

The Kiplinger Tax Letter

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Dear Client:

Washington, Nov. 10, 2011

Corporate tax reform won't be easy to pass. Even though Rep. Dave Camp (R-MI), the chairman of the House Ways and Means Com., has put his plan on paper, he still hasn't filled in all of the details. And a new report by the Joint Com. on Taxation shows how difficult the road to tax reform will be.

Camp's plan sets a 25% top corporate rate, down from 35% now. The goal is to help U.S. firms compete in the global marketplace, because tax rates in most developed countries are lower. As a result, many multinational firms have shifted jobs overseas. Camp would retain the 15% corporate bracket on the first \$50,000 of taxable income. He would recapture the tax savings from the lower bracket via a 5% surtax on income between \$100,000 and \$200,000. Currently, recapture occurs above \$1 million. Personal service corporations would also get the benefit of the 25% maximum rate.

Camp wants to completely revamp how multinational corporations are taxed. His proposal would impose a territorial tax system, so, as a general rule, only income that was earned within U.S. borders would be subject to U.S. income tax. The present system taxes income worldwide and allows a credit for income taxes paid to other countries. Under current law, profits from abroad are taxed when repatriated. Camp's plan would subject 5% of those dividends to U.S. tax upon repatriation. He'd impose rules to nix hanky-panky with transfers of intangibles, such as patents, and limit interest deductions if domestic operations were heavily loaded with debt.

But the Camp plan doesn't say which corporate tax breaks would be nixed to achieve the desired 10-percentage-point reduction in the maximum corporate rate. The Joint Com. on Taxation has pinpointed how to trim the top rate to 28%, three percentage points above the rate Camp is eyeing. Look at what would be cut:

The 9% domestic production deduction against income from U.S. activities.
Fast depreciation. The much slower depreciation schedules under the AMT would apply for regular tax purposes. That would significantly reduce write-offs.
Deducting R&D expenses. The credit for these costs would be preserved.
A batch of tax-saving accounting rules...the LIFO inventory method, the lower-of-cost-or-market method and the completed-contract method of accounting.
Energy credits...solar, geothermal, wind, biomass and renewable resources.
Oil & gas breaks...percentage depletion plus expensing of exploration costs.
Deferring tax via like-kind exchanges, but only for swaps by businesses.
Special tax credits...for low-income housing and rehabbing old buildings, together with the FICA tip credit that restaurants can claim on their servers.

Changes of this magnitude won't be made overnight. There will be sniping between winners and losers, and companies that have relied on these tax breaks will seek favorable transition rules. Remember, the 1986 tax overhaul took two years.

HIGHLIGHTS

[Year-End Planning](#) Business tips

[Medicare](#) Premiums for 2012

[Estate Taxes](#) Deducting interest

[Real Estate](#) Home buyer credit quirk

[Business Taxes](#) Fringe benefits

[Preparers](#) Competency test details

**YEAR-END
PLANNING**

Now let's turn to practical ways your business can save taxes right away, with the end of the calendar year less than two months away. Moves made between now and the end of the year can save you and your company plenty of taxes.

If you are buying assets, it usually pays to put them in service by Dec. 31.

The reason: 100% bonus depreciation. Firms can write off the entire cost of qualifying assets placed in use this year, even for assets purchased in late Dec. They can take bonus depreciation on new assets with useful lives of 20 years or less... machines, equipment, land improvements and farm structures such as chicken coops. Leasehold improvements made to the interiors of commercial realty are eligible, too. The bonus depreciation percentage is scheduled to fall to 50% for assets put in use in 2012, although there is a good chance Congress will extend the 100% write-off because of the weak economy. Even if that occurs, putting a qualifying asset in service in 2011 rather than in 2012 accelerates the income tax benefit from the deduction.

New heavy SUVs put in service in 2011 are entitled to a huge tax break:

You can write off 100% of the cost if no personal use is made of the vehicle, thanks to 100% bonus depreciation. SUVs must have loaded gross vehicle weights over 6,000 pounds to qualify for this break. The \$25,000 ceiling on expensing SUVs doesn't apply if you take bonus depreciation. Used SUVs don't get bonus depreciation. And you can fully write off new pickup trucks with loaded weights over 6,000 pounds. Ditto for used heavy pickup trucks if the cargo bed is at least six feet in length.

For lighter vehicles, the maximum write-off in the first year is \$11,060.

Expensing is also available for assets placed in service by Dec. 31.

If you are putting used assets in service, you cannot claim 100% bonus depreciation on them, but those assets are eligible for expensing. For 2011, firms can expense up to \$500,000 of the assets' cost. Although this cap is supposed to fall sharply after 2011, Congress is likely to keep the higher cap for 2012. The \$500,000 ceiling is reduced dollar for dollar after more than \$2 million of assets are placed in service.

Buying too many assets in the last quarter can cost you some write-offs

on property that isn't eligible for bonus depreciation. If you make more than 40% of your 2011 asset purchases after Sept., regular depreciation on all assets put in use in 2011 is figured on a quarterly basis. So assets you buy in late 2011 get 1½ months of depreciation instead of six months' worth. This rule does not apply to buildings.

Business owners can shift income and expenses between 2011 and 2012.

Professionals can opt to delay year-end billings. Or they can speed them up if they expect to be in a higher tax bracket next year. Since 2012 is an election year, we don't think that lawmakers will be increasing income tax rates for any filers.

Firms can shift expenses from one year to another to tweak their income.

However, the Revenue Service will balk if there is too much distortion of earnings.

Owners can delay paying year-end bonuses so they aren't taxed until 2012.

But this doesn't work for a majority owner if the bonus amount is fixed during 2011 and the firm has the cash to pay it...the owner is in constructive receipt of the money.

Deductions for accrual method firms are limited. They can't deduct bonuses in 2011 that are deferred to 2012 by owners of more than 50% of regular corporations or by owners of any interest in an S corporation, personal service firm or partnership.

And weigh taking dividends in lieu of salary. This pays off if the corporation is in a low tax bracket and the owner is in a high bracket. The owner's tax savings due to the 15% top rate on dividends plus the payroll tax savings on the dividend can exceed the extra tax the corporation pays because the dividend isn't deductible. This won't work for S firms. Or for personal service firms...they pay a flat 35% tax.



MEDICARE In 2012, the basic Medicare Part B premium will rise to \$99.90 per month, up from \$96.40 currently. However, this will be a reduction for seniors who first enrolled in 2010 or 2011. Their monthly premium for 2011 was higher. Upper-income seniors still will pay a significantly larger Part B premium if their modified adjusted gross incomes for 2010 exceeded \$170,000 for couples and \$85,000 for single persons. Modified AGI is AGI plus any tax-exempt interest, EE bond interest that's used for education and excluded foreign earned income. And higher-income seniors will also owe a surcharge on Part D premiums for coverage of their prescription drug costs. This table summarizes the impact:

| For Marrieds | | | | For Singles | | | |
|------------------------------|--------------|--|--|------------------------------|--------------|--|--|
| If your 2010 modified AGI is | | Your 2012 monthly Part B premium will be | Your 2012 monthly Part D surcharge will be | If your 2010 modified AGI is | | Your 2012 monthly Part B premium will be | Your 2012 monthly Part D surcharge will be |
| More than | But not over | | | More than | But not over | | |
| \$170,000 | \$214,000 | \$139.90 | \$11.60 | \$85,000 | \$107,000 | \$139.90 | \$11.60 |
| \$214,000 | \$320,000 | \$199.80 | \$29.90 | \$107,000 | \$160,000 | \$199.80 | \$29.90 |
| \$320,000 | \$428,000 | \$259.70 | \$48.10 | \$160,000 | \$214,000 | \$259.70 | \$48.10 |
| \$428,000 | — | \$319.70 | \$66.40 | \$214,000 | — | \$319.70 | \$66.40 |

Marrieds filing separately will be hit hard if they lived together at any time in 2010. Those with modified AGIs over \$85,000 and up to \$129,000 will pay \$259.70 a month for Part B and a \$48.10 surcharge for Part D per month. And if their modified AGI topped \$129,000, the premium and surcharge will go to \$319.70 and \$66.40 a month.

MEDICAL EXPENSES IRS concedes that the cost of a sex change operation is a medical expense. It will follow a 2010 Tax Court case that allowed a man who was diagnosed with gender identity disorder to deduct the cost of sexual reassignment operations and hormone therapy incurred to become a woman. The Revenue Service now agrees that this disorder is a disease, so the treatment costs can be taken on Schedule A.

ESTATE TAXES Interest on a related-party loan to pay federal estate taxes is deductible as an administration expense. A decedent's estate plan used a trust to pay the estate's debts and federal estate taxes, with the balance to be distributed to subtrusts for his kids. But the estate lacked liquid assets to pay the estate taxes, so the trustees ended up borrowing the money from a related trust that they oversaw. They negotiated a 15-year balloon loan at the same rate quoted them by a bank. The loan terms barred prepayment. The Tax Court OK'd the estate's up-front write-off of all interest due on the loan. In its view, the debt was bona fide and was incurred to avoid having to sell assets at a reduced price (Est. of Duncan, TC Memo. 2011-255).

REAL ESTATE You needn't move into a home right away to take the home buyer credit, the Tax Court says. In 2008, a first-time purchaser bought a residence that needed renovating before he could occupy it. The buyer used the proceeds from the credit to fund the construction, but stopped all work the following year after IRS nixed his claim. The Court ruled that he was entitled to the tax credit because he planned to use the home as his principal residence once the renovations were completed, even though he had not yet moved in (Woods, 137 TC No. 12).

FOREIGN MEETINGS Add Panama to the list of countries that can host tax deductible conventions, now that it has signed a treaty to fully swap tax information with the U.S. Meeting participants needn't show that it is as reasonable to meet in Panama as it is in the U.S. See Revenue Ruling 2011-26 for the complete list of deductible locales.



BUSINESS TAXES

Employer-provided iPads and other tablets qualify as tax free fringes, according to informal statements of IRS officials, the same as cell phones that employers provide to their employees. Thus, as long as the iPads or tablets are given to employees primarily for business, personal use will not be taxable. The same goes where firms reimburse for the usage of employee-owned iPads.

Repeal of the 3% withholding on government contracts is a bit closer.

The Senate is debating a bill to nix this withholding, which is currently scheduled to begin in 2013. The measure will also have another easing that businesses will like: A tax credit for hiring unemployed veterans. Obama proposed this in his jobs plan, and it's one of the few provisions that Republicans support. Firms would get a credit of up to \$2,400 for hiring veterans who've been unemployed for at least four weeks, and up to \$5,600 for vets out of work six months or more. The credit is even higher if the unemployed vet is disabled. This new break would take effect upon enactment.

The Service won't penalize filers of incorrect Form 1099-Ks, except in cases where filers acted in bad faith. This relief applies only to filings for tax year 2011. Early next year, credit and debit card firms will issue 1099-Ks on payments made to merchants in 2011. Third-party networks such as PayPal must file 1099-K forms for payees with over 200 sales transactions and over \$20,000 in annual sales volume.

And backup withholding has been postponed until 2013, the agency says. If a merchant doesn't give a valid tax ID number, 28% backup withholding is triggered. Although withholding was supposed to apply to payments to merchants after 2011, the IRS delayed it a year to give payers more time to develop appropriate systems.

REFUNDS

IRS won't be issuing tax refunds on debit cards in 2012. The pilot program the agency initiated in 2011 that gave some low- and middle-income filers a debit card refund option drew yawns from taxpayers, so it has been terminated.

PREPARERS

Unenrolled preparers can now set up a date for taking the competency test if they have preparer tax ID numbers, according to a bulletin from Prometric, the company IRS selected to administer the exam. Applicants will have 2½ hours to finish the test, which will consist of 120 multiple-choice and true-false questions. Go to www.kiplinger.com/letterlinks/infobulletin to see an outline of the areas covered in the exam, a list of recommended study materials and the rules for taking the test.

Remember, preparers who pass the test can prepare all types of returns, even though the exam covers only the 1040. IRS does not plan to expand the test.

And the Service has put the fingerprinting requirement on hold for now. That's good news for unenrolled preparers and supervised nonsigning preparers.

Enrolled retirement plan agents won't have to get a preparer tax ID number if the only tax returns they prepare for compensation are in the Form 5300 series or 5500 series, according to the Service. This change is effective immediately.

IRS is ratcheting up scrutiny of problem preparers...sending out letters to those who have committed a high number of mistakes on Schedules A, C or E. Those letters will start going out soon. Another mailing will target preparers of questionable earned income credit claims. Those with the highest error rates will get more than just warning letters. They will be visited by revenue agents.

Yours very truly,

The Kiplinger Editors

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