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Inside this issue

Tax & Business letter

SPRING 2013

How will the *American Taxpayer Relief Act* affect you?

The *American Taxpayer Relief Act of 2012*, which was signed into law on January 2, 2013, includes new tax rates, restrictions on itemized deductions and exemptions, and extensions of certain deductions and credits. Some changes will influence your 2013 federal income tax planning, and others can affect your 2012 tax return. Here are highlights.

New tax rates

Certain changes that begin in 2013, such as new tax rates, will affect you when your taxable income reaches specified levels. For example, a federal income tax rate of 39.6% will apply if your 2013 taxable income exceeds $450,000 and your filing status is married filing jointly. The higher rate begins at taxable income over $400,000 when you're single.

Other federal tax brackets – from 10% to 35%, depending on your income – still apply to both 2012 and 2013 individual returns.

In addition, capital gain rates will increase for 2013 and future years when your taxable income exceeds the $450,000/$400,000 thresholds. At that income level, the maximum rate for most long-term capital gains will be 20%.

The zero-percent rate is still in effect when you're married filing jointly and your 2013 income is less than $72,500 ($36,250 if you're single).

Return of former limitations

Restrictions on itemized deductions and exemptions also begin in 2013. Both limitations increase the amount of tax you pay when your adjusted gross income exceeds $300,000 if you're married filing jointly ($250,000 when you're single).

As an illustration, the personal exemption you claim for yourself, your spouse, and your dependents – a deduction of $3,900 each in 2013 – is reduced once your income reaches those levels.

Extended provisions

The *Act* extended familiar itemized deductions, including state and local sales tax and mortgage insurance premiums.

Above-the-line deductions, such as the qualified tuition deduction for higher education expenses and the $250 deduction for unreimbursed expenses if you're a teacher, are also available for both 2012 and 2013.

Another tax break that was renewed: the ability to contribute up to $100,000 from your traditional IRA to a qualified charity. As before, when you're age 70½ or older, you can make a distribution directly from your IRA to the charity. The amount you donate is not included in gross income, and you can consider it part of your required minimum distribution for the year.

Business benefits

For both 2012 and 2013, you can claim 50% bonus depreciation, up to $500,000 Section 179 expensing, and a 15-year life span for leasehold, restaurant, and retail improvements.

The *American Taxpayer Relief Act* contains more beneficial provisions, including opportunities for Roth conversions within your retirement plan and an increased alternative minimum tax exemption. Call us for guidance in creating a tax plan for your specific circumstances and goals. ◆

You can't change your mind after you convert

Under the new tax law, it is now easier to convert your employer-sponsored retirement plan such as a 401(k), 403(b), or 457 into a Roth IRA account. This is similar to converting your traditional IRA into a Roth IRA, but with one very significant difference.

When you convert a traditional IRA into a Roth IRA, you can change your mind and undo this conversion (also known as a recharacterization) by October 15 of the following year. This may make sense when the value of the account has dropped since you did the conversion, because you do not want to pay tax on a higher value than the account currently has.

When you convert an employer-sponsored retirement plan, you do not have the option of undoing the conversion by October 15. Once you convert your employer-sponsored retirement plan into a Roth IRA, it cannot be undone.

If you decide to convert your entire 401(k) into a Roth IRA, the entire balance will be taxable in the year of the conversion.

If you want to take advantage of this new provision, please contact our office first because there are some very important tax planning consequences to consider. If done without proper tax counsel, you may be paying more taxes than you should. In light of the new tax law, there are now more variables that need to be considered in your tax planning. ◆

Manage your business with just a few critical numbers

Regardless of the type of business you're running, monitoring a few key financial indicators is often all that's needed to keep your company growing and prosperous. On the other hand, neglecting a firm's vital signs can lead to management by crisis and corrective action that's too little, too late.

Although annual financial statements provide historical perspective and a wealth of data for long-term planning, correcting current problems is a matter of timely insight and informed analysis. You want to know whether your business is losing money or growing – now, not later.

A company's key financial indicators often fall into one or more of the following categories:

■ *Orders and returns.* Are you selling more units over time? To find out, look at your sales figures by units. Tracking revenues alone may present a false picture. After all, revenues may be growing because prices have increased. If unit sales are declining, you might be losing market share. Are customers returning more and more of your products? Are complaints increasing? If so, it may be time to examine your quality control process or return policy.

■ *Breakeven point.* If you need $100,000 this month to cover fixed and variable costs, are you selling enough products or providing enough services to break even? If you're dipping into reserves to cover revenue shortfalls, adjustments may be required. Expenses may need to be slashed, a new advertising campaign launched, or a new and cheaper supplier procured.

■ *Liquidity.* Knowing the availability of cash is vital to every business. That's why reconciling the firm's bank statements shouldn't be an afterthought. Every month your accountant or bookkeeper should ensure that your general ledger agrees with the bank's records of deposits and withdrawals. If a company is "bleeding cash," the bank statements should tell the story.

■ *Inventory.* Controlling the stuff that's weighing down your retail shelves or accumulating in your warehouse is often a key to profitability. Buying too many items may lead to excessive storage costs; buying too little may lead to burgeoning backorders and lost sales.

■ *Payroll.* Staff size should be commensurate with revenues. Medium-sized firms, especially, can find that labor expenses grow too rapidly. A decline in orders may signal a need to reduce payroll costs.

Over time your business's key numbers may change. The key is to know your company, identify changing conditions, and adapt. A brief but timely report that presents the numbers that really matter will help to keep your firm on the right track. ◆

A bank line of credit: *When does it make sense for your business?*

Just exactly what is a bank line of credit and who should be using one? A bank line of credit is not a great deal different from a credit card. You make draws against your line of credit from time to time as you need cash. You pay interest only on the amount of the loan balance outstanding. You are expected to make payments and occasionally bring your outstanding balance to zero. Let's look at an example.

Let's say that your bank has arranged for you to have a $100,000 line of credit. You are not obligated to draw any of it at any given time, and you will pay no interest until you actually make a draw (much as you do with a credit card).

Assume that you want to build up your inventory for the holiday shopping season and need $30,000 to do so. After your inventory purchase, you still have $70,000 available even if the $30,000 is still outstanding, but you are only paying interest on the $30,000. You may have several occasions during the year to borrow on your line of credit. Since your line of credit is intended for short-term cash needs, your banker expects your balance to be paid down as your cash flow improves.

Do not use a line of credit for capital purchases. If you need to expand your building or buy new equipment, arrange a term loan for that specific acquisition. You should not use a credit card for such an investment, and you should not use your line of credit for that either.

If your business has at least two years of making a profit, you may well qualify for a bank line of credit. Start by checking with your current bank. Your banker would like to keep your business, and if your financial statements support it, you will most likely be offered a loan. Lines of credit for small amounts may not require collateral. On larger loans, you may need to put up collateral, and you may need a co-signer.

A bank line of credit can make your operation more efficient. There is comfort in knowing that you have a reliable source of instant cash for your short-term needs.

Most banks are willing to make loans to businesses that have uneven income cycles. You may want to shop around for the best loan terms. Some banks may already have several customers in your industry and do not want more (perhaps a bank examiner's concern). Accordingly, their terms may be less favorable than some other bank or credit union.

Please contact us if you would like assistance in preparing a request for a bank line of credit. ◆

IRS TAX NOTES

IRS simplifies home-office deduction

The IRS is reducing the recordkeeping required for the home-office deduction, effective for 2013. Taxpayers who qualify may use a new optional deduction calculated at $5 a square foot for up to 300 square feet of an area in a home that is used regularly and exclusively for business. The deduction is capped at $1,500 a year.

Taxpayers opting for the simplified deduction cannot depreciate a portion of the home as they can under the other method. However, business expenses not related to the home, such as advertising, supplies, and employee wages are still fully deductible. This simplified option is available starting with the 2013 tax return which will be filed in 2014.

Farmers and fishermen get extension

The IRS had to delay the start of this year's tax filing season until it completed programming changes made necessary by the late passage of the *American Taxpayer Relief Act of 2012* (signed into law on January 2, 2013).

Normally, farmers and fishermen are not required to make quarterly estimated tax payments if they file their tax return and pay taxes due by March 1 of the following year. The filing delay created by the new law meant that several tax forms needed by these taxpayers would not be ready on time.

As a result, the IRS has announced an extension of the March 1 filing deadline for farmers and fishermen to April 15.

The filing extension will apply to all farmers and fishermen, not just to those who use late-released IRS forms.

To qualify as a farmer or fisherman for 2012, at least two-thirds of the taxpayer's gross income for 2011 or 2012 must have come from farming or fishing. ◆

Prior-year law changes 2013 tax rules

A number of provisions in the 2010 health care reform legislation go into effect this year. Here are some of the changes that could affect you.

- *Medical expense itemized deduction.* The 7.5% income threshold for deducting unreimbursed medical expenses increases to 10% for taxpayers under age 65. Those 65 and older may continue to use the 7.5% threshold through the year 2016.
- *FSA contributions.* The limit on contributions to health care flexible spending accounts (FSAs) is lowered to $2,500.
- *Medicare tax on earned income.* A 0.9% Medicare surtax will be imposed on wages and self-employment income exceeding $200,000 for singles and $250,000 for married taxpayers filing a joint return.
- *Medicare tax on unearned income.* New this year is a 3.8% Medicare tax on unearned income for single taxpayers with adjusted gross income over $200,000 and married couples with income over $250,000. The tax will apply to the lesser of (a) net investment income, or (b) the amount by which modified adjusted gross income exceeds the $200,000 / $250,000 thresholds.

Examples of unearned income include interest, dividends, capital gains, royalties, and rental income. Social security benefits, alimony, tax-exempt interest, and distributions from most retirement plans are examples of unearned income not subject to this new tax.

These changes may affect your 2013 withholding or quarterly estimated tax payments. For more information and planning assistance, contact our office. ◆

NOTE: *This newsletter is issued quarterly to provide you with an informative summary of current business, financial, and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*

We appreciate your business. Please call any time we can be of assistance to you in your tax, financial, or business affairs.

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Tax CALENDAR

SPRING 2013

March 15 – Deadline for calendar-year corporations to elect S corporation status for 2013.

March 15 – Deadline for filing 2012 tax returns for calendar-year corporations.

April 1 – Deadline for payers who file electronically to file 2012 information returns (such as 1099s) with the IRS.

April 1 – Deadline for employers who file electronically to send copies of 2012 W-2s to the Social Security Administration.

April 15 – Deadline for filing 2012 individual tax returns.

April 15 – Deadline for filing 2012 partnership returns.

April 15 – Deadline for filing 2012 gift tax returns.

April 15 – Deadline for making 2012 IRA contributions.

April 15 – First installment of 2013 individual estimated tax is due.

May 15 – Deadline for nonprofit organizations on a calendar-year to file information returns. ◆