Getting ready to file for 2011 taxes and planning for rising tax rates in the future

By Daniel S. Gordon, CPA

As the saying goes, the only two certainties in life are death and taxes. Both are unpleasant topics; however, there are certain strategies to employ that can minimize the effects of the latter. You are on your own for the former. This article will explore what is needed to get ready for 2011 filing as well as strategies that can be employed in times of rising rates.

2011 Taxes

To help you keep your stress level to a minimum, you should check with your CPA to determine which deductions pertain to your situation and make sure you have backup documentation to support those deductions

First, you will need to have an accurate profit and loss statement and an accurate balance sheet for your business. All figures should be reconciled to bank statements. Most expenses that are reasonable and necessary to conduct your business are deductible. Some expenses, by definition, such as penalties, are not deductible. In addition, business meals and entertainment meetings are only deductible at 50 percent. For these expenses, you will need a business log that records the expense, who attended these meetings, and the business purpose of these meetings. If you are audited and you don't have these records, the deductions will be disallowed.

Accurate recording of asset acquisitions, such as vehicles and equipment, will allow you to maximize the depreciation deductions for these purchases. You should check with your CPA to determine if any new assets added in 2011 are eligible for Section 179 deduction (you can literally expense 100 percent of the purchase if the assets are eligible).

If you are a C Corp, your net income will be taxed at the corporate level using the corporate tax tables. Any dividend payments to owners will also be taxed at the individual level, thereby creating a double tax. Dividends are currently taxed at the long-term capital gains rate for 2011 and 2012. During 2013, dividends are scheduled to be taxed at ordinary rates. This can cost as much as an additional 24.6 percent, so be aware!!

If you are a sole proprietor, partnership or LLC taxed as a sole proprietorship, or partnership you will be taxed at the individual level only. Please note: You will be taxed on the profit without regard to whether or not you distribute these profits.

Planning for future increase in tax rates

Now that we have done everything we can to minimize 2011 taxes, what does the future hold? Higher taxes? This is a good possibility. Just ask our friends in Washington.

Conventional wisdom tells us to defer both death and taxes as long as possible. But, over the past couple of decades, the individual tax rate has trended downward. Deferring taxes in an environment where rates are either remaining constant or falling makes sense because at a minimum, you hold on to your money longer, capitalizing on the time value of the money. If rates are falling, that deferral lets you take advantage of the lower rate when you actually recognize the income for tax purposes.

So, is conventional wisdom relevant when taxes are rising? The answer is no. Deferring taxes is not a good strategy in periods of rising rates. For example, assume you are able to make a profit of $100 on a job that you have a choice to do in 2012 or 2013. Let’s also assume that you are in a 25 percent tax bracket. The current tax rates, known as the Bush-era tax cut rates, are set to expire at the end of 2012. If nothing is done in Washington, this 25 percent rate will increase to 28 percent in 2013 (there is talk to raise the rates even further, but let’s use the 28 percent). That means you would pay an additional $3 in taxes in 2013. So, here it would make sense to do that job in 2012 and not defer it until 2013.

A few tax planning ideas relevant in a rising tax environment

Realizing capital gains—Taxpayers who have appreciated property and are looking to sell that property will be taxed a maximum of 15 percent federally. That rate is expected to rise to 20 percent at the end of 2012. By selling the asset and recognizing the gain prior to the expected increase, you will pay less capital gains tax while rates are still low.

Choosing not to defer Income—If you are planning a large construction job or some other large ticket service and are expecting the tax rates to rise, you would be better off performing that job sooner rather than later. If you are a cash basis taxpayer, you will need to be paid prior to the rate increase date.

Deferring Expenses—Where you have the option of deferring an expense into the period where tax rates are rising, you should consider this: Deferring expenses has the exact opposite effect as deferring income; that is, if those expenses are taken when tax rates are higher, then you will shield more of your income from taxes.

Winter is usually when we start to think about taxes. This year, we not only have to think about pulling our information together to prepare for filing 2011 taxes, but we also need to consider the future tax increase environment that seems inevitable in this country. It’s important that you have a competent CPA, who understands the issues and, most importantly, understands the land care industry, on your side.

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