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A "Tax Toolkit" for Small Businesses

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Small businesses are weathering one of the most difficult economic periods in decades and are adapting by making sound investment and business decisions. The year 2010 will likely bring changes in tax laws to boost the economy. A "tax toolkit" can help small businesses navigate compliance with tax laws and anticipate changes to tax laws. A "tax toolkit" for small businesses could consist of reviewing federal tax returns for previous years, evaluating compliance with federal employment tax obligations and monitoring changes to tax laws.

Review federal tax returns

Small businesses should review their federal tax return from previous years to see if they can claim additional tax deductions or credits. An amended return can be filed to claim additional tax deductions or credits if a return has already been filed. For example, small businesses should review their 2009 tax return to determine if they claimed tax deductions or credits provided for in the American Recovery and Reinvestment Act of 2009 ("ARRA"). The tax incentives generally applicable to small businesses in the ARRA include the following:

- Bonus depreciation of 50 percent for certain capital assets (e.g., machinery, equipment or computer software) acquired in 2009;
- A deduction of up to $250,000 for the purchase of certain capital assets (e.g., furniture or fixtures);
- Expanding the Work Opportunity Tax Credit to include unemployed veterans and certain unemployed individuals ages sixteen to twenty-five; and
- Deferring the recognition of income resulting from any debt restructuring for five years.

Small businesses with losses in 2009 should also consider an election to carry back a net operating loss ("NOL") five years rather than just two years as generally provided. Electing to carry back an NOL five years offsets income reported for the tax years starting in 2004. The election could provide small businesses with a refund of taxes previously paid during the carryback years.


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The election to carry back an NOL five years is made by attaching a statement to the federal tax return for 2009. If the federal tax return for 2009 has already been filed, small businesses can file an amended return by September 15, 2010, to make the election. Alternatively, small businesses can make the election by filing a refund claim for taxes paid on Internal Revenue Service ("IRS") Form 1139 by September 15, 2010.

Evaluate compliance with employment tax obligations

Small businesses should also evaluate compliance with federal tax obligations such as paying federal employment taxes, filing employment tax returns (i.e., IRS Form 941, 943 and 944) and documenting business expenses. In February 2010, the IRS initiated a program to randomly audit the federal employment tax returns of 6,000 employers over a three-year period. The IRS indicated the audits will focus on the federal employment tax returns filed for the tax years 2006 to 2008 and will cover the following areas:

- The classification of a worker as an independent contract or employee;
- The reporting of fringe benefits provided to employees such as health care benefits;
- Company policies or plans to reimburse employee expenses incurred while working; and
- Compensation paid to the officers.

Small businesses should adopt procedures to review compliance with federal employment tax obligations. These procedures could include (i) reviewing company policies regarding the classification of employees and the reimbursement of employee expenses; (ii) reconciling the amount of compensation and employment taxes reported in payroll records with the same amounts reported in employment tax returns; (iii) documenting the type and value of fringe benefits provided to employees; and (iv) documenting any specialized knowledge or skill that supports a higher compensation level paid to officers.

Monitor changes to federal tax laws

Several tax provisions that affect small businesses are set to expire on December 31, 2010. Small businesses should consider the effect these changes will have on their operations.

For example, small businesses considering a sale of appreciated property or other assets should complete the sales in 2010. In 2011, the top tax rate increases from 35 percent to 39.6 percent. Also, small businesses should consider investing in machinery or capital assets in 2010, since the deduction for capital expenses drops from a maximum amount of $135,000 in 2010 to $110,000 in 2011. With the expiration of the preferential tax rates on dividends, small businesses that are taxed as corporations should consider paying dividends in 2010 at the preferred tax rate of 15 percent rather than at the maximum tax rate of 39.6 percent in 2011.

The potential impact of health care legislation is unknown, but small businesses should prepare for additional federal taxes and reporting obligations. Also, legislation could be proposed in 2010 to directly benefit small businesses, such as providing for a tax credit to hire new employees in 2010, reimbursing the payment of Social Security taxes and eliminating the capital gains tax on investments in small businesses.

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