

# Tax Talk

*A quarterly publication of Bridges & Dunn-Rankin, LLP*

## Inside this issue:

Year-end Tax Planning Strategies	1
Member in the Spotlight – Scott Fincher	2
IRS Settlement Offer for Misclassified Workers	3
Client in the Spotlight – ChildPlus Software	3
The Presidential Candidates and Their Tax Proposals	3
Increased Work Opportunity Tax Credit for Veterans	4
Quick Notes	4

Dear Clients and Friends,

You may have noticed that the Bridges & Dunn-Rankin logo and color scheme on the mailing label (and back page) of this issue are different. The old brown-on-sand which I came up with 18 years ago (with a little help from our friends at FolioZ) was designed to make our brand new firm look like we had been around forever. Some 17+ years later, the designer updating our website convinced us that we needed a “fresher” look. The advice and service you have come to expect won’t change; just the logo and colors.

This is the time of the year when year-end tax planning takes center stage in our practice. Virtually all individuals and most business entities have a December 31 year end for tax purposes, so December 31 marks the deadline for a lot of potential tax-saving actions. Accordingly, as in past years, we will devote a significant part of our last newsletter issue of the year to year-end tax planning strategies.

We will also discuss the presidential candidates and their tax proposals, an increased tax credit for hiring veterans, and an IRS settlement offer on workers misclassified as independent contractors, and, as always, highlight a member of our firm and one of our clients.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

*Kent Bridges*



Kent Bridges,  
Managing Partner

## Year-end Tax Planning Strategies

Late November through year end is the time for year-end tax planning. While every client’s situation is unique, here are some of the more common strategies we employ.

*Harvesting of capital losses* – Capital losses can, for the most part, only be deducted against capital gains. And while capital losses can be carried forward, for individuals they cannot be carried back to previous years. Accordingly, it is generally a good strategy to go ahead and recognize any potential capital losses you have, at least up to the amount of your capital gains for the year. If you have a significant capital gain from earlier in the year (e.g. from the sale of a business), it is important to realize these losses for tax purposes before year end in order to be able to deduct them against the capital gain.

*Timing of payment of state income taxes* – There seems to be a commonly-held belief that you should always accelerate the payment of your state income taxes into December in order to get the tax deduction in the current year. While that is sometimes a good strategy, such is not always the case. Individuals in the alternative minimum tax (AMT) posture receive no Federal tax benefit from their payment of state income tax. By running tax projections for the current and upcoming year, you can determine the optimal timing for payment of state income tax, sometimes resulting in a substantial permanent tax savings.

*Use of tax credits to minimize state income tax* – There are various tax credits which can be utilized to minimize or avoid state income tax. Some (e.g. the Georgia jobs credit, research credit and retraining credit) must be generated by a business entity, some can essentially be purchased (e.g. the Georgia low-income housing credit and the film credit), and others are based on taking some sort of action which the government is encouraging (e.g. the Georgia credit for donations to Student Scholarship Organizations).

*Timing of charitable donations* – It is generally advantageous to time significant charitable donations to coincide with a year in which you have significant income and are in a higher rate bracket. Because of the percentage of income limitations on charitable donation deductions (e.g. 50% of income for cash donations and 30% of income for donations of appreciated property) and the inability to carry the deduction back to earlier years, making a substantial donation in the year after a big gain can potentially result in the permanent loss of a tax benefit versus having made the donation in the same year as the substantial gain. On the other hand, if you have charitable carryforwards that are in danger of expiring, deferring additional donations to the next tax year may be prudent.

*Estimated tax payments* – In order to avoid a penalty, you are

*(Continued on page 2)*



Scott A. Fincher, CPA

### Member in the Spotlight – Scott Fincher

Scott Fincher holds a Bachelor of Business Administration degree in Accounting from Georgia State University and a Master of Accountancy from the University of Georgia with a specialization in Taxation. After spending seven years working in industry, Scott returned to school to seek a graduate degree and pursue a career in public accounting.

Prior to joining Bridges & Dunn-Rankin 3 1/2 years ago, Scott worked in the accounting department of a regional homebuilding and land development

company located in the Atlanta area. His areas of specialty were cost accounting, general ledger accounting and management reporting for construction, development and real estate marketing.

Scott, his wife Melissa, a sales representative for a commercial printer, and their two sons reside in the Dunwoody area.

Bridges & Dunn-Rankin is proud to have Scott Fincher as a member of our firm.

### Year-end Tax Planning Strategies – continued

*(Continued from page 1)*

generally required to pay in through withholding or quarterly estimated tax payments the lesser of 90% of your current year tax liability or 110% of your prior year tax liability. With respect to estimated tax payments, you get credit the day you actually make the payment. Withholding, however, is generally deemed to have occurred ratably throughout the year, regardless of when actually withheld. Accordingly, if you realize late in the year that you have a shortfall for earlier quarters, you can sometimes avoid the penalty by increasing your withholding late in the year; e.g. having all of a year-end bonus withheld for taxes.

*Acceleration or deferral of income and deductions* – Businesses which use the cash basis of accounting for income tax purposes often have a great deal of control over the timing of income and deductions. Shifting income from a high-rate bracket year to a low-rate bracket year can obviously result in a permanent tax savings.

*S-corp and LLC basis and at-risk limitations* – In general, you can deduct your share of losses from S-corps, LLCs and partnerships, and distributions from such entities are generally tax-free. However, the ability to deduct losses or receive tax-free distributions is limited by the “basis” and “at-risk” rules. Basically, the amount of loss you can deduct or distributions you can receive tax free is limited to your unreturned investment in the entity (including past undistributed profits and, in the case of partnerships and LLCs, your share of the entity’s liabilities which are either bank debt on a real estate project or debts for which you are personally liable). With respect to flow-through entities in which you own a stake, you should review your basis and at-risk amounts prior to year end to determine whether any tax advantage can be gained by increasing such amounts and whether such is prudent from an economic standpoint.

*Exercise of ISOs in year not in AMT* – “Incentive stock options” (ISOs) hold out the promise of being able to potentially convert what would otherwise be ordinary income (taxed at the highest rates) into long-term capital gain (taxed at more favorable rates). However, because the bargain element is an “alternative minimum tax” (AMT) adjustment on the date of exercise, the AMT often eliminates much of the hoped for benefit. A tax year in which you will not be in the AMT represents an opportunity to exercise some ISOs at no tax cost, meaning a potential permanent tax savings if you hold the stock for the requisite period of at

least one year from date of exercise and two years from date of grant.

*Sale of ISO shares that have fallen in value* - If you exercise ISOs and sell in the same tax year, then the AMT issue goes away. Accordingly, we typically advise our clients who want to exercise and hold ISOs to do so early in the year, giving us almost a full year to watch the stock price and to sell the stock before year end if necessary in order to cure the AMT problem.

*Bonus first-year depreciation* – For most new depreciable assets (other than buildings) placed in service during 2011, 100% of the cost can be expensed immediately, with the balance recovered under the regular depreciation rules.

*Section 179 expense* – Small companies (which for these purposes means those which have purchased less than \$2,000,000 in furniture and equipment) can elect to immediately expense up to \$500,000 of the cost of furniture and equipment against otherwise taxable profit. Because of the 100% bonus depreciation rules which apply for 2011 (see paragraph above), the section 179 provision (with its limitations) is not as important as usual for 2011. However, while only “new” assets are eligible for bonus depreciation, “used” assets can qualify for section 179 expensing.

*Selection of accounting methods* – New businesses can, within certain limitations, select the tax accounting methods (e.g. cash or accrual) which are most beneficial for them. And existing businesses have some latitude to later change their accounting methods. Your situation should be reviewed each year in order to determine which accounting methods are most advantageous for you.

*Net operating loss carryback claims* – Tax operating losses can generally be carried back to recover tax paid in previous years. Accordingly, if you will have a tax loss for the current year and paid tax at a high rate in previous years, then maximizing your current year tax loss may be advantageous.

*Conversion of IRA to Roth status* - With a traditional deductible IRA, you get a tax deduction on the front end when you make the contribution, but then are subject to ordinary income tax rates on any withdrawals (with an additional 10% penalty generally applying if you make withdrawals before age 59 ½). With a

*(Continued on page 3)*

## Year-end Tax Planning Strategies – continued

*(Continued from page 2)*

nondeductible traditional IRA, you get no tax deduction on the front end and then are subject to ordinary income tax rates on a portion of your withdrawals (the portion representing the income earned by the IRA account). With a “Roth IRA”, you get no front-end tax deduction but the appreciation in value permanently escapes tax. Traditional IRAs can be converted to Roth IRAs. The conversion is a taxable event, so careful planning is necessary to determine if a conversion makes sense for you.

*Utilization of annual gifting exclusion* – With respect to the estate and gift tax, there is an annual exclusion which permits you to give up to \$13,000 per year per donee, without incurring any gift tax or eating into your lifetime exemption against such.

## IRS Settlement Offer on Workers Misclassified as Independent Contractors

The IRS has launched a new Voluntary Classification Settlement Program (VCSP) that permits employers to prospectively reclassify as employees workers they have classified (possibly erroneously) as independent contractors in the past, while limiting their exposure to tax, penalty and interest for past years.

To be eligible for the VCSP, the employer must have consistently treated the workers as nonemployees, must have filed all required 1099s for the workers for the previous three years, and must not be under audit by the IRS or under a worker classification audit by the DOL or a state agency.

## Client in the Spotlight – ChildPlus Software

ChildPlus Software was started in 1985 by Tom and Marsha McMurrain to provide software for Head Start agencies. Head Start is a program of the US Department of Health and Human Services that promotes school readiness by enhancing the social and cognitive development of children through the provision of educational, health, nutritional, social and other services to enrolled children and their families.

ChildPlus.net, the nation’s most widely used Head Start program management software helps agencies achieve compliance, boost productivity and improve performance.

Today, under the leadership of David McMurrain, ChildPlus

## The Presidential Candidates and Their Tax Proposals

The next Presidential election is less than a year away, and taxes and the economy will likely play a significant role. Here is a brief look at the major candidates’ position on taxes, and what the future may hold.

*President Obama* – Mr. Obama would permit the “Bush tax cuts” to expire for higher income individuals. This would mean that effective for 2013 the highest marginal rate on ordinary income and dividends would increase to 39.6% and the rate on long-term capital gains would increase to 20%. Combined with the new Medicare taxes which were included as part of the healthcare legislation, state income tax, and self-employment tax

For married couples electing gift-splitting, this amount is effectively doubled to \$26,000 per year per donee. For those with a significant number of potential heirs, this represents an opportunity to remove a significant amount of value from their taxable estate, especially where gifting assets that may be subject to discounted valuation (e.g. an interest in a family partnership). The annual exclusion is on a use-it-or-lose-it basis with no carryover, so if you haven’t maximized your annual exclusion gifts yet for 2011, consider doing so before year end.

*Setting expectations and avoiding surprises* – One of the key advantages to engaging in year-end planning is that it enables you to appropriately plan your required cash outlay for taxes and avoid any unpleasant surprises at April 15 or any regrets as to actions that could have been taken by year-end but weren’t.

A taxpayer who participates in the VCSP (by filing an application on Form 8952) agrees to prospectively treat the class of workers as employees and pay 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year (as determined under the reduced rates of IRC section 3509). In exchange for this agreement, the employer will not be liable for interest and penalties on the liability, and will not be subject to an employment tax audit with respect to classification of the workers for prior years.

Software is used by more than 1,000 agencies, and the company has enjoyed growth in excess of 100% over the past three years.

Bridges & Dunn-Rankin is proud to be associated with ChildPlus Software.



or FICA, the marginal rate on investment income could exceed 50% and the marginal rate on earned income could exceed 60%. President Obama also favors limiting the value of itemized deductions for higher income taxpayers and retaining the estate tax with a \$3.5 million exclusion and a 45% rate.

*Herman Cain* – Mr. Cain has proposed a “9-9-9 Plan” which consists of a 9% corporate income tax rate, a 9% individual income tax rate, and a 9% Federal sales tax. The corporate income tax would be based on gross income less purchases from

*(Continued on page 4)*

## The Presidential Candidates and Their Tax Proposals – continued

(Continued from page 3)

other U.S. businesses, capital investments and net exports. The individual income tax would be based on gross income less charitable donations. There would be no payroll tax, no tax on capital gains or repatriated profits, and no estate tax. The 9-9-9 plan would be the first step towards complete elimination of the income tax in favor of a national sales tax.

**Newt Gingrich** – Mr. Gingrich proposes to extend the Bush tax cuts permanently, eliminate the tax on capital gains, reduce the corporate tax rate to 12.5%, permit 100% expensing of investments in new equipment, provide an optional flat tax rate of 15% for individuals (with deductions for charitable and mortgage interest), and repeal the estate tax.

**Rick Perry** – Mr. Perry proposes to give individuals a choice between the current tax system or a flat rate of 20%. The new optional system would permit deductions for mortgage interest and charitable donations. Dividends, capital gains and social security benefits would not be taxable, and the estate tax would be repealed. On the corporate side, the tax rate would be reduced to 20%, we would transition to a “territorial system” (whereby US companies do not pay US tax on profits earned abroad), and US companies could repatriate profits earned offshore in past years at a reduced rate.

**Mitt Romney** – Mr. Romney favors extending the Bush tax cuts, reducing taxes for the middle class, and repealing the estate tax. On the corporate side, he favors a lower rate (25%) with fewer deductions and credits and a “territorial system” for multinational companies.

**Stalemate** – Absent new legislation being enacted, effective January 1, 2013 the “Bush tax cuts” will expire. This could

### Increased Work Opportunity Tax Credit for Veterans

Recent legislation includes a “Returning Heroes Tax Credit” and a “Wounded Warriors Tax Credit”. Employers may be eligible for a credit of up to \$5,600 for each veteran they hire who has been unemployed for six months or more, or a credit of up to \$2,400 for each veteran they hire who has been unemployed more than four weeks but less than six months. Similarly, employers may be eligible for a credit of up to \$9,600 for each

mean an increase in the top individual rate to 39.6%, an increase in the tax rate on qualified dividends to 39.6%, and an increase in the long-term capital gains rate to 20%. It could also mean an increase in the estate tax rate to 55%, with a reduction in the exemption amount to \$1,000,000.

*What is likely to happen?* – Predicting the outcome of elections is dangerous, and predicting the future of tax legislation even more difficult. However, absent a significant turnaround in the economy, it seems that the Republicans have a very good shot at retaking the White House in 2012. Cain and Perry seem to be struggling at the moment. Gingrich is surging, but Romney may be the Republican with the best shot of defeating Obama. The Deficit Reduction Committee has been unable to reach any agreement on taxes. It seems quite possible that no significant tax legislation may be enacted before the 2012 elections, with a lame duck Congress passing another temporary extension of the Bush tax cuts. Longer term, it seems that we may be headed for a lower Federal corporate tax rate (e.g. 25% versus the current 35%) in order to make US companies more competitive with those abroad; with the trade-off being the elimination of various deductions and credits. A move towards a “territorial system” (whereby US companies do not pay US tax on profits earned abroad) is popular with many, as is the idea of a lower tax rate on repatriated profits. On the individual side, it seems that any significant reduction in rates will be difficult to accomplish without limiting or eliminating the deductions or exclusions for mortgage interest, charitable donations and employer-paid health insurance; and those three “tax expenditures” are all very popular. Most Republicans favor a repeal of the estate tax, but a compromise which involves an exemption in the \$3.5 - \$5 million range and a rate of 35% seems more likely.

veteran they hire who has a military service-connected disability and has been unemployed for six months or more, or a credit of up to \$4,800 for each veteran they hire with a service-connected disability who has been unemployed for less than six months. In each case, the amount of the credit is based on 40% of eligible wages.



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### Quick Notes

- For 2012, the Social Security wage base increases to \$110,100, the maximum permissible elective 401(k) deferral increases to \$17,000 (\$22,500 for those age 50 and older), and the maximum wage base for computing retirement plan contributions increases to \$250,000.
- The required 3% Federal tax withholding on payments to government contractors (which had been delayed until 2013) has now been repealed.

*The information provided in this newsletter is presented for educational and informational purposes only, and is not intended to constitute legal, tax or accounting advice. The articles provide only a very general summary of complex rules. For advice on how these rules may apply to your specific situation, contact a professional tax advisor.*

Bridges & Dunn-Rankin, LLP is an Atlanta-based full-service accounting firm serving clients in the technology, real estate, services, manufacturing, distribution, construction and healthcare industries, as well as high net worth families.