June 2012 Monthly Newsletter

Second 2012 estimated tax payment is due June 15

June 15, 2012, is the due date for making your second installment of 2012 individual estimated tax. Your check to the United States Treasury should be accompanied by Form 1040-ES. June 15 is also the due date for calendar-year corporations to make their second quarter 2012 estimated tax payment.

IRS releases vehicle deduction limits for 2012

The IRS has published depreciation limits for business vehicles first placed in service this year. Because 50% bonus depreciation is allowed only for new vehicles, these limits are different for new and used vehicles.

For new business cars, the first-year limit is $11,160; for used cars, it's $3,160. After year one, the limits are the same for both new and used cars: $5,100 in year two, $3,050 in year three, and $1,875 in all following years.

The 2012 first-year depreciation limit for trucks and vans is $11,360 for new vehicles and $3,360 for used vehicles. Limits for both new and used vehicles in year two are $5,300, in year three $3,150, and in each succeeding year $1,875.

For details relating to your 2012 business vehicle purchases, contact our office.

Ask questions before going into business with your spouse

Starting and running a business is rarely a safe or simple process, and doing so with one's spouse creates an additional layer of complexity. Whether that complexity will have a positive or negative effect depends on several factors. Here are some of the questions you need to discuss before going into business with your spouse.

How well do you work together at home? If you cooperate and collaborate for domestic chores, you'll probably carry that pattern into your workplace. If you bicker constantly over how to do the laundry or maintain the yard, working together in business might be a risky option.

Even if you work well together, some disagreements are inevitable. How do you handle differences of opinion?

Will your business be adequately capitalized? You won't have an outside salary to fall back on during hard times.

Will there be other partners or employees? Each spouse’s role and responsibilities with respect to coworkers and subordinates should be clearly defined. Spouses with drastically different management styles can make life miserable for employees and each other.

Will one of you be supervising the other and/or reviewing the other’s work? You’ll need to concentrate on treating one another with respect, especially when giving or taking constructive criticism. Conversely, continually overlooking your spouse’s mistakes or failings may drag down employee morale or otherwise harm your business.

Are your strengths complementary or redundant? For example, if you’re a pair of engineers starting an engineering firm, you might leave functions such as marketing and accounting to employees or outside services so you can work together within your area of expertise. If you find your professional decisions tend to clash, consider splitting up your clients or processes and working separately within two divisions.

We can help you address the relevant issues and devise a business plan based on your capabilities, personalities, and desires. Call us for an appointment to explore the possibilities.

Taxes play a role in diversifying your investments

Savvy investors often spread their risks by investing in a variety of asset classes such as stocks, bonds, commodities, and real estate. But with a changing tax landscape, investors might consider three more classes: taxable, tax-deferred, and tax-free.

In days gone by, taxpayers often worked under the assumption that their tax bracket would be lower after they retire. Therefore, a common strategy was to defer as much taxable income as possible to the golden years. Now, however, with the possibility of higher tax rates in the future, it could be more efficient to pay those taxes today while rates remain lower. Since no one knows for sure what Washington will do, it might be time to hedge your tax risk and allocate your portfolio between accounts with differing tax consequences.

Taxable accounts, such as savings or brokerage accounts, result in current taxation on earnings, but they do provide maximum flexibility. You can withdraw as much as you wish whenever you wish, with no IRS penalties or taxes. Keeping some of your nest egg in this type of account will provide immediate funds for major purchases or debt reduction.

Tax-deferred accounts, such as IRAs or 401(k)s, only postpone the payment of taxes; eventually you will have to pay Uncle Sam when you withdraw the funds. But in the meantime, you generally receive a current-year tax deduction when you contribute, and the account can grow tax-free until you take it out at retirement.

Tax-free accounts, such as Roth IRAs, are funded with after-tax dollars. What you put in, including any investment earnings, can be later withdrawn tax-free. The downside? You generally must wait until after age 59½ (and the account has to be open for five years) to make a tax-free withdrawal.

Diversifying your portfolio is only the first step. The next (and trickiest) step is properly investing in each type. For instance, your goal for a taxable account might be to generate growth while keeping taxable earnings to a minimum. This could be done by investing in tax-exempt municipal bonds or low-dividend yielding growth stocks.

In a tax-deferred account, investment income is not taxed until withdrawn, so earnings can come from any source without immediate tax implications. However, since you must start withdrawing funds from an IRA or 401(k) at age 70 ½, you might want to stay away from highly volatile investments as you approach that age. Your account will have less time to rebound from a down market.

Tax-free Roth IRAs offer the longest time horizon for investing since you are not required to make a withdrawal at any age. So investments with higher risks or lower liquidity might fit best here.

In an era of high uncertainty and low expectations, tax-efficient investing has never been more important. To review the tax implications of your investments, give our office a call today.

Corporations should consider paying dividends in 2012

Business owners often grow their business by continually reinvesting earnings and profits. This is a good strategy, but eventually most business owners want to tap into these earnings. The problem is that withdrawing cash from a corporation can be very tax inefficient. The purpose of this letter is to alert you to tax planning opportunities that exist this year that will allow you to tap into the hard-earned cash of your business at historically low tax costs.

Normally, dividend treatment is something to avoid because of the double taxation issue. In effect, dividends are subject to double taxation. Your corporation pays income taxes on the earnings that generate the dividends, then you have to pay income taxes too when the earnings are paid out to you. This harsh effect has been softened somewhat for the last several years because the maximum dividend tax rate was only 15%. However, in 2013, barring any tax legislation, this favorable maximum rate is scheduled to skyrocket. The actual tax rate you will pay on dividends will depend on your marginal ordinary tax rate. However, for taxpayers in the top ordinary tax rate bracket, it looks like the federal tax rate could be as high as 43.4% after 2012.

If your corporation has built up substantial earnings and profits over the years, sometime before the end of 2012 is an ideal time to consider paying some dividends. Although, double taxation is assured, a 15% tax rate may be quite manageable. In addition to getting cash into your hands at historically low tax rates, paying dividends this year may have additional benefits for your corporation:

- *Reduce Future Exposure to Accumulated Earnings Penalty Tax.* A profitable corporation becomes exposed to the accumulated earnings penalty tax when it accumulates earnings in excess of reasonable business needs and does not pay dividends. Right now, the accumulated earnings tax rate is only 15%. Absent a law change, after 2012, the accumulated earnings tax rate will return to the maximum individual federal rate on ordinary income—39.6% for 2013. Therefore, now is a great time to pay out dividends and reduce your corporation's exposure to this penalty tax.

- *Better Tax Treatment for Distributions in Future Years.* To the extent 2012 cash distributions reduce the corporation's earnings and profits, there's a greater likelihood that distributions in future years will be treated as tax-free returns of capital or as long-term capital gains (which may once again be taxed at lower rates than dividends).
- *Establish a Dividend Paying Record.* A history of paying dividends will make it more difficult for the IRS to characterize compensation paid to business owners (which is deducible by the corporation) as disguised dividends (which aren't deductible). In other words, future compensation amounts will be easier to defend as reasonable if at least some dividends have been paid in the past.

As you can see, the current low federal tax rates on dividends make the idea of taking corporate distributions a better idea than at any time in recent memory. With careful planning, we can help you determine whether you would benefit from having your corporation make dividend distributions this year.

Please give us a call if you have questions or want more information.