

# Perspective

FALL 2011



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## Depreciation-related tax breaks still beckon businesses

For many companies, year end tax planning could begin with a close look at any asset purchases made during the year and those anticipated in the coming months. Why? Because the tax code has long offered businesses the opportunity to lower their tax bills by claiming depreciation-related breaks, and accelerating asset purchases into the current tax year can accelerate the tax savings.

This year is no different. In fact, 2010 tax legislation allows for some prime deals on depreciation. But time is running out on a couple of these breaks in their current form (though Congress might extend them).

### Good ol' 179

The Section 179 deduction may allow you to expense, rather than depreciate, a specified dollar amount of qualified asset acquisitions in a given year. For 2011, that amount is \$500,000 — much more than in past years. And, as of this writing, the limit is scheduled to drop to \$125,000 (indexed for inflation) for 2012.

**“Bonus depreciation is a tax break that has given a little more ‘bounce’ to depreciation-related strategies in years past, and it’s still here.”**

The tax code limits qualifying purchases to certain assets, such as equipment, office furniture and some computer software. In addition, for 2011 only, up to \$250,000 of your Sec. 179 expenses can be for qualified leasehold-improvement, restaurant or retail-improvement property.



A used asset may also qualify as long as it's new to your company and used at least 50% for business in your first year of ownership. Bear in mind that, whether you buy an asset new or used, you can deduct only the business-use percentage of the purchase price.

Other limitations apply as well. For 2011, the Sec. 179 deduction starts to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed \$2 million. This limit is scheduled to drop to \$500,000, indexed for inflation, for 2012.

In addition, you must not only buy the qualified assets before year end (or the end of your tax year that begins in 2011), but also put them into service by then. Finally, you can claim the deduction only to offset net income, not to reduce it below zero.

### A bonus still bouncing

Bonus depreciation is a tax break that has given a little more “bounce” to depreciation-related strategies in years past — and it's still here. In fact, because it's now larger than ever and it isn't subject to any asset purchase limits, this year's bonus may lessen the importance of the Sec. 179 deduction.

(Before choosing one or the other, however, look at the state tax impact.)

So how big is it? Try 100%. That's right, you can deduct 100% of the cost of qualified assets acquired and placed in service this year (or by Dec. 31, 2012, for certain long-lived and transportation property). For 2012, bonus depreciation generally drops to 50%. And after Dec. 31, 2012, bonus depreciation is scheduled to disappear.

For this tax break, you'll have to skip the used equipment. What types of assets are eligible? New tangible property with a recovery period of 20 years or less qualifies, as does computer software, water utility property and qualified leasehold-improvement property.

As great as this may sound, if your company is a corporation, you might be better off *not* claiming bonus depreciation. Corporations can accelerate certain credits in lieu of claiming bonus depreciation for qualified assets placed in service through

Dec. 31, 2012 (Dec. 31, 2013, for certain long-lived and transportation property).

### Accelerate to shorten

Another useful tax strategy that's available through 2011 and, as of this writing, *only* through 2011, is accelerated depreciation.

It allows companies to claim a shortened recovery period of 15 years — rather than 39 years — for qualified leasehold-improvement, restaurant and retail-improvement property. Note that qualifying assets may also qualify for Sec. 179 expensing or bonus depreciation, which can provide a greater tax benefit.

### Useful assets

A company's physical assets can do more than assemble products and process data. They can lead the way to tax breaks that, ultimately, boost cash flow. Check in with your tax advisor about the strategies mentioned here and any others that catch your interest. ♦

## How do Sec. 179 and bonus depreciation affect vehicles?

Whether your company maintains a fleet of vehicles or just a couple, you may wonder whether vehicle purchases are eligible for Section 179 expensing or bonus depreciation. (See main article.) The answer is: only if the vehicle in question qualifies under a number of rules and limits.



For instance, you may expense under Sec. 179 up to \$25,000 of the purchase price of a new or used SUV rated at more than 6,000 pounds but not exceeding 14,000 pounds. For vehicles weighing more than 14,000 pounds, the typical Sec. 179 expensing limits are generally applicable. The cost of these vehicles, if new, may be 100% deductible under bonus depreciation rules.

Vehicles weighing 6,000 pounds or less won't be defined as an SUV and, therefore, will be subject to the passenger automobile limits. The first year depreciation limit for autos placed in service in 2011 is \$3,060 (\$3,160 for trucks and vans). But an *additional* \$8,000 may apply under bonus depreciation, potentially making your available 2011 depreciation as high as \$11,060 for cars, \$11,160 for trucks and vans.

Finally, luxury auto rules may limit how much you can deduct under Sec. 179 expensing, bonus depreciation and other applicable methods. Your deduction will be further limited if the vehicle isn't used exclusively for business purposes — especially if used less than 50% for business.

# Not fade away: Rolling over a 401(k) plan

There's a line from an old rock 'n' roll song that goes, "It's better to burn out than to fade away." When it comes to managing a 401(k) plan from a previous employer, one could change this lyric to, "It's better to roll it over than to let it fade away in your memory." Although not nearly as catchy, that's generally sound advice.

## Good targets

The main reason to roll over a previously established 401(k) is to simplify and consolidate the management of your retirement accounts. There are two good "targets" for a rollover: a new 401(k) or an IRA. If you don't have an IRA and intend to participate in your new employer's 401(k), rolling over your account into the new 401(k) is likely the simpler option.

But, if you want to own a specific mutual fund or security, an IRA provides more flexibility. An IRA custodian can help you choose the funds or securities you want, while a 401(k) limits you to the options your employer chooses to make available.

Of course, IRAs have their downsides. They typically charge modest administrative fees, while employers typically pick up 401(k) plan fees — though more are starting to pass some fees along to employees.

Also, IRAs can't allow loans, while 401(k) plans can (and many do). On the other hand, IRAs offer more opportunities for penalty-free withdrawals before age 59½.

## Direct or indirect

Whether you decide to roll over your account into your new employer's 401(k) or an IRA, a "direct" rollover is almost always best.

Under this method, you never take possession of your funds. The administrator of your old 401(k)



plan transfers your assets directly to your new 401(k) administrator or IRA custodian. In some cases, the check will first be sent to you to hand over to the new administrator or custodian. As long as the check isn't made out to you personally, this is still considered a direct rollover.

By contrast, an "indirect" rollover entails your taking personal possession of your assets before rolling them over. If you don't redeposit the funds in your new 401(k) or your IRA within 60 days, it's considered a distribution, and you'll owe income taxes and, if you haven't reached age 59½, generally an additional 10% early withdrawal penalty.

What's more, your old employer will be required to withhold 20% of the distributed amount as a down payment on potential federal income taxes. (You may be able to receive a refund of the amount

withheld when you file your tax return, depending on your overall tax liability for the year.)

When you do your rollover, you'll want to replace the withheld amount with funds from another source. Otherwise, even if you meet the 60-day deadline, you'll owe income tax — and perhaps the 10% penalty — on the amount withheld.

**“Tapping your retirement funds too early accelerates tax liability and can subject you to stiff penalties.”**

### Risky move

There may be a few instances, such as a medical or financial emergency, when you need to consider cashing out your 401(k) instead of rolling it over. But doing so is risky.

Tapping your retirement funds too early accelerates tax liability and can subject you to stiff penalties. You'll owe federal income taxes — and, depending on where you live, maybe state and local income taxes — on the withdrawal, as well as potentially the 10% early withdrawal penalty. (One key exception: If you're age 55 or older when you leave your job, you may be exempt from this penalty. Ask your tax advisor for details on this and other exceptions.)

In addition, by withdrawing funds you'll not only reduce the size of your nest egg, but also lose its future tax-deferred growth potential. The combined effect of significant taxes and penalties and lost appreciation potential going forward can be enormous.

### Loose ends

A 401(k) from a previous job may seem like a loose end that you could leave dangle indefinitely. But your nest egg will sit much more snugly if you tie it up properly. ♦

## Keeping up with your life insurance needs

The appropriate life insurance coverage tends to change throughout our lifetimes. What suits us as young adults will likely not protect us adequately as we grow older. So it's important to keep up on the amount and type of coverage you may need.

### Through the years

How do our life insurance needs change throughout our lifetimes? Here are a few selected life stages to explore some of the specifics:

**Young adulthood.** Say you're a young, single professional with no dependents, little debt and

healthy savings. In this case, you likely need only limited coverage.





**Married but without children.** At this stage, life insurance needs generally rise. For instance, if you've bought a home and need both incomes to keep up with the mortgage payments, a life insurance policy should cover the potential loss of one of those paychecks.

**“Term policies usually cost less than other types, but you risk being inadequately covered or even going without coverage after they expire.”**

**Parenthood.** When children enter the picture, life insurance becomes even more important. If one spouse dies, the survivor bears an even greater financial burden. Food, health care, housing and especially educational costs can add up quickly.

**Nearing or in retirement.** Retired couples with grown, financially independent children and lower

living expenses may be able to reduce their coverage. On the other hand, life insurance can play a greater role in overall estate planning at this point.

### **The key distinction**

When choosing life insurance at any stage of life, you'll need to understand the key distinction between the two major policy types.

Under a *term* policy, you make regular premium payments in exchange for a set

sum to be paid to your designated beneficiaries should you die during a specified “term” typically ranging from one to 30 years, after which the policy expires. Term policies usually cost less than other types, but you risk being inadequately covered or even going without coverage if you're less insurable or uninsurable after they expire.

Alternatively, under a *permanent* (or “whole life”) policy, you pay premiums to both provide a death benefit and build cash value that you can potentially tap in the future. Such policies typically don't expire as long as the premiums are paid. Variations on the whole life theme allow you to make investment choices within the policy. The added flexibility, however, brings the associated risks of investing.

### **A worthy endeavor**

The life insurance coverage you should opt for requires a look at your life stage as well as a close look at your personal situation. No matter where you are in life, making sure you have the right amount and type of protection is important. ♦

# Stay on the lookout

## *3 major types of employee fraud threaten most companies*

While business owners fight to maintain and build their bottom lines, many are overlooking a rising threat: More employees may be using the difficult economy to rationalize committing fraud against their employers.

Losing dollars and assets to such theft can undercut even the savviest of profit-building efforts. That's why, now more than ever, business owners must be on the alert for fraud — which requires knowing what to look for. Let's review the three major types of employee fraud:

**1. Asset misappropriation.** Among the wrongdoings in this category are the theft or misuse of cash. If employee fraud does strike your business, it will likely be in this form. Most fraud schemes involve the misappropriation of assets, though



such acts tend to be less costly compared with those in the other two categories.

One example is the classic "ghost" employee ploy, in which a staff member with payroll powers channels funds to a nonexistent worker. Naturally, those funds end up in the real employee's pocket.

Other asset misappropriation schemes can be as simple as an employee handing you (or a manager) a check made out to "Visa" — but it's his or her account, not the company's. Or a worker may take a check made out to the IRS, change the "IR" to "MR." or "MRS." and then add his or her name.

**2. Corruption.** Here an employee uses his or her influence or job position for personal gain — and his or her company's loss. The schemes in this category are rarely simple and may go on for months, even years, without notice.

For instance, a corrupt employee works with a vendor's rep to inflate prices and then the two split the difference. What's worse, a scam like this can hurt not only your finances but also your public image. If word gets out that an employee is corrupt, your company looks bad — even if it's also a victim.

**3. Fraudulent financial statements.** In these schemes, the perpetrator falsifies the financial statements of his or her employer to either hide mistakes or commit outright theft. On the bright side, this category is generally the least prevalent. The downside? It's often the most costly, with such crimes sometimes costing businesses millions of dollars.

The specifics of these scams are usually complicated and tailored to the books of the affected company. Think way back to the Enron scandal and all of its complexities. Suffice it to say that the system of checks and balances that should exist in the creation and maintenance of financial statements is subverted with disastrous consequences. ♦

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