

# Nolan, Giere & Company

Certified Public Accountants

## 2011 YEAR-END TAX PLANNING FOR BUSINESSES

Many tax benefits for business will either expire at the end of 2011 or become less valuable after 2011. Two of the most important benefits are bonus depreciation and Code Sec. 179 expensing. Both apply to investments in tangible property that can be depreciated. Other sunseting opportunities might also be considered.

### Bonus Depreciation

Bonus depreciation is 100 percent for 2011. In the first year, a business can write-off the entire cost of its investment in the new depreciable property. Under current law, bonus depreciation will decrease to 50 percent in 2012 and will terminate after 2012. (These deadlines are extended one year for certain transportation property and property with a longer production period.) President Obama has proposed to extend 100 percent bonus depreciation through 2012. Normally, this would have a good chance of being approved, but with the focus on deficit reduction and the linking of tax benefits to tax increases, it is not at all clear what will happen.

Therefore, if a business has income in 2011 and plans to invest in depreciable property, it is worthwhile to consider making that investment in 2011, while the available write-off is at its highest.

Planning for bonus depreciation is important because the property must satisfy placed-in-service and acquisition date requirements. Property is placed in service when it is in a condition or state of readiness on a regular ongoing basis for a special specifically assigned function in a trade or business. The acquisition date rules may vary. For 2011, property is acquired when the taxpayer incurs or pays its cost. This could occur when the property is delivered, but it could also be when title to the property passes. For 2012, property is acquired when the taxpayer takes physical possession of the property.

### Code Sec. 179 Expensing

Code Sec. 179 expensing (first-year write-off) has been around for a while, but at higher amounts more recently. While there is no limit on bonus depreciation, expensing is limited to a statutory amount. For 2011, this amount is \$500,000. It is scheduled to drop to \$139,000 in 2012 and to \$25,000 after 2012 (adjusted for inflation). Moreover, the cap is reduced for the amount of total investment in Code Sec. 179 property.

The phaseout threshold is \$2 million for 2011, dropping to \$560,000 for 2012 and \$200,000 for 2013 and subsequent years.

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For businesses who want to invest in depreciable property, the payoff is definitely greater in 2011. Taxpayers taking advantage of expensing should write off assets that would otherwise have the longest recovery periods.

### Other 2011 Benefits

Some other important benefits expire at the end of 2011 or become less valuable. A significant benefit in 2011 is the 100 percent capital gain exclusion for small business stock. After 2012, the normal exclusion rate will drop to 50 percent, although it has been 75 percent in recent years. The exclusion is based on the year the stock is acquired; the stock must be held for five years before being sold and satisfy other requirements.

Another important benefit is the 20 percent research credit. The credit has been extended one year at a time for a long period, so it is likely to be extended again. Nevertheless, until Congress acts, there is some uncertainty for research expenses incurred after 2011.

### Conclusion

To maximize the benefits of 2011 year-end tax planning, a business must be proactive in determining what upcoming capital investments might be accelerated into this year and what investments become cost effective because of the immediate tax benefits that they offer. Some business-related tax benefits will be less valuable after 2011; for others, it is not clear what Congress and the administration will do in terms of surprising taxpayers with a year-end tax bill.

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## Merry Christmas & Happy New Year



From,

Nolan, Giere & Company

Quarterly Report

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# Perspective

## An Inside View

Dear Clients and Friends,

The recent Super Committee failure marks the third year in a row that taxpayers head into December with major tax-code issues unaddressed. As Laura Saunders said in the Wall Street Journal recently “Epic failure in Washington is causing epic uncertainty for taxpayers.”



Nick Nolan

Now most tax experts do not expect action on the most important issues until after next year's elections. Lawmakers are facing a long list of expirations at the end of 2011, including the 2% Social Security payroll tax cut for employees, the alternative minimum tax “patch” and the popular IRA charitable contribution for people older than 70 1/2. Other changes set for 2013 include the expiration of tax cuts enacted in 2001 and 2003. The top ordinary tax rate would reset to 39.6% from 35%, capital gains would rise to 20% from 15% and the 15% dividend rate would lapse, as would the current generous estate tax provisions.

The general theme in 2011 and 2012 is that several traditional tax planning techniques need to be reversed i.e. accelerate income into 2011 and 2012 and defer tax deductions into 2013 when rates are expected to be higher.

Many other planning opportunities are discussed as well in this quarterly news letter for your consideration.

In spite of a very difficult year economically and politically, we are still seeing very optimistic results across our client base. The closely held business owners who are cutting costs and taking advantage of new sales and growth opportunities have positioned themselves with strong balance sheets in the process. Washington should pay attention. These business truly are the backbone of the nation's economy.

On this positive note, we all wish you a very Merry Christmas and a prosperous New Year.

Sincerely,

*Nick*

Nicholas F. Nolan III, President

## INFLATION ADJUSTMENTS MAY GENERATE TAX SAVINGS IN 2012

The IRS recently announced that inflation is increasing many dollar amounts in the Tax Code for 2012. For taxpayers, the inflation adjustments may help reduce their overall tax liability in 2012.

### Inflation Adjustments

Many provisions in the Tax Code are required to be adjusted annually for inflation. These include various deductions, exemptions and exclusion amounts. The tax law also requires that the individual income tax brackets be adjusted annually for inflation.

In October, the IRS announced that inflation is running at just over 3.8 percent. In response, the IRS adjusted a number of amounts in the Tax Code upward for 2012.

### Retirement Accounts

**401(k) plans.** For 2012, the maximum amount an individual can contribute tax-free to a 401(k) plan increases \$500 from \$16,500 to \$17,000. However, some 401(k) plans limit maximum contributions to levels below the ceiling in the Tax Code.

**IRAs.** The deduction for taxpayers making contributions to a traditional IRA is phased out for single individuals and heads of households who are covered by a workplace retirement plan. For 2012, the income phaseout range starts at \$58,000 and ends at \$68,000, up from \$56,000 and \$66,000, respectively, for 2011. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phaseout range for 2012 starts at \$92,000 and ends at \$112,000, up from \$90,000 and \$110,000, respectively, for 2011. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out for 2012 if the couple's income is between \$173,000 and \$183,000, up from \$169,000 and \$179,000, respectively, for 2011.

Roth IRAs are subject to similar rules. The AGI limit for maximum Roth IRA contributions, for a married couple filing a joint return for 2012 is \$173,000, an increase of \$4,000 from 2011. The AGI limitation for all other taxpayers (other than married taxpayers filing separate returns) increases from \$107,000 for 2011 to \$110,000 for 2012.

**Standard deduction.** The standard deduction increases by \$300 for married couples filing a joint return from \$11,600 for 2011 to \$11,900 for 2012. The standard deduction for single individuals increases from \$5,800 for 2011 to \$5,950 for 2012.

**Personal exemption.** The amount of the personal exemption and the dependency exemption increases from \$3,700 for 2011 to \$3,800 for 2012. Also, the personal exemption phaseout for higher income taxpayers for 2011 and 2012 has been temporarily repealed.

**Estate tax.** The 2010 Tax Relief Act provided that the basic exclusion amount for estates of decedents dying after December 31, 2009 is \$5 million. For 2012, the inflation-adjusted amount is increased to \$5,120,000.

**Gift tax exclusion.** For 2012, you can give up to \$13,000 to any person without incurring gift tax. Married couples can gift up to \$26,000 tax-free to any person. These amounts are unchanged from 2011.

# Business Solutions

## Professional Accounting Expertise

### SETTING YOUR SALARY: WHAT IS THE RIGHT AMOUNT

One of the greatest perks of owning a small business is flexibility. You can set your own hours and salary. You can plot the firm's trajectory without consulting your boss, upper management, or even corporate policy. But that same flexibility may become a curse if handled unwisely. A small business owner without discipline and a well-thought-out strategy may fall into serious financial trouble. Employees in larger firms often rely on the human resources department to establish pay scales, retirement plans, and health insurance policies. In a small company, all those choices and many more fall to the owner, including decisions about personal compensation.

While there is not a one-size-fits-all formula for determining how much to pay yourself as a business owner, here are the three factors to consider:

#### Personal Expenses

Tracking your business and personal expenses separately makes it easier to track the firm's cash flow, and lets you know how much salary you can realistically draw without hurting profitability. In most cases, money to cover the rent or mortgage, insurance, utilities, and other personal expenses will come from an outside job, personal savings, or the business itself.

Start with your household budget, then determine how much you are willing to draw from personal savings to keep your household afloat as the company grows. For a start-up company, owner compensation may be minimal. Beware, however, of going too long without paying yourself a reasonable salary. Be sure to document that you are in business to make a profit; otherwise the IRS may view your perpetually unprofitable business as a hobby or a sham enterprise aimed at avoiding taxes.

#### The Market

If you were working for someone else, what would they pay for your skills and knowledge? Start by answering that question; then discuss salary levels with small business groups and colleagues in your geographical area and industry. Check out the Department of Labor and Small Business Administration websites. In the early stages of your business, you probably will not draw a salary that is commensurate with the higher range of salaries, but at least you will learn what is reasonable.

#### Affordability

Review and continually update your firm's cash flow projections to determine the salary level you can reasonably sustain while keeping the business profitable. As the company grows, that level can be adjusted upward. As a rule of thumb, many successful business owners establish their own compensation at 50% or less of business profits.

### WHAT IS NEW WITH THE HEALTH INSURANCE DEDUCTION

When you are self-employed, you cannot afford to overlook your health or your health insurance tax deduction.

The deduction is available for sole proprietors, partners, and greater-than-2%-shareholders in S corporations. You report the deduction on page one of your individual income tax return, and you can claim it whether you itemize or not (an above-the-line deduction). Amounts you are unable to take above-the-line, such as those limited by your business income, can be included in your itemized deductions on Schedule A of your tax return.

The added benefit of using your premiums to reduce your self-employment tax expired at the end of 2010, but other rules remain intact.

That means you will want to have your business pay premiums by year-end. When the insurance plan is in your name, be sure to reimburse yourself and remember to add up all eligible costs. In addition to health insurance premiums for you, your spouse, your dependents, and adult children who are age 26 or younger, you can also count premiums for long-term care policies and Medicare.

*Note:* If you forgot to include Medicare premiums in prior years, ask us about filing amended returns.

For S corporation shareholders, there's one more step: You'll need to include the premiums on your Form W-2 for 2011. They're subject to withholding, but not FICA or Medicare tax.

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## WHAT IS CASH FLOW?

Cash flow, simply defined, is the movement of money in and out of your business; these movements are called *inflow* and *outflow*. Inflows for your business primarily come from the sale of goods or services to your customers. The inflow only occurs when you make a cash sale or collect on receivables. Remember, it is the cash that counts! Other examples of cash flows are borrowed funds, income derived from sales of assets, and investment income from interest.

Outflows for your business are generally the result of paying expenses. Examples of cash outflows include paying employee wages, purchasing inventory or raw materials, purchasing fixed assets, operating costs, paying back loans, and paying taxes.

### Cash Flow Versus Profit

Profit and cash flow are two entirely different concepts, each with entirely different results. The concept of profit is somewhat broad and only looks at income and expenses over a certain period, say a fiscal quarter. Profit is a useful figure for calculating your taxes and reporting to the IRS.

Cash flow, on the other hand, is a more dynamic tool focusing on the day-to-day operations of a business owner. It is concerned with the movement of money in and out of a business. But more important, it is concerned with the times at which the movement of the money takes place.

Theoretically, even profitable companies can go bankrupt. It would take a lot of negligence and total disregard of cash flow, but it is possible. Consider how the difference between profit and cash flow relate to your business.

### Analyzing Your Cash Flow

The sooner you learn how to manage your cash flow, the better your chances for survival. Furthermore, you will be able to protect your company's short-term reputation as well as position it for long-term success.

The first step toward taking control of your company's cash flow is to analyze the components that affect the timing of your cash inflows and outflows. A thorough analysis of these components will reveal problem areas that lead to cash flow gaps in your business. Narrowing, or even closing, these gaps is the key to cash flow management.

Some of the more important components to examine are:

- **Accounts receivable.** Accounts receivable represents sales that have not been collected in the form of cash. An accounts receivable is created when you sell something to a customer in return for his or her promise to pay at a later date. The longer it takes for customers to pay on their accounts, the more negative the effect on your cash flow.
- **Credit terms.** Credit terms are the time limits you set for your customers' promise to pay for their purchases. Credit terms affect the timing of your cash inflows. A simple way to improve cash flow is to get customers to pay their bills more quickly.
- **Credit policy.** A credit policy is the blueprint you use when deciding to extend credit to a customer. The correct credit policy—neither too strict nor too generous—is crucial for a healthy cash flow.

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- **Inventory.** Inventory describes the extra merchandise or supplies your business keeps on hand to meet the demands of customers. An excessive amount of inventory hurts your cash flow by using up money that could be used for other cash outflows. Too many business owners buy inventory based on hopes and dreams instead of what they can realistically sell. Keep inventory as low as possible.
- **Accounts payable and cash flow.** Accounts payable are amounts you owe to your suppliers that are payable some time in the near future - "near" meaning 30 to 90 days. Without payables and trade credit, you would have to pay for all goods and services at the time you purchase them. For optimum cash flow management, examine your payables schedule.

Some cash flow gaps are created intentionally. For example, a business may purchase extra inventory to take advantage of quantity discounts, accelerate cash outflows to take advantage of significant trade discounts, or spend extra cash to expand its line of business.

For other businesses, cash flow gaps are unavoidable. Take, for example, a company that experiences seasonal fluctuations in its line of business. This business may normally have cash flow gaps during its slow season and then later fill the gaps with cash surpluses from the peak part of its season. Cash flow gaps are often filled by external financing sources. Revolving lines of credit, bank loans, and trade credit are just a few of the external financing options available that you may want to consider.

Monitoring and managing your cash flow is important for the vitality of your business. The first signs of financial woe appear in your cash flow statement, giving you time to recognize a forthcoming problem and plan a strategy to deal with it. Furthermore, with periodic cash flow analysis, you can head off those unpleasant financial glitches by recognizing which aspects of your business have the potential to cause cash flow gaps.

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