Dear Client:

As 2012 draws to a close, there is still time to reduce your 2012 tax bill and plan ahead for 2013. This letter highlights several potential tax-saving opportunities for you to consider. I would be happy to meet with you to discuss specific strategies and issues.

Deferring Income to 2013

Deferring income to the next taxable year is a time-honored year-end plan. If you expect your AGI to be higher in 2012 than in 2013, or if you anticipate being in the same or a higher tax bracket in 2012 than in 2013, you may benefit by deferring income into 2013. Some ways to defer income include:

Use of Cash Method of Accounting: By using the cash method of accounting instead of the accrual method of accounting, you can generally put yourself in the best position for accelerating deductions and deferring income. There is still time to accomplish this strategy, because an automatic change to the cash method can be made by the due date of the return including extensions. The following three types of businesses can make an automatic change to the cash method: (1) small businesses with average annual gross receipts of $1 million or less (even those with inventories that are a material income producing factor); (2) certain C corporations with average annual gross receipts of $5 million or less in which inventories are not a material income producing factor; and (3) certain taxpayers with average annual gross receipts of $10 million or less. Provided inventories are not a material income producing factor, sole proprietors, limited liability companies (LLCs), partnerships, and S corporations can change to the cash method of accounting without regard to their average annual gross receipts.

Delay Billing: Delay year-end billing to clients so that payments are not received until 2013.

Interest and Dividends: Interest income earned on Treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income, consider buying short-term bonds or certificates that will not mature until next year. If you have control as to when dividends are paid, arrange to have them paid to you after the end of the year.

Accelerating Income into 2012

You may benefit from accelerating income into 2012. For example, you may anticipate being in a higher tax bracket in 2013, or perhaps you need additional income in 2012 to take advantage of an offsetting deduction or credit that will not be available to you in future tax years. Note, however, that accelerating income into 2012 will be disadvantageous if you expect to be in the same or lower tax bracket for 2013.

If you report income and expenses on a cash basis, issue bills and attempt collection before the end of 2012. Also see if some of your clients or customers are willing to pay for January 2013 goods or services in advance. Any income received using these steps will shift income from 2013 to 2012.

Business Deductions

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and their dependents as an above-the-line deduction, without regard to the 7.5%-of-AGI floor.

Equipment Purchases: If you purchase equipment, you may make a “Section 179 election,” which allows you to expense (i.e., currently deduct) otherwise depreciable business property. For 2012, you may elect to expense up to $139,000 of equipment costs (with a phase-out for purchases in excess of $560,000) if the asset was placed in service during 2012. Note that for assets placed in service in 2012, taxpayers can expense 50% of their business equipment purchases under a provision giving taxpayers bonus depreciation, mitigating the need for the §179 election.

In 2013, the dollar amounts for §179 expensing are scheduled to be $25,000, with a phase-out amount of $200,000.

In addition, careful timing of equipment purchases can result in favorable depreciation deductions in 2012. In general, under the “half-year convention,” you may deduct six months' worth of depreciation for equipment that is placed in service on or before the last day of the tax year. (If more than 40% of the cost of all personal property placed in service occurs during the last quarter of the year, however, a “mid-quarter convention” applies, which lowers your depreciation deduction.) A popular strategy in recent years is to purchase a vehicle for business purposes that exceeds the depreciation limits set by statute (i.e., a vehicle rated over 6,000 pounds). Doing so would not subject the purchase to the statutory dollar limit, $11,160 for 2012 (due to bonus depreciation rules), $11,360 in the case of vans and trucks (due to bonus depreciation rules). Therefore, the vehicle would qualify for the full equipment expensing dollar amount. However, for SUVs (rated between 6,000 and 14,000 pounds gross vehicle weight) the expensing amount is limited to $25,000.

NOL Carryback Period: If your business suffers net operating losses for 2012, you generally apply those losses against taxable income going back two tax years. Thus, for example, the loss could be used to reduce taxable income—and thus generate tax refunds—for tax years as far back as 2010. Certain “eligible losses” can be carried back three years; farming losses can be carried back five years.

Bad Debts: You can accelerate deductions to 2012 by analyzing your business accounts receivable and writing off those receivables that are totally or partially worthless. By identifying specific bad debts, you should be entitled to a deduction. You may be able to complete this process after year-end if the write-off is reflected in the 2012 year-end financial statements.

Home Office Deduction: Expenses attributable to using the home office as a business office are deductible under §280A if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business.

Business Credits

Small Employer Pension Plan Startup Cost Credit: For 2012, certain small business employers that did not have a pension plan for the preceding three years may claim a nonrefundable income tax credit for expenses of establishing and administering a new retirement plan for employees. The credit applies to 50% of qualified administrative and retirement-education expenses for each of the first three plan years. However, the maximum credit is $500 per year.

Credit for Employee Health Insurance Expenses of Small Employers: For taxable years beginning after 2009, eligible small employers are allowed a credit for certain expenditures to provide health insurance coverage for their employees. Generally, employers with 10 or fewer full-time equivalent employees (FTEs) and an average annual per-employee wage of $25,000 or less are eligible for the full credit. The credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than $25,000. The credit is phased out completely for employers with 25 or more FTEs or an average annual per-employee wage of $50,000 or more. The credit amount is 35% of certain contributions made to purchase health insurance.

Inventories

Subnormal Goods: You should check for subnormal goods in your inventory. Subnormal goods are goods that are unsalable at normal prices or unusable in the normal way due to damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange. If your business has subnormal inventory as of the end of 2012, you can take a deduction for any write-downs associated with that inventory provided you offer it for sale within 30 days of your inventory date. The inventory does not have to be sold within the 30-day timeframe.

Planning for 2013 Tax Increases and Potential Expiration of Tax Relief Provisions

S Corporation Built-In Gains Tax: An S corporation generally is not subject to tax; instead, it passes through its income or loss items to its shareholders, who are taxed on their pro-rata shares of the S corporation's income. However, if a business that was formed as a C corporation elects to become an S corporation, the S corporation is taxed at the highest corporate rate on all gains that were built in at the time of the election if the gains are recognized during a special holding period. While for tax years beginning in 2009 and 2010, the special holding period was shortened from 10 years to seven years, it is shortened even more for tax years beginning in 2011, to five years. For taxable years beginning in 2012, the holding period reverts back to 10 years.

100% Exclusion of Gain Attributable to Certain Small Business Stock: The incentive for individuals to acquire qualified small business stock was higher before the end of 2011. An individual ordinarily may exclude 50% of the gain from qualified small business stock that is held for at least five years (subject to a cap). “Qualified small business stock” is stock of a corporation the assets of which do not exceed $50 million when the stock is issued. The 50% exclusion of gain was increased to 75% for qualified small business stock acquired after February 17, 2009, and before September 28, 2010. The 2010 Small Business Jobs Act (SBJA) excluded 100% of the gain for qualified small business stock acquired or issued after September 27, 2010, and before January 1, 2011, and the 2010 TRA extended the 100% exclusion to qualified small business stock acquired before January 1, 2012. In addition, the alternative minimum tax preference item attributable to the sale is eliminated. For stock acquired after December 31, 2011, only 50% of the gain from the sale/exchange of qualified small business stock held for more than 5 years is excluded from gross income. For tax years beginning in 2012, the holding period is once again 10 years.

Qualified Dividends: Qualified dividends received in 2012 are subject to rates similar to the capital gains rates. Therefore, qualified dividends are taxed at a maximum rate of 15%. Qualified dividends are typically dividends from domestic and certain foreign corporations. Unless Congress acts, all dividends will be treated as ordinary income beginning January 1, 2013.

Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property: The rule that the basis of an S corporation shareholder's stock is decreased by charitable contributions of property by the S corporation in an amount equal to the shareholder's pro rata share of the adjusted basis of the contributed property expired for contributions made in taxable years beginning after December 31, 2011.

Employer-Provided Child Care Credit: For 2012, employers may claim a credit of up to $150,000 for supporting employee child care or child care resource and referral services. The credit is allowed for a percentage of "qualified child care expenditures," including for property to be used as part of a qualified child care facility, for operating costs of a qualified child care facility, and for resource and referral expenditures. Note that this credit is scheduled to expire at the end of 2012, therefore, it would be wise to make any planned qualified child care expenditures in 2012 to take advantage of the credit.

Work Opportunity Credit: The work opportunity credit is an incentive provided to employers who hire individuals in groups whose members historically have had difficulty obtaining employment. The credit gives a business an expanded opportunity to employ new workers and to be eligible for a tax credit against the wages paid. The credit is determined based on first-year wages paid for employees hired on or before December 31, 2011 (December 31, 2012, for qualified veterans).

Bonus Depreciation: Taxpayers can claim 50% bonus depreciation for assets placed in service in 2012. Bonus depreciation is also allowed for machinery and equipment used exclusively to collect, distribute, or recycle qualified reuse and recyclable materials and qualified disaster assistance property. In 2013, the bonus depreciation generally does not apply.

Reporting

Uncertain Tax Positions: The final Instructions for Schedule UTP state that a corporation must file Schedule UTP with its income tax return if it: (1) files Form 1120, Form 1120-F, From 1120-L, or Form 1120-PC; (2) has assets of $50,000,000 or more beginning with the 2012 tax year, and $10,000,000 or more beginning with the 2014 tax year (the threshold was $100,000,000 or more for tax years before 2012); (3) issued (or a related party issued) audited financial statements reporting all or a portion of the corporation's operations for all or a portion of the corporation's tax year; and (4) has one or more tax positions that must be reported on Schedule UTP. A taxpayer that files a protective Form 1120, 1120-F, 1120-L, or 1120-PC and satisfies the conditions set forth above also must file Schedule UTP.

Unique Reference Identification Number: For taxable years beginning in 2012, Forms 5471, 8858, and 8865 will be revised to contain a Unique Reference Identification number (URI) for each foreign entity with respect to which reporting is required. The URI will be used to track the foreign entity from year to year.

Electronic Deposits

Electronic Funds Transfer: A corporation must make its deposits of income tax withholding, FICA, FUTA, and corporate income tax by electronic funds transfer (EFT), including through the IRS's Electronic Federal Tax Deposit System (EFTPS).

If you have any questions, please do not hesitate to call. I would be happy to meet with you at your convenience to discuss the strategies and requirements outlined above. There is still time to implement these strategies to minimize your 2012 tax liability and plan for 2013.

Pricing Changes

While we are mindful of the economic times we currently live in, it has become necessary to adjust a couple of our fees. Our S-Corp return preparation fees will change from $300 to $350 effective January 1, 2013 and our 1099 preparation fees will change from $50 to $100 effective January 1, 2013. With increase legislation and documentation requirements the time and risk for these services has increased dramatically. We appreciate your understanding.

We hope you have had a very good year and wish you a Merry Christmas and an Extraordinary New Year!

Sincerely,

Jenkins CPA, LLC