Online Advisor - July 2012

Major Tax Deadlines
For July 2012

*** July 31** - Due date for filing retirement or employee benefit plan returns (5500 series) for plans on a calendar year.

NOTE: Businesses are required to make federal tax deposits on dates determined by various factors that differ from business to business.

Payroll tax deposits: Employers generally must deposit Form 941 payroll taxes (income tax withheld from employees' pay and both the employer's and employees' share of social security taxes) on either a monthly or semiweekly deposit schedule. There are exceptions if you owe $100,000 or more on any day during a deposit period, if you owe $2,500 or less for the calendar quarter, or if your estimated annual liability is $1,000 or less.

* Monthly depositors are required to deposit payroll taxes accumulated within a calendar month by the fifteenth of the following month.

* Semiweekly depositors generally must deposit payroll taxes on Wednesdays or Fridays, depending on when wages are paid.

For more information on tax deadlines that apply to you or your business, contact our office.

What's New in Taxes

Supreme Court upholds health care law

On June 28, the Supreme Court ruled that the "Patient Protection and Affordable Care Act of 2010" was constitutional, including the provision in the law requiring individuals to have health insurance coverage starting in 2014.

Several provisions in the health care law had already gone into effect, and many new tax provisions are scheduled to take effect in 2013. These are the provisions you should factor into your tax planning for the rest of this year. A quick review of these tax provisions:

* Annual contributions to health flexible spending accounts (FSAs) will be limited to $2,500.

* The 7.5% income threshold for deducting unreimbursed medical expenses increases to 10% for those under age 65. Those 65 and older may continue to take an itemized deduction for medical expenses exceeding 7.5% of adjusted gross income through the year 2016.

* The payroll Medicare tax will increase from 1.45% of wages to 2.35% on amounts above $200,000 earned by individuals and above $250,000 earned by married couples filing joint returns.

* A new 3.8% Medicare tax will be imposed on unearned income for single taxpayers with income over $200,000 and married couples with income over $250,000.

Cancelled debt may be considered taxable income by the IRS

With the recent economic downturns experienced by many taxpayers, there is a tax concept that is very important: cancellation of debt. You would think that the cancellation of debt by a credit card company or mortgage company would be a good thing for the taxpayer. And it can be, but it can also be considered taxable income by the IRS. Here is a quick review of various debt cancellation situations.

*** Consumer debt**

If you have gone through some type of credit "workout" program on consumer debt, it's likely that some of your debt has been cancelled. If that is the case, be prepared to receive IRS Form 1099-C representing the amount of debt cancelled. The IRS considers that amount taxable income to you, and they expect to see it reported on your tax return. The exception is if you file for bankruptcy. With bankruptcy, generally the debt cancelled is not taxable.

Even if you are not legally bankrupt, you might be technically insolvent (where your liabilities exceed your assets). If this is the case, you can exclude your debt cancellation income by reporting your financial condition and filing IRS Form 982 with your tax return.

*** Primary home**

If your home is "short" sold or foreclosed and the lender receives less than the total amount of the outstanding loan, you can also expect that amount of debt cancellation to be reported to you and the IRS. But special rules allow you to exclude up to $2 million in cancellation income in many circumstances. You will again need to complete IRS Form 982, but the exclusion from taxable income brought about by the debt cancellation on your primary residence is incredibly liberal. So make sure to take advantage of these rules should they apply to you.

*** Second home, rental property, investment property, business property**

The rules for debt cancellation on second homes, rental property, and investment or business property can be extremely complicated. Generally speaking, the new laws that cover debt cancellation don't apply to these properties, and the IRS considers any debt cancellation income taxable. Nevertheless, given your cost of these properties, your financial condition, and the amount of debt cancelled, it's still possible to have this debt cancellation income taxed at a preferred capital gains rate, or even considered not taxable at all.

Be aware that many of the special debt cancellation provisions are set to expire at the end of 2012.

If you're unsure as to how debt cancellation affects you, contact our office to review your situation and determine how much, if any, cancelled debt will be taxable income to you.

New Business

Midyear tax planning is critical this year

With big tax changes scheduled to take effect in 2013, every business should make time for a midyear 2012 tax review. Here are five tax-cutting ideas to consider as part of your review.

1. Hire your kids. If your child is under age 18 and works for your unincorporated business, there are no social security or Medicare taxes on the child's pay. Wages paid to the child are also deductible. Just make sure the compensation is reasonable for the work actually performed.

2. Track your business driving. For 2012, the rate for business-related mileage is 55.5 cents per mile, and you can deduct actual costs for parking fees and tolls in addition to mileage. Keep detailed records to substantiate your deduction.

3. Deduct equipment purchases. You can expense up to $139,000 of business equipment purchased this year.

4. Check your benefits. If you offer health benefits to your employees, look into tax-advantaged plans such as health savings accounts, flexible spending accounts, or health reimbursement arrangements. These plans can reduce your taxes and help control your benefit costs. Also, check the new tax credit for health insurance you provide to employees. You must meet certain requirements to qualify.

5. Establish a retirement plan if you don't already have one. Examining the choices now gives you time to select the best plan for your business and to get the paperwork completed. Then you'll be set to make contributions as your cash flow allows -- and to take the deduction on your 2012 tax return. Another plus: You may be able to claim a credit on this year's tax return for the costs of establishing the plan.

To discuss the tax-saving ideas best suited for your business, give us a call.

Starting a business? Don't make these mistakes

According to the Small Business Administration, a third of small businesses fail within the first two years. Over half fail in the first five years. So if you're thinking about starting a small business, it pays to take an honest look at yourself, your business idea, and the marketplace. You can increase the odds that your business will survive by avoiding three very common mistakes.

*** Mistake # 1: Not enough cash.** If you're starting out, it's a good idea to accumulate -- before you enter the marketplace -- a cash reserve that's about three times your estimated need. Small businesses often face down times, when sales aren't exactly stellar and revenues slow to a trickle. Also, unforeseen expenses for insurance, staff, buildings, advertising, taxes (the list goes on and on) can cripple your business and shut it down before it's out of the starting block. Extra cash can make the difference between a survivor and a statistic. A reserve fund provides an extra bit of cushion to keep the business operating as you work toward the next sales goal.

*** Mistake # 2: Inadequate planning.** Building a business is like building a house. You need a foundation, clear goals, and an implementation strategy. Where do you want to be a year from now and beyond? If people built houses with as little foresight as many startup businesses put into planning, you'd see a lot more folks camping in their basements. Developing a sound business plan means doing solid research. It means understanding the marketplace, knowing what sets your product apart, getting a grip on the costs to implement your plan. An idea is not a business plan. You need to flesh out the idea and get down to specifics.

* **Mistake # 3: Inflexibility.** Once you've developed your business plan, be willing to adapt it to changing conditions. More than a few businesses have started with a great business model, but failed to modify that model when market conditions evolved. If your customers or competitors change (and they will over time), don't be afraid to change with them.

If you're considering starting a small business and would like assistance, give us a call.

What's New in Finances

Health Savings Account limits for 2013 announced

Health Savings Accounts (HSAs) allow taxpayers with high-deductible health insurance to set aside tax-deductible dollars that can be used tax-free to pay unreimbursed medical expenses.

If you have an HSA, you'll be able to contribute more in 2013, thanks to the inflation-adjusted limit recently announced by the IRS. The amount you can set aside in 2013 will increase to $3,250 for an individual and to $6,450 for a family. If you're 55 or older, you're allowed an additional $1,000 contribution.

For 2013, a high-deductible health plan is one with an annual deductible that is not less than $1,250 for self-only coverage or $2,500 for family coverage. Annual out-of-pocket expenses cannot exceed $6,250 for self-only coverage or $12,500 for family coverage.

What are your options for taking social security benefits?

When should you start taking social security? If you're approaching retirement and are eligible for social security, you have three broad options for drawing your benefits: start early, wait until your "full" retirement age, or hold out a few years longer to qualify for the monthly maximum.

*** Early withdrawals**

Starting your withdrawals at the earliest allowable date (age 62) may be a good idea if you (a) plan to stop working or cut back to part-time status, and (b) really need the income. Your health is also a consideration, since an early start will maximize your lifetime benefits if your life expectancy is much below eighty.

Selecting early retirement will permanently reduce the amount you receive each month. In addition, until you reach full retirement age, your benefits will be cut by one dollar for every two dollars over $14,640 that you earn (as of 2012). Consequently, if you're in good health, don't need the extra income, and/or plan to keep on working, you're generally better off postponing your benefits until full retirement age or beyond.

*** Full retirement age**

Full retirement age is 66 for workers born between January 1, 1943, and December 31, 1954. For those born later, the age limit gradually increases to 67.

Once you've reached full retirement age, your social security benefits are no longer reduced by any amount of earned income. If you've waited to start your benefits, your monthly income will be greater than under early retirement, although less than you'd get by waiting until age seventy.

*** Maximum retirement age**

If you wait until age 70 to begin drawing social security, your monthly benefits will be maximized for the rest of your life. This option is generally the best choice for people who are in good health and who can afford to wait. The disadvantage is that political factors might cause changes to the program in the interim.

*** Other factors**

Although the above three ages are the major milestones, the years between are also important, since each year you wait will increase your monthly benefit. If you're now working for a relatively high income, your overall benefits will increase even more because they're recomputed annually based on your highest earning years.

Other considerations include your marital status, the relative ages and earnings of each spouse, and expected survivor benefits. The potential variables are too complex to address here, but if you're interested in planning for your own retirement, just call our office to schedule an appointment.

Take a Break

Knowledge vs. wisdom...

Knowledge is knowing a tomato is a fruit. Wisdom is not putting it in a fruit salad.

The information contained in this newsletter is of a general nature and should not be acted upon in your specific situation without further details and/or professional assistance. For more information on anything in the Online Advisor, or for assistance with any of your tax or business concerns, contact our office.