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Tax & Financial Newsletter

This ***Tax and Financial Newsletter*** has four parts: the five-step approach to saving income taxes; business ***Tax Tips!***; individual ***Tax Tips!***; and, investment ***Tax Tips!***.

THE FIVE-STEP APPROACH TO SAVING INCOME TAXES

Most tax planning strategies utilize one or more of the following to reduce taxes.

1. Exclude from taxation the income and gains that you can. Examples of income that can be excluded include tax-exempt interest, employer cafeteria plans, Roth IRAs, some capital gains, etc.

2. Defer income that you must report. Continuously identifying strategies to defer recognizing income is an excellent tax reduction strategy. Some of the easiest deferral methods are: contributing to a pension plan, delaying a sale until next year, using installment sales, and, like-kind exchanges, etc.

3. Reduce that which you must report. This involves taking advantage of all the deductions and credits to which you are entitled. Though this may seem obvious, available deductions and credits are not always readily apparent. Further, implementing minor changes will often yield nice tax savings with little effort.

4. Pay taxes on the rest. Some taxes simply cannot be avoided. Pay them.

5. Pay on the latest date possible without incurring penalties and interest. This includes strategically paying estimated tax payments, adjusting withholdings, and paying on the due date. Incurring penalties and interest for late payments merely off-sets tax saving strategies.

Updating and implementing the five steps each year will reduce your taxes. A good place to start is to calculate your 2013 taxes now, next consider the following ***Tax Tips!*** to reduce the 2013 taxes, and then start planning for 2014.

Business Tax Tips!

√ Bonus Depreciation and §179 Election: The tax climate for depreciating business equipment has been very favorable the last several years, including 2013. This year bonus depreciation allows taxpayers to expense 50% of their business equipment purchases.

A business may also want to consider making a "Sec. 179 election". It allows a taxpayer to *fully deduct* certain business equipment. However, the election has three limitations in exchange for a 100% write-off. First, $500,000 is the most a business can deduct under §179. Second, the election begins phasing out for purchases exceeding $2,000,000. Third, the §179 is curtailed to prevent a net operating loss (NOL). An NOL can be very valuable.

Bonus depreciation on the other hand can generate NOLs. Many times, a taxpayer would prefer not to have an NOL and "save" deductions until profits are generated. In those cases, a §179 is the preferable route. But in any event, purchasing business assets (especially automobiles) before year-end may be advisable as the depreciation rules are scheduled to be more restrictive for 2014.

The 50% bonus depreciation is expiring at the end of 2013 and the dollar limitations for §179 expensing are dropping dramatically to $25,000 in 2014 (as opposed to $500,000 for 2013), with a phase-out of $200,000 instead of $2,000,000.

Tax Tip! My opinion is the scheduled §179 decreases will be replaced with the more liberal limitations similar to 2013. §179 elections have a long history in the tax code and there always seems to be political support for it.

√ ***Home Office Deduction*:** A home office deduction is a good deduction for small businesses. Do not pass it up because of the perception it is "audit bait." A typical home office deduction is about $2,000 to $5,000. Expenses attributable to using the home office as a business office are deductible if the home office is used regularly and exclusively: (1) as a taxpayer's principal place of business for any trade or business; (2) as a place where patients, clients, or customers regularly meet or deal with the taxpayer in the normal course of business; or (3) in the case of a separate structure not attached to the residence, in connection with a trade or business.

√ ***Tax Basis**:* Make sure you have tax basis in all your partnerships, LLCs, and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods including loans and capital investments.

√ ***Active Participation:*** Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses.

√ ***Sale of Loss Entities:*** Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

√ ***Pension Plans:*** Set up pension plans before year-end and fund those plans. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2014 for a year 2013 tax deduction.

√ ***Small Employer Pension Plan Startup Cost Credit*:** For 2013, certain small businesses may claim a tax credit for expenses of establishing and administering a new retirement plan for employees. The credit applies to 50% of qualified administrative and retirement-education expenses for each of the first three plan years. The maximum credit is $500 per year.

√ ***Credit for Employee Health Insurance Expenses of Small Employers*:** Generally, if a business provides health insurance for its employees, and it employs less than 25 people, and the average wages are less than $50,000, a tax credit is available. The credit is as high as 35% of the cost of the health insurance!

√ ***Self-Employed Health Insurance Premiums*:** Self-employed individuals can claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and dependents. Tax savings may result by paying a January, 2014 premium in December, 2013.

√ ***S Corporation Built-In Gains (BIG) Tax*:** S corporations usually do not pay taxes. But, if an S corporation was formerly a C corporation, it may be subject to the BIG tax. The BIG tax can be triggered when "gain assets" are sold, but not held long enough. Absent Congressional action, it appears the holding period will increase to ten (10) years starting in 2014 from the current five (5) year holding period. Therefore, it may be advisable for S corporations to dispose of their built-in gain property before the end of 2013 to meet the shorter holding period limitations.

√ ***Payment by Check*:** Cash basis businesses can date checks before the end of the year and mail them right before January 1, 2014 to obtain a 2013 deduction.

√ ***Deferring Income to 2014*:** Deferring income is an excellent method to slow down the cash required for taxes. Not only do the current year taxes decrease, but, estimated tax payments for the following year can decrease. Some ways to defer income include: (1) electing the cash method of accounting versus the accrual method of accounting; many small businesses are reporting taxes on the accrual method when they could convert to the cash method; converting to the cash method can be made by the due date of the return including extension; (2) delay year-end billing to clients so that payments are not received until 2014; (3) take advantage of §1031 like-kind of exchanges for real estate; (4) electing the installment method of accounting; and, (5) delay selling gain assets until 2014.

√ ***Accelerating Income into 2013*:** If you are expecting a higher tax bracket next year or are in an unusually low bracket this year, consider accelerating income. Acceleration methods include: (1) selling gain assets before year-end; (2) taking distributions from pension plans; (3) converting a Roth IRA to a Traditional IRA; (4) electing out of the installment method of accounting; and, (5) elect slower depreciation methods and hold off deductions until next year.

Individual Tax Tips!

√ ***State Tax Payments:*** Pay your state estimated tax payment(s) that is due January 15, 2014 in late December. Consider paying all your state income tax liability before year-end. This strategy is especially useful if you have an unusually large increase in income for 2013. Keep in mind the alternative minimum tax may mitigate the advantages of paying state income taxes early.

√ ***Oklahoma Taxes:*** Pay close attention to your Oklahoma state income taxes and make sure you are claiming all the state tax benefits. Oklahoma has extensive state tax breaks that are not applicable to a federal return.

√ ***December W-2 Withholdings:*** Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your December paychecks.

√ ***Pension Plan Contributions:*** Increase your 401(k) contributions before year-end and take advantage of employer matching contributions.

√ ***Lower College Tuition by 5%:*** Take advantage of the Oklahoma §529 plans now by contributing to the plan in December, 2013 for January, 2014 college costs.

√ ***Charitable Contributions***: If you are short on cash, a 2013 charitable tax deduction is possible by charging the contribution on a credit card and paying for it in 2014. Also, consider gifting appreciated property to your charitable organization for a deduction equal to its fair market value.

√ ***Interest Expense:*** Careful planning of debt can otherwise convert non-deductible personal interest into deductible business, passive, investment, or home mortgage interest.

√ ***Single and Head of Household:*** If you are single and assist your parents financially, make sure you meet the support level test to file head of household instead of single.

Investment Tax Tips!

√ ***Short-Term Capital Gains:*** Capital gains on property held one year or less can be taxed as high as approximately 50%, which includes the regular tax rate, the new health care tax, and state income taxes.

√ ***Long-term capital gains:*** Long-term capital gains are taxed as high as about 30%, but for taxpayers not in the highest bracket, the tax rate can be as low as zero.

√ ***Dividend Taxes***: Qualifying dividends are taxed at long-term capital gains rates.

√ ***Defer the Sale:*** If you have a borderline holding period, consider holding the asset a little longer to take advantage of the favorable long-term capital gains rates.

√ ***Oklahoma Capital Gain Exclusion:*** If you have appreciated Oklahoma real property or own stock, partnership interest or LLC membership interests in companies that are located primarily in Oklahoma, the capital gain, under many circumstances, can be totally excluded from Oklahoma taxation.

√ ***Personal vs. Pension Plan Investments:*** If you have tax deferred retirement accounts and personal investments, and the investments in the two accounts are capital gain type items (growth stocks), and ordinary income generators (bonds, money markets, etc.), hold the ordinary income generators in the pension plans and the growth stocks personally.

√ ***Offset Gains***: Consider selling capital assets that will generate a loss to offset any capital gains recognized earlier in the year. Yet, be careful not to waste the benefits of long-term capital gains.

√ ***Avoid Fluctuations***: Refrain from having net capital gains in one year and net capital losses in the following year. Capital loss deductions can be limited to as little as $3,000 a year.