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SPECIAL EDITION

**Exclusively for
PIA Western Alliance members**

*Berntson Porter & Company's mission is to assist its clients in identifying, clarifying and achieving their goals.
We accomplish this by caring about our clients' families and companies as if they were our own.*

Tax Saving Tips

REASONS TO CONVERT FROM A C CORPORATION TO AN S CORPORATION

Converting from a C Corporation to an S Corporation will benefit most agencies. For those agencies that are currently operating as C Corporations, now is the perfect time to consider the tax savings and benefits of converting to an S Corporation.

Owners must elect to be an S Corporation no later than 2 months and 15 days after the start of their tax year. For calendar year taxpayers, this means that S Corporation elections must be made by March 15, 2005 to take effect in the 2005 tax year.

All agency owners must plan for the eventual sale or transition of their business. One of the major advantages of S Corporations compared to C Corporations is the avoidance of double taxation associated with C Corporations. Annual earnings are taxed to the C Corporation and again to the shareholder upon dividend distribution, sale of stock, or liquidation. Appreciated assets can also trigger a double tax at the time of sale and liquidation of a C Corporation or upon distribution to shareholders. A very common example of appreciated assets in an agency is the goodwill value

associated with your book of business. Oftentimes, over 40% of an agency's goodwill value evaporates upon sale because of taxes due at both the C Corporation and shareholder levels.

Other advantages for S Corporations include the pass-through of losses, deductions and credits to the shareholders on their individual tax returns; minimizing the risk of an unreasonable compensation attack for excessively high salaries; and the potential to minimize payroll tax costs by holding corporate salaries below FICA maximums while increasing S Corporation distributions.

As with all tax decisions, there are potential disadvantages of converting from a C Corporation to an S Corporation. The major issue to manage is the corporate-level built-in gains tax imposed following conversion from C to S status. However, if properly planned, this disadvantage can be minimized or even eliminated.

Your tax advisor can coach you through this process and determine whether converting to an S Corporation is right for you.

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YEAR-END TAX PLANNING FOR AGENCIES AND THEIR OWNERS



Time Your Income

Insurance agency taxpayers can save taxes by timing income so that it is received in the year it will be taxed at the lowest rate. Your agency's accounting method determines when you must recognize income and deduct expenses. Cash-method taxpayers report income when actually or constructively received and deduct expenses when payments are actually disbursed. Accrual-method taxpayers report income and expenses in the year that their right to the income becomes final and all events have occurred creating a liability to pay the deductible expenses.

From a strategy standpoint, the timing of your invoicing process may allow for deferral of income, both in the case of direct billing and agency billing. Under the accrual method, the income is recognized in the period invoiced, while under the cash method, income is recognized when premiums are received.

Turn Losses into Tax Gains

Proper planning to recognize/deduct certain types of losses can provide tax benefits to your business or to you individually, depending on the form of your entity. Losses recognized by C Corporations benefit the corporation because they are deducted at the corporation level, while losses recognized by sole proprietors, S Corporations and LLCs are generally deducted on the personal returns of their owners.

Potential losses to be on the lookout for include:

1. Business bad debts.
2. Capital losses on investment assets.
3. Losses on sale of business assets.
4. Casualty and theft losses.
5. Net operating losses (overall loss from annual business operations).

If your business generates an NOL (net operating loss), you generally may carry back the loss two years. You can secure a refund of income taxes paid for 2002 and 2003 for losses generated in 2004. Unused losses may be carried forward for 20 years to offset future income. If you are a sole proprietor or S Corporation, be careful of the at-risk limitations, which can limit the amount of loss you may

utilize. Simply put, the at-risk rules limit the amount of loss you can deduct to the amount of money you, the agency owner, have at risk in the business.

As the end of this year approaches, watch for these planning items:

1. If you expect a loss in 2004 that can be carried back and used to offset taxable income in a prior year, you might consider opportunities to increase the loss by accelerating deductions into 2004.
2. S Corporation shareholders should make sure they have sufficient basis and amounts at-risk in order to claim any losses passed through from the corporation. Making a direct loan to the S Corporation or adding additional paid-in-capital before the end of the tax year can serve to increase basis.
3. If you expect to convert from a C Corporation to an S Corporation at year end, consider paying a bonus to generate an NOL that can be carried back to prior years to generate a refund of previously paid taxes and likely minimize the negative impact of retained C Corporation earnings.

Coordinate Depreciation Tax Breaks

This year it is more important than ever to review your business asset situation before year end. The 2003 tax law's bonus depreciation provisions expire at the end of the year, and these provisions can greatly increase your first-year deduction for qualifying asset purchases. When you purchase assets and how you depreciate them can make a difference in your tax bill.

First-Year "Bonus" Depreciation: Your business may claim a special first-year depreciation "bonus" equal to 50% of the cost (or other adjusted basis) of qualified business property purchased and placed in service in 2004. This is in addition to any regular depreciation deduction for first-year depreciation.

Section 179 Expensing: A business can elect to "expense" the cost of qualifying property purchased and placed in service before the end of the year. This expensing deduction can be as high as \$102,000 for 2004. This election is subject to taxable income limits and the amount available for the

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expensing election is reduced dollar for dollar for annual asset purchases exceeding \$410,000.

Planning tip: Review your capital budget to determine when assets should be purchased. If you plan to make the expensing election but find your total asset purchases exceed \$102,000, you may want to postpone buying any additional items until 2005. Conversely, if you are considering purchasing assets in 2005 and have not met the \$102,000 threshold, you may consider buying those assets in December 2004 to take advantage of the \$102,000 expensing election and 50% bonus depreciation.

Maximize Other Deductions

Check to see whether you can benefit from any of these planning strategies to accelerate deductions:

1. Review equipment or vehicle repair requirements and supply needs and purchase them before year end if these expenses would be incurred in early 2005.
2. Consider making a profit-sharing plan contribution. Accruing a profit-sharing plan contribution, even though not paid until the due date of your business tax return (a possible 8 ½ months after year end if your corporation receives an approved extension), is a great way to get a deduction even though funds are not available at year end to pay for the deduction.

Accrual-method taxpayers also have a little more freedom to accelerate deductions by using the following planning strategies:

1. Consider employee bonuses. To deduct them in 2004, make sure you declare them before year end and pay them within the first 2 ½ months of 2005.
2. Accrue vacation pay that is vested and paid within the first 2 ½ months of 2005.

As a note, if you anticipate a substantial increase in business income in 2005, you may want to postpone expenses until 2005. Postponing expenses until 2005 may be more tax effective than accelerating expenses into 2004. Consider your expected tax rate for 2004 and 2005 to determine which strategy works best.

Tax-Smart Distribution Decisions

If your agency is organized as a C Corporation, remember to keep taxes in mind when making decisions about corporate distributions of earnings:

Dividends are taxable to you and other shareholders when you receive them but are not deductible by the corporation. The cost of receiving dividends has decreased because the maximum tax rate on dividend income is 15%. Therefore, consider distributing prior years' retained earnings as dividends if excess cash is available and reasonable compensation has already been paid to shareholder-employees.

Contribute to Retirement Plans

A secure retirement is a high-priority financial goal for most people.

How much can you contribute to a retirement plan for 2004 and 2005?

Type of Plan	2004		2005	
	Under Age 50	Age 50 or Older	Under Age 50	Age 50 or Older
Traditional IRA	\$3,000	\$3,500	\$4,000	\$4,500
Roth IRA	\$3,000	\$3,500	\$4,000	\$4,500
401(k), SEP	\$13,000	\$16,000	\$14,000	\$18,000
SIMPLE IRA	\$9,000	\$10,500	\$10,000	\$12,000

As always, all contributions are subject to limitations and maximizing your annual contribution is a great way to reduce current taxes. Company-sponsored profit-sharing plans can reduce the company's current taxes and allow the company to supplement contributions on your behalf, with an overall \$41,000 individual contribution limit for 2004. Defined-benefit plans combined with the right mix of employee plans can provide significantly higher deductions.

HOW LONG SHOULD YOUR BUSINESS STORE RECORDS?

Basic record retention recommendations:

Keep for three years

Bank statements/reconciliations
Duplicate deposit slips
General correspondence

Keep for four years

Invoices to customers
Petty cash vouchers
Employee expense reports

Keep for seven years

Accounts payable ledgers
Accounts receivable ledgers
Canceled checks (routine)
Canceled stock and bond certificates
Insurance policies (expired)
Notes receivable records
Payroll records and summaries
Terminated employee personnel records

Keep permanently

Capital stock & bond records
Chart of accounts
Canceled checks (important)
Legal correspondence
Deeds, mortgages, bills of sale
Financial statements
Property appraisals
Property records
Tax returns and documents
Minute books of directors and
stockholders (including by-laws)
Trademark registrations
General and private ledgers



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