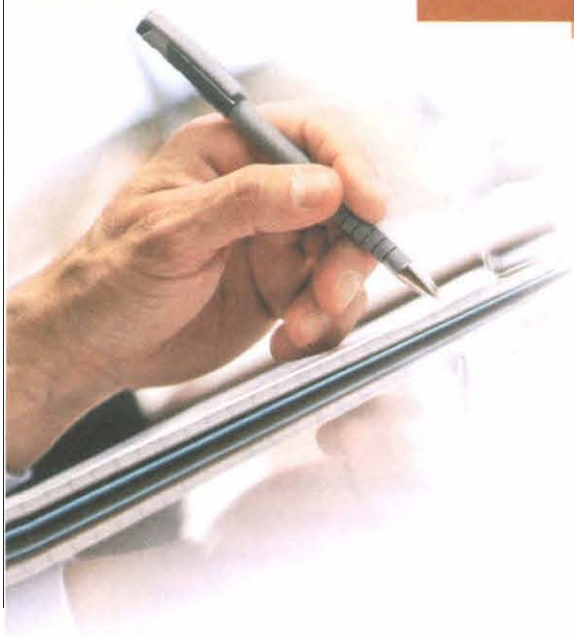

Opportunities for BUSINESS owners

Business tax planning is a year-round activity. But the last several months of the year may present specific opportunities to minimize taxes on your business income.

INCOME

Your business structure determines how your business income will be taxed. And, while taxes are only one consideration in choosing a business form, they can be an important one.

Compare business forms

As a preliminary to your year-end business tax planning, look at your current form of doing business. You may discover that another form would be more beneficial. With certain exceptions, a corporation that has an S election in place doesn't pay federal corporate income taxes. Instead, S corporation income, losses, deductions, and credits "pass through" to the owners to be reported on their tax returns. Thus, S corporation income generally is taxed only once — to the shareholders — unlike regular C corporation income, which is taxed twice — once to the corporation and again to the shareholders when it is paid out as dividends.

Like a corporation, a limited liability company (LLC) generally provides owners with protection from personal liability for business debts and obligations. But most LLC owners can choose to have their businesses treated as partnerships for income-tax purposes. Partnership treatment means:

- Income, losses, deductions, and credits pass through to the individual owners (called "members") to be reported on their individual returns.
- LLC income isn't subject to double taxation.
- An LLC can specially allocate income and expenses among its owners to the same extent a partnership can.

TAX ALERT

Remember, as the tax law currently stands, starting in 2013, the top individual tax rate (and, thus, the top rate for LLC and partnership income) is scheduled to rise to 39.6% — 4.6 percentage points higher than the 35% corporate tax rate for C corporations (see table). This could be a factor in reviewing your business form.

Plan earnings distributions for best tax results

Consider these tax factors when making decisions about distributing corporate earnings.

- Corporate earnings paid out to you as compensation are included in your taxable income, but are deductible by the corporation. Thus, the income is taxed only once — to you.
- Individual tax rates may be higher in 2013 and later. Take this factor into account when planning year-end 2012 bonuses.
- If you pay out earnings as compensation, be aware that the compensation must be "reasonable" for it to be deductible by the corporation.

The IRS can assess a corporate accumulated earnings tax penalty on companies that accumulate excessive amounts of earnings and profits. This penalty is 15% in 2012. It's scheduled to rise to 39.6% (the same as the top individual marginal tax rate) in 2013.

ACTION ALERT

If your corporation has built up significant earnings and profits, distributing excess cash as dividends in 2012 may be advantageous since shareholders are taxed on qualified dividends at no more than 15%. (Requirements apply.) Absent further legislation, dividends will be taxed at ordinary rates as high as 39.6% in 2013. A distribution may also help the corporation avoid the accumulated earnings tax penalty in 2012 and the higher penalty rate currently scheduled for 2013. But be sure a thorough analysis has been performed before making a decision.

DEDUCTIONS

An easy way to lower your business's taxable income is to increase deductions. So take care not to overlook any deductions your business may be entitled to claim.

CORPORATE TAX RATES

If your company is a C corporation other than a personal service corporation,* you can estimate your corporation's regular 2012 federal income taxes using this table.

If taxable income is over	But not over	Your tax is	Of the amount over
$0	$50,000	15%	$0
$50,000	$75,000	$7,500 + 25%	$50,000
$75,000	$100,000	$13,750 + 34%	$75,000
$100,000	$335,000	$22,250 + 39%	$100,000
$335,000	$10,000,000	$113,900 + 34%	$335,000
$10,000,000	$15,000,000	$3,400,000 + 35%	$10,000,000
$15,000,000	$18,333,333	$5,150,000 + 38%	$15,000,000
$18,333,333		A flat 35%	

* Personal service corporations pay a flat 35% tax.

Use losses to your advantage

No business owner welcomes a net operating loss (NOL). However, if you expect your company to show a loss this year, plan to use it to your best tax advantage. An NOL generally may be carried back two years. By carrying back an NOL, you may secure a refund of income taxes paid for those years. Unused NOLs may be carried forward to offset future taxable income for as long as 20 years. A special election to forgo the carryback period is also available.

ACTION ALERT

Identify any bad debts lingering in the aftermath of the economic downturn. If your company uses the accrual method of accounting, you generally may deduct business bad debts when they become totally or partially worthless. You'll need documentation to support the deduction, so be sure to keep good records of your failed collection attempts.

Take advantage of "bonus" depreciation while you can

In 2012, businesses can claim a first-year depreciation "bonus" equal to 50% of the adjusted basis (or cost) of qualified property acquired and placed in service after December 31, 2011, and before January 1, 2013. Many types of new machinery, equipment, and other fixed assets qualify. Note:

- The 50% bonus depreciation is subtracted from the property's cost basis *before* the regular first-year depreciation is computed.
- While real estate generally won't qualify for the depreciation bonus, certain improvements to the interior of a leased nonresidential building may qualify.

ACTION ALERT

Since bonus depreciation generally won't be available for 2013 purchases, consider purchasing new fixed assets (with a loan if necessary) that you'll need next year if you'll be able to claim 50% bonus depreciation (or the Section 179 deduction discussed below) for those assets in 2012.

Because bonus depreciation isn't limited to taxable income, the deduction can contribute to or create a net operating loss. This might be an advantage for a C corporation that can carry back the loss and secure a tax refund. Similarly, a net operating loss generated by a flow-through entity, such as an S corporation or partnership, can provide a tax benefit to the owners individually.

Elect Section 179 treatment for purchases

As an alternative to depreciating assets, your business may be able to elect under Section 179 of the tax code to currently deduct ("expense") the cost of qualifying new or used assets. For 2012, the Section 179 expensing limit is generally $139,000. The amount of the available expensing election is reduced dollar for dollar as annual asset purchases rise from $560,000 to $699,000. For 2013, expensing is limited to $25,000 of purchases, and the phaseout begins once 2013 asset acquisitions exceed $200,000.

You can't expense more than the amount of your taxable income from active trades or businesses. Real property doesn't qualify for the expensing election. And any part of an asset's cost that is expensed can't also be depreciated.

Some ways to best take advantage of expensing:

- If your company purchased both new and used fixed assets and your purchases will exceed the Section 179 expensing limit, use a combination of the 50% first-year depreciation bonus for some of the new assets, along with the Section 179 election for the used assets.
- Where a company is going to elect Section 179 expensing for only some of its asset acquisitions and depreciate others, it may make sense to use the Section 179 election for the assets with the longest lives.

Look at using regular depreciation

Your business may elect out of claiming 50% bonus depreciation for all qualifying assets placed in service during 2012 or for certain asset classes and instead claim regular depreciation under the Modified Accelerated Cost Recovery System (MACRS). Section 179 treatment is also elective.

Why might you want to elect out? This choice could be advantageous in some situations. For example, it might be to your benefit if you want to preserve depreciation deductions for future years when you expect your business income to be taxed at a significantly higher rate. (Be sure to do a present value analysis first.)

Claim the manufacturing/production deduction

Business taxpayers that are involved in domestic manufacturing, construction, engineering or architectural services related to construction projects, or other eligible production activities

DEPRECIATION ASSET CLASSES

Property class	Assets included
3-year	Tractor units for over-the-road use
5-year	Automobiles, trucks, computers, copiers and other office machinery
7-year	Office furniture and fixtures, farm machinery and equipment
10-year	Vessels, barges, tugs
15-year	Certain land improvements
20-year	Farm buildings (other than certain single-purpose structures)
25-year	Water utility property
Residential rental property (27.5-year)	Apartment buildings, single-family rental properties
Nonresidential real property (39-year)	Office buildings, stores, warehouses

These asset classes are used when computing depreciation under the Modified Accelerated Cost Recovery System (MACRS). The lists of property included in each class aren't all-inclusive.

shouldn't overlook the "domestic production activities deduction." For 2012, the maximum deduction is 9% of the lesser of: (1) qualified production activities income or (2) taxable income before taking the deduction into account. (Sole proprietors use their adjusted gross income, with certain modifications, instead of their taxable income.) However, the deduction may not exceed 50% of W-2 wages allocable to domestic production gross receipts. If your company is eligible, the deduction could reduce your taxes — and increase your after-tax profits — without any additional outlay of cash.

Deduct new-business start-up costs

If you're launching a new business this year, you may incur expenses before the business actually begins operating. Examples include the costs of conducting market surveys, traveling to find customers or suppliers, advertising, and training employees. You may elect to deduct up to $5,000 of these expenses in 2012 as long as the business is up and running by year-end. (The $5,000 limit is reduced dollar for dollar once

total start-up costs exceed $50,000.) The remainder of your start-up costs can be deducted ratably over a 180-month period.

Contribute to retirement plans

As a business owner, you can lower your business taxes — and help accumulate funds for your own retirement — by maximizing contributions to tax-favored retirement plans. Check out the table for the 2012 contribution and deduction limits for various retirement plans. Let us know if you need assistance choosing a suitable plan.

Accelerate/increase deductions

While you're thinking about your deductible expenses, you may also want to consider ways you might accelerate deductible expenses into 2012 to increase your business deductions and lower taxes. Here are a few ideas:

- You might have equipment or vehicle repairs done or purchase supplies before year-end if these expenses would be incurred in 2013 anyway.
- If you're an accrual-method taxpayer, you have a little more freedom to accelerate deductions. Look at deducting employee bonuses that you don't plan to pay until early next year (within the first 2½ months of 2013). But note that you generally can't use this strategy for employees who own a greater-than-50% interest in the business, and other restrictions may apply.

COMPARING RETIREMENT PLANS

	401(k)	Profit Sharing	Simplified Employee Pension (SEP)	SIMPLE IRA
Employee contributions allowed?	Yes: see page 4 for 2012 deferral limits	No	No (except for certain plans established before 1997)	Yes: see page 4 for 2012 deferral limits
Employer contribution required?	No — however, employer contributions are allowed	Yes — contributions can be discretionary	Yes — discretionary contributions	Yes — must match employee deferrals up to 3% of pay or contribute 2% of pay for all eligible employees
Maximum annual contribution	Smaller of $50,000 or 100% of participant's compensation	Same as 401(k)	Smaller of $50,000 or 25% of participant's compensation	Employee deferral plus required employer contribution
Maximum deduction	25% of all participants' compensation plus employee deferrals	25% of all participants' compensation	Same as profit sharing plan	Same as maximum contribution

Compensation is generally limited to $250,000 in 2012. Calculating the contribution limit for a self-employed individual's profit sharing contribution involves a special computation. SIMPLE IRAs are available only to small employers.

- You also may be able to deduct vacation pay that is vested at year-end and will be paid within 2½ months after year-end.
- To deduct charitable contributions your accrual-method corporation will make in the first 2½ months of 2013, make sure you note the charitable obligation in the corporate minutes before the end of 2012 (assuming the company uses a calendar year).
- Increasing business use of a car that you drive for both business and personal purposes can boost your total write-off for the vehicle. When actual expenses are deducted, your deduction depends on the ratio of business miles to total miles driven. If you use the standard mileage rate, increasing business mileage will give you a higher deduction.

TAX CREDITS

As they do for individual taxpayers, tax credits can offset your business income tax, dollar for dollar.

ACTION ALERT

2012 may be the last year to claim the employer-provided child care credit for buying, rehabilitating, or expanding property to be used as part of an employer's qualified child care facility and for amounts paid or incurred under a contract to provide child care resource and referral services to employees. Be sure to take advantage of this credit if you can, while you can.

SEE IF YOU QUALIFY FOR TAX CREDITS

General business credit	
Investment	10% (or more) of the costs of (1) qualified rehabilitation of a building first placed in service before 1936 and certified historic structures (regardless of when placed in service) or (2) installation of solar, geothermal, or combined heat and power system property
FICA tip	The amount of a food and beverage establishment employer's FICA tax obligation attributable to employee tips received in excess of tips treated as wages for purposes of satisfying minimum wage requirements (whether or not the tips are reported)
Employer-provided child care	25% of expenses to buy, build, rehabilitate, or expand property that will be used as part of an employer's child care facility plus 10% of amount paid under a contract to provide child care resource and referral services to employees, up to a maximum credit of $150,000 a year (not available after 2012 tax year)
Disabled access	For eligible small businesses, 50% of eligible access expenditures greater than $250 and not more than $10,250
Small employer health insurance	Up to 35% of employer contributions for employee health insurance (through 2013; up to 50% starting in tax year 2014)
Small employer pension plan start-up	50% of administrative and retirement-related education expenses ("qualified start-up costs") for the first three plan years, up to a maximum credit of $500 a year

Note that this list of credits isn't all-inclusive. Various requirements apply.

ALTERNATIVE MINIMUM TAX

Like individual taxpayers, larger corporations can find themselves subject to alternative minimum tax. When it applies, the corporate AMT rate is 20%, and the exemption amount is $40,000 (subject to an income-based phaseout with alternative minimum taxable income between $150,000 and $310,000).

Your corporation will be *exempt* from AMT if it satisfies a gross receipts test. The exemption generally applies where a corporation's average annual gross receipts for all three-tax-year periods beginning after 1993 and ending before the current tax year are $7.5 million or less. (There's a lower $5 million threshold for the first three-tax-year period taken into account in the test.)

THE CLOCK IS TICKING

Now that you've reached the end of this guide, we hope you have a better understanding of the need for tax planning and the short time frame you have for taking advantage of year-end planning opportunities. As skilled professionals, we have the experience, knowledge, and expertise to help you with your planning needs. For more information on any of our services, call us today.

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