

Small Businesses Fight Soaring Health Care Costs

The New York Times recently reported that "health insurance costs are still rising, particularly for small businesses."

What can business owners do about this threat to the bottom line? One tactic is to stop offering a health plan to employees; however, that may not be practical. Starting in 2014, businesses with 50 or more full-time employees will owe fines if they don't offer health insurance plans.

Smaller companies won't be required to offer health insurance; however, under current law, most people will be required to have health insurance by 2014, so employees of companies not offering coverage generally will have to buy their own. As a result, a company that does not provide an employee health plan will be at a disadvantage in attracting and retaining capable workers.

High deductibles, low premiums

Companies that want to provide health insurance but control costs can choose high-deductible plans. As is the case with any type of insurance policy, a higher deductible means that the insured individual will pay more before the insurance takes effect. Insurers have less exposure, so the consumer's cost is lower.

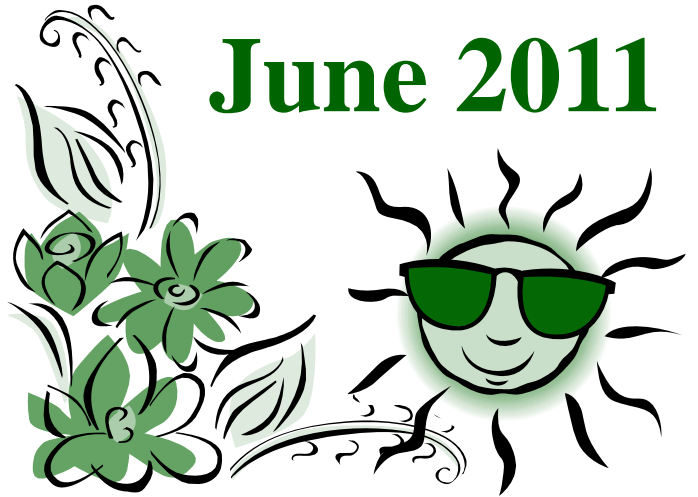
What's more, certain types of high-deductible health insurance plans can be paired with a health savings account (HSA). Individuals enjoy major tax advantages with HSAs, so employees might appreciate a high-deductible health plan that is compatible with HSAs.



Qualifying criteria

In order for a health plan to be matched with HSAs, the insurance policies must meet certain tests.

June 2011



Here are the rules for 2011:

Individual coverage. The deductible must be at least \$1,200. Insured individuals must have a maximum out-of-pocket cost (for deductibles, copays, coinsurance, etc.) of no more than \$5,950 before the insurance pays all ongoing costs. If those conditions are met, the maximum HSA contribution in 2011 is \$3,050 (\$4,050 for people 55 and older).

Family coverage. The deductible must be at least \$2,400. The insured family must have a maximum out-of-pocket cost of no more than \$11,900. If those conditions are met, the maximum HSA contribution in 2011 is \$6,150 (\$7,150 for people 55 and older).

Helping out

While business owners save money by providing high-deductible health insurance, employees have more financial exposure because of the increased deductible. Therefore, some companies make tax-deductible contributions to employees' HSAs. Even after these contributions, a business owner might have a lower total cost because of savings from choosing a high-deductible plan. ■

Lower Taxes May Mean More Jobs



In some ways, the title of the Small Business Jobs Act of 2010 says it all. This new federal law aims to create jobs within the United States, with small companies acting as engines of growth. Among the multiple provisions of this act, several provide tax benefits for small businesses. The authors of the new law hope that lower taxes will make many small companies more profitable and thus more likely to add employees.

Equipment deductions

One provision of the new law expands Section 179 of the tax code, which allows small companies to buy business equipment and take a first-year tax deduction. Ordinarily, companies must depreciate the equipment they buy, thus spreading deductions over several years.

From 2008 through 2010, Congress passed a series of laws setting the maximum first-year expensing amount at \$250,000. Once annual equipment purchases topped \$800,000, companies would lose the tax benefits of expensing, dollar for dollar. In the Small Business Jobs Act of 2010, the \$250,000 expensing cap for 2010 was increased from \$250,000 to \$500,000, and the higher limit was set for 2011 as well. (Up to \$250,000 of the \$500,000 cap can be deducted for qualified real property, which includes leasehold improvements, such as renovations to a store or a restaurant.) For each of those two years, the phaseout threshold is now \$2 million.

Example 1: ABC Corp. spends \$450,000 on business equipment in 2011. It can immediately deduct \$450,000, which is under the \$500,000 cap.

Example 2: DEF Corp. spends \$1.1 million on business equipment in 2011. It can immediately deduct \$500,000, the amount of the cap. The company can depreciate the other \$600,000 of equipment purchases under standard IRS rules.

Example 3: GHI Corp. spends \$2.2 million on business equipment in 2011. The company's expenditures are \$200,000 over the \$2 million phaseout threshold so its expensing election is reduced by \$200,000, from \$500,000 to \$300,000. The company can depreciate the other \$1.9 million of equipment purchases under standard IRS rules. With the new law in place, if a company spends \$2.5 million or more on equipment this year, no expensing will be permitted.

Startup deductions

The new law also increases startup deductions allowed under Section 195 of the tax code. For 2010 and 2011, the ceiling on the deduction is raised from \$5,000 to \$10,000, and the phaseout threshold rises from \$50,000 to \$60,000. With this arrangement, new companies can deduct the lesser of the amount of the startup expenses or \$10,000, reduced by the amount by which the startup expenditures exceed \$60,000.

Example 4: MNO Corp. has startup expenses of \$63,000 in 2011. The company is \$3,000 over the \$60,000 threshold so it can deduct \$7,000 of its outlays: \$10,000 minus the excess \$3,000. You incur startup costs when you're investigating or creating a new business but have not actually begun operations. (Money spent to buy capital equipment doesn't qualify.) Those costs might include market surveys, advertisements, travel to line up suppliers, consulting fees, and wages paid prior to opening the doors of a new business. Such outlays may be deductible in the year that you begin operations, under Section 195. Costs you can't deduct right away can be amortized over 180 months, beginning in the month operations begin.



Built-in gains

Standard C corporations face many tax hurdles. They could owe corporate income taxes on profits, for example. The IRS might determine that a business owner's compensation is unreasonable and deny a deduction for the compensation to a C corporation.

To avoid such tax traps, small companies may elect to be S corporations rather than C corporations. To qualify for this election, S corporations must meet certain criteria: they can have no more than 100 shareholders and only one class of stock, for example. After making an S corporation election, business owners report company profits on their personal tax returns and the company owes no corporate tax.

Some C corporations elect S corporation status while holding appreciated assets. In the past, a 10-year rule had been in effect - if holdover assets with built-in gain were sold within 10 years of a switch to S corporation status, the company would owe tax on the built-in gain at the highest corporate tax rate, which is now 35%. The American Recovery and Reinvestment Act of 2009 shortened that 10-year holding period to seven years for 2009 and 2010.

The new Small Business Jobs Act further reduces the holding period to five years for dispositions of assets with built-in gain in 2011. With this new provision, companies that have made the C-to-S switch won't owe corporate income tax in 2011 on the built-in gain of appreciated assets sold after five years from the conversion.

Cell phones

The tax code considers certain types of assets to be listed property. The list includes items such as cars, motorcycles, cameras, and computers—in essence, assets that a business might provide to employees but that also can provide a nonbusiness personal benefit. Employees with listed property must keep records to show business use versus personal use. When cell phones were introduced, they were relatively expensive; employer-provided cell phones were often a perk to selected employees. Therefore, cell phones were classed as listed property. Now, of course, cell phones are priced for a mass market and may be a workplace necessity. The new law removes cell phones and similar devices from the category of listed property, effective in 2010. If an employer-provided cell phone is used primarily for business, employees won't have to report any taxable income for personal use.



Fed funding

Under the new law, the Small Business Administration (SBA) will create an online lending platform that lists all lenders offering SBA-guaranteed loans. This platform will display the interest rates each lender charges for SBA loans so that small business borrowers can compare rates. Among other features of the Small Business Jobs Act are increased funding and lower fees for some SBA loans. The SBA also will conduct a three-year pilot program that offers grants to states with plans to increase small business exports. Beyond the SBA, federal contracting requirements are being amended to encourage bids from small companies, and federal agencies have been told to solicit bids from small businesses. ■ □

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Businesses Get the Green Light for Going Green



Companies have many reasons for going green these days. Business owners might hope to save energy costs or develop products that appeal to environmentally conscious consumers. Employers may want to motivate employees or follow their own ideals regarding what's best for the planet. Companies that go green can improve their reputation, expand their marketing potential, and appeal to concerned customers. Many consumers are eager to buy products and services from environmentally friendly companies. The Natural Marketing Institute has reported that over 63 million American consumers are classified as members of the "lifestyles of health and sustainability" (LOHAS). With LOHAS attitudes, customers may be willing to pay a premium for green products and services. Such consumers often prefer to do their buying from smaller companies, which may be perceived as more likely to be green than global giants.

Going green may involve some initial costs. Fortunately, help is available. The federal government offers tax and financing incentives to companies that want to go green, and many states have their own programs.

Greener pastures

What does it mean to "go green?" That expression can cover a lot of territory, but a few common principles apply to most businesses.



Any process, product, or service that saves natural resources or reuses these resources is considered green. For example, green companies often emphasize a reduction in paper usage minimize the amount of trees that must be cut down. A company that emphasizes electronic communications instead of paperwork is likely to be perceived as environmentally friendly. Similarly, companies that actively pursue recycling strategies for their waste products may receive plaudits for those efforts.

Continued on Page 4

Green companies might use solar panels for some of their power, instead of fossil fuels. Companies that generate solar energy not only can use that energy themselves, they may be able to sell unused solar energy to the local power grid for an additional source of revenue.

A sophisticated solar power system can be used to offset expensive peak rates and help control overall energy costs. In case of a spike in oil prices—or even a shortage of imported oil—solar power will continue to be available with no increase in cost.

Flying high

Some high-profile companies are going green. The National Football League's Philadelphia Eagles reportedly will install about 2,500 solar panels, 80 20-foot-high wind turbines, and a generator that runs on a combination of natural gas and biodiesel. The team intends to make Lincoln Financial Field, where it plays its games, the first stadium capable of generating all of its own electricity.



The Eagles have hired Solar Blue, an alternative energy company, for the installation. Not only will the Eagles have a predictable source of renewable energy, immune to spikes in prices, the team expects to immediately reduce its energy costs by almost 25%. Solar Blue can sell any excess energy it creates to the local utility companies, and the Eagles have generated new revenues by selling sponsorships to other companies eager to be linked with these green business practices.

Powerful tax credits

Controlling energy costs may provide other financial benefits. Federal tax incentives exist for improvements that businesses make to rented or owned commercial buildings. If your company makes a 50% cut in energy costs by installing heating, cooling, ventilation, or internal lighting equipment, it can get a tax deduction of \$1.80 a square foot. For smaller reductions in energy usage, your company might qualify for deductions of 60 cents per square foot.

Your company also can receive tax credits of 10% or 30% by installing certain alternative energy sources for its own use. If your company does not owe enough tax to use the credits, it may qualify to take those credits as grants—that is, it can apply to the IRS for cash to help with the purchase price instead of receiving the tax credit. You cannot, however, apply for both.

To get a 30% tax credit, a business can install fuel cells that generate electricity, solar equipment that generates electricity, solar equipment to illuminate a building using fiber optic distributed sunlight, or small wind turbines. (After 2016, solar equipment will generate only a 10% tax credit.) For the 10% tax credit, your company can install equipment for producing or distributing geothermal energy; very small combustion turbines; combined heat and power systems; or for periods ending before January 1, 2017, equipment that uses the ground or ground water for heating or cooling (geothermal heat pumps). Some of the equipment that can generate a 10% tax credit must be installed by 2016.



Alternative approaches

Alternative energy systems may receive other tax benefits. Purchasers of solar power systems, for example, may use five year accelerated depreciation for the project.

Moreover, states such as California, Connecticut, and New Jersey require utilities to produce some of their energy from renewable sources, such as wind and solar systems. The utilities, in turn, can purchase the renewable energy they are required to provide from private companies. For example, New Jersey issues solar renewable energy certificates (SRECs) to solar system owners. Each time a system generates 1,000 kWh of electricity, an SREC is earned and placed in the customer's electronic account. The SRECs can then be sold on the SREC tracking system, providing the system owner with revenues for up to 15 years.

Further encouragement



Government encouragement to green businesses also can take the form of money. The Energy Policy Act of 2005, for example, provides financial incentives such as loan guarantees and subsidies for developing alternative fuels. The Department of Agriculture backs a Small Business Innovation Research Program that awards from \$80,000 to \$250,000 to companies practicing environmentally friendly methods. The Environmental Protection Agency gives grants to small companies working to protect the environment. Additionally, some states dole out funds to small companies that are active in areas such as pollution prevention and recycling. As of this writing, the federal tax outlook for 2011 was undetermined. ■ □

Use Appreciated Assets for Charitable Donations

Writing a check is the easiest way to make charitable contributions. However, donating appreciated assets can be more tax-efficient. That's true if the donated assets have been held longer than one year and, thus, would qualify for long-term capital gains tax treatment on a sale.

Example: Mark Parker wants to donate \$5,000 to a local animal shelter. If he writes a check for \$5,000, he'll get a \$5,000 tax deduction. Mark's cost for this deduction is \$5,000, after-tax.



Instead, Mark goes through his portfolio and finds a stock he bought in 2009 for \$3,000 and, thus, would qualify for long-term capital gains treatment. That stock now sells for \$5,000. Mark decides to donate the stock to the animal shelter. With this approach, Mark gives a donation of \$5,000, the fair market value of the donated assets. However, those shares are really not worth \$5,000 to Mark.

To cash them in, he would owe tax on a \$2,000 long-term capital gain. At a 15% tax rate, Mark would owe \$300. Therefore, by donating the shares, Mark gets a \$5,000 tax deduction by relinquishing an asset that would be worth only \$4,700 to him, after-tax.

After the contribution, the animal shelter can sell the donated shares. As a charitable organization, the shelter owes no tax on the sale. Consequently, the charity gets the same \$5,000 contribution with this strategy, and Mark is better off than he would have been writing a check.

To implement this strategy, you can call the charity and get its brokerage account number. Then call your own broker or mutual fund company and explain what you want to do and provide the charity's account number.

If you wish to donate part of a position, specify the shares you wish to contribute. Follow up by sending an e-mail to your broker or fund company and eventually check with the charity to confirm the transaction.

Different rules apply to contributions of tangible personal property, patents and other intellectual property, and property contributed to certain private foundations. In most cases, the deduction for a property in one of these categories will be limited to the property's fair market value less the long-term capital gain that would have been recognized if the property had been sold for fair market value at the time of contribution.

Spreading the wealth

The procedure described in the previous paragraph can work well if you are making one or two relatively large charitable contributions. However, if you plan to make \$500 contributions to each of 20 charities, the process may get cumbersome. Instead, consider donating through a donor-advised fund (DAF). Many financial firms and local community foundations offer a DAF. You make donations directly to the fund; the minimum initial contribution might be a lump sum donation of \$10,000. You'd get a charitable deduction for the year the assets go into the DAF. If you donate appreciated assets held longer than one year, your deduction usually will be the assets' fair market value.

The DAF typically will create an account in your name after it has received your initial contribution. Then the DAF will sell the donated assets, owe no tax, and put the cash into your account. Subsequently, you can request the DAF to make grants to specified charities from your account. For multiple donations of appreciated securities, using a DAF will simplify the process. ■

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Referrals . . .

Thank you for your referrals. Because of your referrals, Rowles & Company, LLP continues to grow.

As we grow, we are always accepting applications from accountants as well as professional support staff. If you are interested in working for a growing, professional firm, please send your resume to Steve Halpern or Judy Schaule.

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Be Sure About Beneficiaries

The new tax law greatly reduces exposure to federal estate tax for most individuals and families. However, the new law does not remove the need for all estate planning. You'll need a thoughtful estate plan to ensure that your assets go to the desired recipients with a minimum of time, expense, and contention.

Your estate plan should begin with a will that was drafted by an experienced attorney. Whenever there is a major change in the law—such as for this year—you should review your will to make sure it still expresses your wishes. The same is true after major life events: births, deaths, marriage, and divorce.



Beyond your will

You also should be aware that some assets generally do not pass under your will. Instead, they will go to a beneficiary you name. That's true

for employer-sponsored retirement plans, individual retirement accounts (IRAs), life insurance policies, and annuities. Some investment accounts and savings accounts also belong to this group if they are transfer-on-death or payable-on-death accounts.

To see how this might work, suppose that Dan Smith creates an IRA when he begins his working career. He names his sister, Beth, as the beneficiary. Many years later, Dan has a substantial amount in his IRA, as well as other assets. When Dan creates a will as part of his estate plan, he states that all of his assets should go to his nephew who is supporting a family on a modest income. Dan does not include his sister in his will because Beth has substantial assets of her own.

However, Dan has neglected to change his IRA beneficiary, in this scenario. At his death, his IRA will pass to Beth, who is still the designated beneficiary. For Dan's IRA assets, his will is disregarded.

Supreme Court's view

If you think the Dan Smith example is unlikely, consider this real-life story. An employee at a major U.S. corporation was divorced. In the divorce agreement, the employee's wife relinquished all claims to his company benefits. The employee, however, did not change the beneficiary designation on his account in the company's savings and investment plan.

The employee died several years later, with about \$400,000 in this plan. The company paid all the money to the ex-wife, who was still the designated beneficiary. The deceased employee's estate sued the company, and, in 2009, the U.S. Supreme Court unanimously ruled for the company (*Kennedy v. Plan Administrator for DuPont*). The employee's failure to revisit his beneficiary selections thwarted his estate plan.

Check and keep checking

As previously mentioned, you should create a will and revisit it periodically. The same is true for your beneficiary selections. Check them at regular intervals to make sure that the people you have named are still the ones you'd like to inherit those assets. ■□

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State Taxes Can Crimp Your Cash Flow



If your company does business solely in one state, it probably owes tax to that state as well as to the federal government. Many companies, however, operate across state lines, and therefore may owe tax to more than one state. In the current economic slowdown, some states are endeavoring to address tax shortfalls by aggressively seeking more tax from companies based in other states.

Types of tax

State taxes come in several categories. The most common include:

- ❖ ❖ **income taxes.** If your company has receipts from operations within a state, that state may tax a portion of the profits.
- ❖ ❖ **sales taxes.** These taxes generally are imposed on the retail sale of goods (that is, when goods are sold to an end user). The buyer usually pays this tax, but the seller is ultimately responsible for collecting the tax and remitting the money to the state.
- ❖ ❖ **use taxes.** Buyers who avoid sales tax on a purchase will generally owe a use tax on it. A *use tax* is a tax on the storage, use, or consumption of tangible personal property within a state. In some states, use taxes also apply to purchases of certain services. Use taxes are complementary to sales taxes; if a taxpayer pays sales tax on an item or service, it will be exempt from use tax.

For example, suppose a company based in Maine purchases goods from a supplier located in Massachusetts and uses the goods in Maine. If the company in Maine does not pay a sales tax, it will owe a use tax. Use tax rates are the same as sales tax rates.

❖ ❖ **other taxes.** States sometimes also employ a variety of other taxes in addition to or in place of the taxes discussed previously. These include franchise taxes, which are taxes imposed for the privilege of doing business in that state, and taxes on a taxpayer's gross receipts.

Complex connections

Even if your company has some out-of-state activity, it may not owe any or all of these taxes to every state in which it operates. Generally, your company's tax obligation will depend on whether its activities in a given state are sufficient to create *nexus*. This term describes a connection to a state that reaches a level justifying taxation. If a company has nexus with a state with regards to a particular type of tax, it will be subject to that tax in that state.

While the principle of nexus is easy to understand, determining when a business has nexus with a state for a specific type of tax can sometimes be anything but easy. Within broad parameters prescribed by the U.S. Constitution and certain federal laws, each state can set its own nexus standards, and these standards can vary widely from state to state. Also, within the same state, the standards for nexus for one type of tax can be significantly different than for another type of tax. In addition, because the ways that companies do business are constantly changing (for example, selling through the Internet and employing telecommuters), and the states are constantly seeking to expand the boundaries of nexus in order to increase their potential tax base, the rules in this area are seldom stable. Activities or situations that in the recent past may not have been a source of nexus with a particular state may now or in the future result in a company's being taxed by the state.

The bottom line is that states differ in what they consider nexus, and the rules in the area are continuously evolving. Due to the very serious repercussions that having nexus with a state can cause, many cases challenging a state's assertion of nexus have come before different states' courts, with varying outcomes. Before you expand your operations beyond your home state, check the nexus laws of the new states in which you are planning to do business and decide whether the business opportunities justify the potential tax cost. ■

Most Households Paid No Income Tax in 2009

According to information pasted to the website of Senator Orrin Hatch (see <http://hatch.senate.gov/public/index.cfm/economyandtaxes>), an analysis by the Joint Committee on Taxation (JCT) found that 51% of U.S. households did not pay any federal income tax in 2009 because they had zero income tax liability or received a refundable credit. For example, of the 81.1 million single returns for 2009, JCT projected that 26.8 million had zero income tax liability, 16.6 million received a refundable credit, and 37.8 million had a positive income tax liability. For the 58.9 million married filing joint returns, 7.3 million had zero income tax liability, 16.2 million received a refundable credit, and 35.5 million had a positive income tax liability for 2009.

source: PPC's 5 Minute Tax Briefing 5/18/2011

A Little About Us...

Rowles & Company, LLP is pleased to introduce Christopher Azzaretto.



Chris joined Rowles & Company, LLP in August 2010. He participates in audits of banks, credit unions, and employee benefit plans. He also prepares tax returns for individuals and corporations.

In May 2010, Chris graduated from Loyola University Maryland with a Bachelor of Business Administration in Accounting. In college he was a member of the Financial Management Association, and played for the Loyola Ice Hockey team for 4 years. Chris studied in Beijing, China during the fall semester of 2008 learning the Chinese language and travelling the country. He plans to take the CPA exam during the summer of 2011.

In his spare time, Chris enjoys skiing, ice hockey, golf, martial arts, and weight lifting. His other interests are cars, travelling, swimming, watching movies, and spending time with friends.

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The 64th Annual Financial Institution Crab Feast and 14th Annual Hardshell Shootout sponsored by Rowles & Company and M&T Bank is scheduled for Thursday, July 14, 2011.

Independent Community Bank Conference

Our 31st Annual Independent Community Bank Conference was held on Wednesday, April 20, 2011 at the Hilton Baltimore BWI Airport Hotel. Once again, it was extremely well attended with 190 participants. There were 45 community banks represented.

We thank everyone for joining us, and we also thank all our guest speakers.

Rowles Relays!!!

Friday, June 17th



Relay is the single largest fundraiser for the American Cancer Society, last year bringing in approximately \$380,000,000! Over 3 million Americans participate in Relay annually. You join a team (the Rowles Relayers) and ask people to support you by donating to the American Cancer Society (tax deductible!).

This year, the North Baltimore County Community Relay will be held at Goucher College, on their lovely track.

On Friday, June 17, 2011 at 7:00 p.m., we will gather at Goucher for opening ceremonies, then we are committed to having at least one person from the team walk on the track for the rest of the night.

Please go to www.RelayForLife.org to learn more.