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OLD TAX RETURNS

Small-business owners seeking tax relief would be wise to review prior year tax returns filed, for several reasons. First, opportunities to amend these returns and receive a tax refund could be available and provide much-needed cash. Second, old tax returns may be a reminder of items and deductions to take in consideration in the current tax year. Here are some to consider.

- Carryovers: Some tax deductions are limited each tax year, but unused amounts may be claimed in the future.
- Home-office: Deductions for home-office expenses cannot exceed gross income from the home-office activity. But, unused portion of deductions can be carried forward and used up to the amount of income from a home-office activity in a future year. This is true even if you relocate and have a new home office. There is no time limit on a carry forward.
- Net operating losses (NOLs): Unused business losses from a current year can be carried back to prior year tax returns filed (between 2 – 5 years, depending on various factors), or carried forward and used over 20 years. If unused NOLs exist for more than one year, track these losses by year. When the losses may be claimed are governed by specific rules.
- Tax credits: Current year unused general business tax credits may be allowed a carry back within certain time frames, or carried forward up to 20 years.

Seek Help. Ask a competent tax professional to analyze these returns to look for missed opportunities.

COURT DECISIONS

A federal district court decided earlier in the year that severance payments made under a company plan to downsized workers were not "wages" for purposes of Social Security and Medicare (FICA) taxes. The government is appealing the decision so the matter is unsettled. However, some companies have filed a protective claim so a potential refund will not be barred by the expiration of the statute of limitations. The IRS thus far has denied these claims; employers can appeal within the IRS and ultimately take their cases to court. Smaller employers who do not have the money to pay the professional fees needed to pursue action should watch for developments on the matter and, if the issue is decided in favor of employers, then small employers should file for refunds.

A number of courts, last year, decided Limited Liability Company members should not be treated as limited partners for purposes of the passive-activity loss rules. Instead, these members are permitted to demonstrate material participation, which means the member participates on a regular, continuous, and substantial basis in order to escape the PAL limits. This year, the IRS acquiesced on this matter. Members of an LLC who failed to claim a loss from a passive activity in which they

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Last Month:

- SEC Plans to Limit Sales Commissions
- Are You Ready for More Paperwork
- Year End Estate and Gift Planning

Important Links:

Internal Revenue Service
Indiana Department of Revenue

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materially participated can file an amended return to claim those losses.

TAX ELECTIONS

The Internal Revenue Code has specific rules, called elections, for how certain transactions may be handled. Most elections are irrevocable when made without IRS approval. Others may be changed without approval. Where allowed, if you change your mind and receive approval by the IRS, you must file an amended return to obtain benefit of the change. Here are some examples:

- First-year expensing election: The so-called Section 179 election to deduct the cost of equipment in the year of purchase, rather than depreciate the cost over a fixed number of years, is beneficial when profitable. For the years 2003 through 2010, taxpayers may elect to claim this deduction by asking the IRS for approval. Therefore, if you failed to take the expense deduction the first year equipment was placed in service, but could have benefited from it, file an amended return to claim a refund as long as the statute of limitations has not expired.
- If business property was sold at a gain, and at least one payment is received following the year of sale, you have made what's called an installment sale. This means the gain must be spread out over the years payments are received unless an election is made to report the gain in the year of sale. This election is generally irrevocable, but if you intended to elect out of installment reporting because losses could offset gains, or for some other reason, consider asking the IRS for permission to make this change. It could be granted if you instructed your tax preparer to make the election but failed to do so.

THESE ARTICLES MAY NOT BE USED FOR PENALTY PROTECTION