The View on Year-End Tax Planning

Unique tax-saving opportunities for 2012

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The stars are aligned to make 2012 a truly memorable year-end from a tax-planning perspective. Just consider the following points:

- Tax rates are scheduled to increase in 2013. All brackets will be adjusted upward, and the two top rates of 33% and 35% will be replaced by top rates of 36% and 39.6%, respectively.
- Beginning in 2013, the maximum tax rate for net long-term capital gain is scheduled to increase from 15% to 20% (from 0% to 10% for certain low-income investors), while qualified dividends will be taxed at ordinary income rates.
- A new 3.8% Medicare surtax may apply to investment income above a certain threshold received by high-income taxpayers.
- Valuable tax breaks for small businesses, including the Section 179 and bonus depreciation deductions, will be curtailed or eliminated.
- The November elections may have a substantial impact on year-end tax planning. Depending on the outcome, other tax law changes could occur.

Keeping all that in mind, here are several year-end tax-planning ideas for individuals and small-business owners to consider.

Tax Planning for Individuals

Capital gains and losses: As in the past, you may realize capital losses to offset capital gains recognized earlier in the year. Any excess can then offset up to $3,000 of ordinary income in 2012 before being carried forward to next year. Similarly, capital gains realized at year-end may absorb prior capital losses. Because the maximum tax rate on net long-term capital gain is increasing in 2013, there will likely be a greater emphasis than usual on harvesting capital gains this year-end.

Investment income: Beginning in 2013, a 3.8% Medicare surtax applies to the lesser of your "net investment income" or your excess modified adjusted gross income (MAGI) over a threshold amount. The MAGI threshold is $200,000 for single filers and $250,000 for joint filers. If you will be affected, you might arrange to sell property in 2012 that would constitute net investment income if it were realized next year.

Charitable donations: Generally, you can deduct the full amount of cash donations made before the end of the year. If a donation is made by credit card, the gift is deductible on your 2012 return, even if the charge isn't actually paid until next year. But note that the tax law imposes strict substantiation rules. Also, extra record-keeping requirements apply to gifts of property.

Alternative minimum tax: Whether or not exemption amounts for the alternative minimum tax (AMT) calculation for 2012 are eventually increased, millions of taxpayers will still have to pay this "stealth tax." Have your professional tax adviser estimate your current AMT liability. Depending on your analysis, you might shift certain "tax preference items" to 2013 to avoid or reduce AMT liability. Alternatively, you may decide to accelerate income into 2012 if the AMT rate is lower than your expected top tax rate. The AMT rate is 26% on taxable income up to $175,000; above that figure, it's 28%.

Medical and dental expenses: For 2012, you may deduct unreimbursed medical and dental expenses to the extent the annual total exceeds 7.5% of your adjusted gross income (AGI). The AGI floor is increasing to 10% in 2013 for those younger than age 65. If you have already cleared the 7.5%-of-AGI hurdle for 2012, additional medical expenses are deductible, so you might accelerate non-emergency medical and dental visits into this year.

Family income-splitting: You may be able to reduce the overall family tax bill by shifting income-producing assets to other family members, such as your children, in lower tax brackets. However, the "kiddie tax" may undermine this strategy. Generally, unearned income over $1,900 received in 2012 by a child under age 19 or a full-time student under age 24 is taxed at the top marginal tax rate of the child's parents.

Tax Planning for Small Businesses

Section 179 deductions: Under Section 179 of the tax code, a business may currently deduct the cost of qualified business assets placed in service during the year. For 2012, the maximum write-off is $139,000, phased out on a dollar-for-dollar basis for purchases exceeding $560,000. The maximum deduction for 2013 is scheduled to drop to $25,000, with a phaseout threshold of $200,000. Thus, a small-business owner may decide to step up purchases of equipment and other assets in 2012.

Bonus depreciation: A company may benefit from a special "bonus depreciation" deduction equal to 50% of the cost of qualified assets placed in service in 2012 if it acquires qualified business assets this year. (A 100% bonus depreciation deduction was allowed in 2011.) Furthermore, bonus depreciation can be combined with the Section 179 deduction (see "Section 179 deductions") and regular depreciation deductions. Under current law, the bonus depreciation deduction is scheduled to expire after 2012.

Bad business debt: In these uncertain economic times, a business may have difficulty collecting past-due amounts. As a general rule, bad debts of a business may be deducted from gross income when they become worthless. Keep records of all collection efforts—letters, telephone calls, e-mail communications and collection agency activities—to support deductions based on the worthlessness of the debts.

Repairs vs. improvements: Generally, if you simply repair a business asset, you may currently deduct the entire cost. In contrast, the cost of a capital improvement to business property must be capitalized. When possible, you might make minor repairs before the end of the year to offset your taxable income for 2012. However, if you make repairs and capital improvements at the same time, the IRS may lump in the cost of the repairs with the improvements as part of a general betterment plan.

Section 199 deductions: A deduction under Section 199 may be available to a business entity with qualified domestic production activities. For 2012, this "manufacturing deduction" is equal to the lesser of 9% of taxable income from qualified production activities or taxable income. But do not assume that Section 199 write-offs are limited to traditional manufacturing firms. Obtain professional guidance concerning your operation.

Business supplies: A business can generally deduct the routine supplies it purchases during the year, even if some of the supplies are not used until the following year. When appropriate, your company might purchase additional supplies before January 1, 2013, to increase its deduction for 2012.

This is just an overview of several year-end tax-planning concepts for 2012. Of course, the tax law is subject to change, especially in the wake of the national elections. Be prepared to react quickly if new legislation is enacted. Your Henry & Horne, LLP professional tax adviser can provide guidance in those situations.

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