Accounting at a Glance

Tax Planning in Uncertain Economic Times

By Jim Van Houten

As we head into the final days of the year and prepare to close the book on 2011, it's still possible to potentially lower your taxes and head into 2012 with a few extra bucks in your bank account. As of the writing of this article, 2012 federal tax rates are scheduled to remain at 2011 levels; therefore, much of the tax planning that can be done at year-end is predicated simply on timing. For example, a cash basis taxpayer can accelerate the payment of expenses or defer the receipt of income to lower taxes for 2011, but this benefit generally comes at the cost of less deductions or more taxable income in 2012. Since rates are scheduled to stay the same and tax savings could be achieved sooner, this scenario may make sense. On top of that, taxpayers can still take advantage of beneficial tax provisions that expire at the end of 2011.

Tax planning for individuals in 2012 may be trickier because of the expiration of the Bush-era tax cuts at the end of 2012 that's again looming on the horizon. Couple that with a new 3.8 percent surtax on net investment income that comes into play in 2013 for individuals with adjusted gross income (AGI) above $200,000 and married couples filing jointly with AGI over $250,000 and you've got a perfect storm of tax changes, highlighted in the below chart. (Note: For wages or self-employment earnings in excess of these similar threshold amounts, an additional 0.9 percent payroll tax is also applicable). In fact, it may even make more sense to accelerate income and defer expenses in 2012 as the savings from the lower tax rates could likely outweigh the benefit of deferring taxable income to 2013.

Top Tax Rates for Individuals

	2011–2012	2013*	Rate Increase
Ordinary income	35%	43.4%	24%
Long-term capital gains	15%	23.8%	59%
Qualified dividends	15%	43.4%	189%
Estate and gift	35%	55%	57%

* Includes 3.8 percent surtax on net investment income with AGI over $200,000 (single filers) or $250,000 (joint filers). Note that net investment income doesn't include certain defined income or gains attributable to qualified business holdings in flow-through entities, such as S corporations and partnerships.

Opportunities for Businesses in 2011 and 2012

Generous depreciation provisions enacted to promote capital investment are scheduled to be scaled back starting in 2012 and then further diminished in 2013. For 2011, bonus depreciation allows for 100 percent of the cost for qualified assets acquired and placed into service to be immediately deducted. For 2012, this immediate deduction declines to 50 percent of the cost of qualified assets. The deduction expires completely at the end of 2012. Thus, if significant asset purchases are planned, it's critical to consider the timing of the purchase in light of the upcoming changes.

Another reason to consider accelerating asset purchases is the Section 179 depreciation deduction. For qualifying assets acquired in 2011, this deduction is $500,000. It decreases dollar-for-dollar when total depreciable assets purchased exceed $2 million. This deduction is scheduled to decrease to $125,000 for 2012 and revert to $25,000 for 2013 and later.

Through 2012, qualified dividends will be taxed at 15 percent, similar to long-term capital gains. C corporations (and S corporations with undistributed C corporation earnings) might consider distributing dividends to shareholders prior to the end of 2012, particularly in light of the significantly higher tax rate on dividends scheduled to begin in 2013.

Through 2012, C corporations can take an enhanced deduction for contributions of certain wholesome food inventory, computer technology or equipment, or book inventory. The deduction is equal to the lesser of (a) basis plus half of the property's appreciation or (b) twice the property's basis. The enhanced deduction for wholesome food inventory is available to other types of entities but cannot exceed 10 percent of the taxpayer's net income for the year. In addition, through 2012, S corporations can deduct the fair market value of appreciated assets contributed to charity while reducing shareholders' basis in the S corporation by the assets' basis.

Several new credits have been introduced as economic stimulus in recent tax acts, and existing credits may be more relevant than ever as the unemployed are reentering the workforce. If your business is hiring, providing health coverage for employees, or simply doing business in certain federal or state designated areas, there may be credits available that could save your business thousands of dollars.

Opportunities for Individuals in 2011 and 2012

The current 15 percent federal long-term capital gains rate is scheduled to go up at the end of 2012. With the recent ups and downs in the stock market, it's quite possible that your portfolio has some investments that are underwater. Consider recognizing these losses before the end of 2011 to offset any current-year gains. Even without any gains to offset, it may make sense to recognize these losses as they can be accumulated and carried forward to offset future gains that would otherwise be taxed at the higher rates starting in 2013. Along those lines, if

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you're contemplating an installment sale, in which taxes are paid over time as payments are received, consider electing out of installment-sale treatment to take advantage of the current low 15 percent long-term capital gains tax rate.

Estate and Gift Taxes

Through 2012, there exists an unprecedented planning opportunity to preserve hard-earned wealth and pass on a financial legacy to future generations, thanks to highly favorable gift and estate tax changes introduced late last year. Business owners in particular, who may be postponing planning for estate taxes because a majority of their net worth lies within the value of the business, may be able to do more now than ever. A carefully crafted gifting strategy could be one way to reduce future estate tax burden, so it would be worthwhile to explore and pursue this opportunity before the gift tax rates expire.

For taxable gifts in excess of the annual exclusion ($13,000 per donee), the value of gifts excluded from gift tax is $5 million for 2011 and will rise to $5.12 million in 2012. However, this amount is scheduled to decrease back to $1 million on January 1, 2013. The combination of the $5 million gift tax exemption with historically low interest rates and potentially depressed business values creates a unique window of opportunity to proactively plan now and transfer greater wealth to your heirs using the power of leverage, discounts and certain types of trusts.

With all this in mind, tax law can change with the stroke of a pen. Thus, it's important to monitor tax planning over time to stay on top of any changes.

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