

# DEADLINE TAX PLANNING

April 15th. The date that strikes fear into the hearts of landscape contractors everywhere. As it fast approaches, you might want to run down this list of hints that can help reduce the amount of money Uncle Sam picks from your pocket.

by Mark E. Battersby

**U.S. Corporation Income Tax Return**

1986 or tax year beginning \_\_\_\_\_, 1986, ending \_\_\_\_\_

► For Paperwork Reduction Act Notice, see page 1 of the Instructions

Number and street \_\_\_\_\_

City or town, state, and ZIP code \_\_\_\_\_

**1040** U.S. Individual Income Tax Return

Department of the Treasury Internal Revenue Service

For the year January 1-December 31, 1987, or other year beginning \_\_\_\_\_

Use IRS label. Your first name and initial (if joint return, use both names) \_\_\_\_\_

choices: straight-line depreciation or accelerated depreciation. But look at the basic depreciation rules.

As every landscaper knows, business and income-producing property (other than land) generally lose their usefulness or value over a period of time. Our tax rules permit an annual deduction or "cost recovery" of a portion of the cost. Under our present tax rules, cost recovery is normally accomplished by using statutory accelerated methods. Long gone are the concepts of "estimated useful life" and "salvage value." This almost eliminates arguments with the Internal Revenue Service about depreciation, formerly a consistent source of litigation.

Depreciation or cost recovery currently looks like this:

- Personal property: accelerated 200 percent declining balance depreciation will be allowed for three-, five-, seven- and 10-year class property. Business autos and light trucks are now classified as five-year property.

- Luxury autos: ACRS (accelerated cost recovery system) deduction is limited to \$2,560 for the year in which the auto was placed in service, \$4,100 for the second year; \$2,450 for the third year; and \$1,475 for all later years.

- Real property: Straight-line depreciation over 31½ years for all commercial property. Now is the time to not only place newly-acquired property into the proper asset class, but to decide whether the ACRS method would be more beneficial in the long run than the only existing alternative, straight-line depreciation.

Another tactic that requires thought is the first-year expensing option. Up to \$10,000 of so-called "personal property" (signs, desks, mowers, tractors, typewriters, computers, etc.) can be expensed or imme-

This is a confusing time of the year. The tax year for the landscaping operation has ended, cutting off all hope of making any more tax-saving moves. Plus, the impact of the Tax Reform Act of 1986 is just finding its way onto the annual tax return.

Fortunately, there are still quite a

few good moves that can be made to substantially reduce that tax bill.

## 'Depreciation'

One good example of pre-filing planning is provided by equipment or fixtures bought before the year's end. On the surface, it might appear that the landscape contractor has only two

diately written off. Those write-offs, however, are subject to a phase-out on a dollar-for-dollar basis where the landscaper's total investment in qualified property exceeds \$200,000 for the year.

Although asset expenditure or acquisition may have already been made, it still must be decided whether the expense is currently deductible or can only be deducted ratably over the depreciation period. Unlike the costs of running a landscaping business which are currently deductible, expenditures for items of a more permanent nature (i.e., lasting more than a year) generally must be capitalized.

#### **Profit or loss?**

Whether the landscaping operation actually made a profit or lost money is something else that can't be determined with any degree of accuracy until after the close of the tax year. At either end of the spectrum, tax decisions must be made before filing the annual income tax return.

First, those losses: a so-called "net operating loss" (NOL) arises when the expenses of a business exceed the income earned. An NOL is first carried back three years and, if not absorbed,

carried forward for up to 15 years. Or the landscape contractor can choose to give up the carryback altogether.

Giving up the carryback might be appropriate when a landscaper, whose prior three years' income was taxed at low rates, expects to be in higher brackets in the future. Or when a landscape contractor used the preferential long-term capital gain

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rates in prior years.

In other words, if a loss resulted and sufficient income has been reported during the previous three years, then compare the tax benefits of a future-year deduction with an immediate cash refund. If last year was bad—but not bad enough to produce a loss—were estimated taxes overpaid?

The incorporated landscape contractor can apply for a "quickie" re-

fund of those overpaid taxes. This must be done after the year has ended and before the income tax return is filed and, in any event, no later than 2½ months after the end of the tax year.

It may be difficult to conceive, but under our tax law, there is such a thing as too much profit. Unless there is a proper business reason for a landscaping corporation to accumulate earnings in excess of \$250,000 (\$150,000 for certain personal service corporations), a penalty may be assessed of 27.5 percent on the first \$100,000 of current year excess and 38.5 percent on the balance. For 1988, and thereafter, a flat rate of 28 percent is applied.

Profitable landscape contractors should carefully document the business reasons for accumulating earnings. These should be specific both as to the proposed use and the amounts needed. Plus, there is also the "2½-month" rule which can be used as another avenue of escape from this penalty. What could be easier than paying dividends within 2½ months after the year ends?

The "2½-month" rule allows shareholder income shifting, which

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might also be valuable for other reasons. If the dividends are large enough, the penalty tax problem would disappear for the current tax year.

### Splitting income

An often-overlooked method of splitting income among family members involves giving stock in an S corporation to the minor children of parents who are also stockholders. This usually involves transferring the stock to one of the parents as custodian under a gifts-to-minors act—a transfer that should have occurred prior to the end of the tax year.

Any income over \$500 attributed to a minor from this transfer will be taxed at the highest marginal rate of the parents if:

- income is split among family members as a result of such a gift made in earlier years;
- the minor is under 14; and
- the parents are in a higher tax bracket than the minor.

### Organizing records

Now is also an excellent time to put all of the contracting operation's records in order. They will not only be needed

to properly prepare the income tax return but also to comply with the new tax law.

Nowhere is this more evident than under the rules governing meals and entertainment. All landscape contractors need to review their accounting system to assure that meal and entertainment expenses not be subject to the new 80 percent rule are separately identified. Plus, a review of the accounting records should be made to determine if they meet the new rules and substantiation requirements.

The Tax Reform Act of 1986 limited the deduction for meals (including meals incurred while away from home) and entertainment expenses to 80 percent of the amount that is otherwise tax deductible. Fortunately, this 80 percent limitation does not apply to the following items:

- items taxed as compensation or excluded under the *de minimis* fringe benefit rules;
- reimbursed expenses (the contractor making the reimbursement is the one subject to the 80 percent rule);
- traditional employer-paid recreational expenses for employees and their spouses (e.g., holiday parties and

summer outings); and

- meals provided in 1987 or 1988 as an integral part of a banquet meeting where more than 50 percent of the participants are away from home, at least 40 people attend and the banquet includes a speaker.

Once the records are assembled, it is a simple matter to pick out expenses that may get lost in the tax filing shuffle. Medical expenses, for instance, may be relegated to the personal income tax return as they have been in the past—but perhaps they no longer should. Normally, medical expenses are only deductible as an itemized expense on landscapers' personal income tax returns. Self-employed contractors, however, may now claim a business expense deduction for 25 percent of their health insurance premiums for themselves, their spouse and their dependents.

It should be obvious by now that many things can still be done before the deadline for filing that income tax return that will substantially reduce the annual income tax bill.

Even with the assistance of a professional tax return preparer, the bottom line rests in the hands of the landscape contractor. **LM**

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