensive," she says. "Taxes have a huge impact on the growth, health and future of my business."

But here's some good news for DiUlio. It appears that the new administration and the Democrat-controlled Congress are unlikely to raise taxes, at least in the short term. Doing so would be a disastrous move, given the deep recession and the need for economic stimulus, says tax expert Ken Goldstein, an economist with The Conference Board, a not-for-profit research firm in New York City. And President Obama has publicly supported small business tax breaks.

Unfortunately, the tax picture isn't so pretty at the state level. Every state but Vermont has a balanced-budget requirement—meaning that, unlike the feds, state governments can't engage in deficit spending to goose the economy. "States are getting slammed, and they will have to make some ugly choices," says James Horney, a researcher at the Center on Budget and Policy Priorities, a Washington, D.C. think tank.

Look for cash-starved states to try to land a big chunk of federal stimulus aid. But they're still bound to fall short of their fiscal requirements and will likely raise taxes and cut spending to make up the difference. In the longer term, the federal tax picture also looks bleak. Obama has prepared Americans for record trillion-dollar deficits in each of the next two years. But at some point somebody will have to pay for all that spending, and a few years hence, capital gains and other taxes will probably be hiked.

With the future of taxes cloudy, small business owners have all the more reason to take advantage of all tax breaks that are available now. —J.M.

Peerless Saw manufactures round steel blades that are used by such companies as International Paper and Pella, the windowmaker. Based in Groveport, Ohio, Peerless is coming off one of its worst years since the company was founded in 1931. Revenues dropped to $9 million in 2008 from $9.5 million in 2007. Profits plunged as well.

During this challenging year, CEO Tim Gase chose to keep his firm competitive by buying new equipment. Among his purchases were two state-of-the-art grinders capable of crafting steel to tolerances of less than a thousandth of an inch. The total tab: $150,000.

**In 2008 did your business lose money, break even or profit?**

**Lost money: 27%**
**Broke even: 22%**
**Profit: 49%**
**Not sure: 2%**

Gase could have opted to depreciate the machinery over seven years in accordance with the IRS's schedule. Instead, thanks to Section 179, Peerless was able to write off the entire $150,000 in 2008. This will lower its tax bite, providing fast cash to the struggling firm. "Why wouldn't you take the whole thing now if you need it?" asks Gase, adding, "We need it."

Section 179 is truly a small business tax break. It cannot be used by companies whose equipment purchases total more than $1,050,000 in a given year. (Businesses that have posted a net loss are also disqualified.) For 2008 firms can write off a generous amount under this section. Last winter, as part of an emergency economic stimulus package, Congress raised the limit from $128,000 to $250,000. (It drops back to $133,000 for 2009.)

Another write-off accelerator, bonus depreciation, was also created as part of last year's emergency stimulus package. (The legislation before Congress at press time would extend bonus depreciation through 2009.) Bonus depreciation allows you to write off half the cost of a piece of equipment during the first year. Say you spent $5,000 on a computer, an item that depreciates over five years. Under bonus depreciation, you could write off $2,500 in the first year and depreciate the balance over four years.

It's even possible to combine Section 179 with bonus depreciation. For example, if you bought $800,000 worth of equipment, you could write off the first $250,000 this year, maxing out your Section 179 deduction. For the remaining $550,000, you could use bonus depreciation to immediately write off half ($275,000). The balance would be depreciated over multiple years according to the usual schedule.

## Put Unsold Inventory to Work

ENLITEN MARKETS NOVELTY ITEMS THAT ARE SOLD AT the checkout counter at such chains as Walgreens and Wal-Mart. Unfortunately, beleaguered consumers weren't in the mood for many impulse purchases in late 2008. The Delray Beach, Fla. company had roughly $1 million in revenues but posted a deep loss. It also got stuck with a warehouse full of unsold doodads.

John Burke, a partner in the business, decided to donate some of the items to charity. During the holidays EnLiten gave 500 Unsound Advice dolls—battery-operated fortunetellers that answer questions with preprogrammed phrases such as "The prospects look good"—to a soup kitchen in Boynton Beach, Fla. Many of the soup kitchen's patrons are recent Latin American immigrants who don't speak English well.

"My company is struggling mightily, and this product didn't exactly fly off the shelves," says Burke. "Unsound Advice helps people new to America learn English phrases. At least we're doing something good with the dolls."

In exchange for donating this inventory, EnLiten will receive a tax deduction equal to the company's original cost. For goods manufactured in-house, the deduction is generally equal to the cost of producing the finished goods. EnLiten's Unsound Advice dolls are manufactured in China at a price of $9 per unit, so EnLiten will get a write-off worth roughly $4,500 for donating 500 dolls.

"My company is struggling mightily, and this product didn't exactly fly off the shelves. Unsound Advice helps people new to America learn English phrases. At least we're doing something good with the dolls."

**John Burke**
Partner, EnLiten

To claim a donated-inventory deduction, a company must provide goods that a nonprofit organization will actually use. "You could give unsold paper to a school," says Barbara Weltman, author of *J.K. Lasser's Small Business Taxes*. "But you could not unload a bunch of unsold steel ball bearings on said school."

**Are you in favor of the estate tax?**

**Yes: 26%**
**No: 67%**
**Not sure: 7%**

If you can't find a charitable use for your leftover items, you can dispose of them and claim an abandoned-inventory deduction, which confers identical tax benefits. Take time-stamped photographs that show your goods were, in fact, discarded, says Weltman. In case of an audit, you'll want to show the photos to the IRS.

Finally, the tax experts we consulted said not to worry if you've already filed your 2008 taxes: These tips will all work next year as well. Here's wishing you better fortunes in 2009. ☐

To give feedback, please write to **fsb_mail@timeinc.com** or go to **cnnmoney.com/smallbusiness**.