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TAX AND BUSINESS Alert™

October 2012

Lower Your Taxes by Purchasing a Business Vehicle

As we enter the final quarter of 2012, purchasing a new business vehicle may be an effective way to lower your 2012 tax bill. The tax code allows increased first-year depreciation limits for qualifying vehicles purchased and placed in service during 2012.

Taxpayers can claim up to an additional $8,000 of first-year depreciation (in addition to the normal maximum of $3,160) on automobiles in 2012, for a total maximum of $11,160. For light trucks, vans, and SUVs, the $8,000 additional first-year allowance is in addition to the normal maximum of $3,360, for a total maximum of $11,360. The vehicle must be new and purchased during 2012. Like the regular depreciation rules, the additional first-year depreciation is reduced proportionately when business use is less than 100%.

Heavy SUVs continue to receive favorable treatment under the tax laws. Business owners can expense up to $25,000 of the cost of a new heavy SUV (those with gross vehicle weight ratings between 6,001 and 14,000 pounds) purchased in 2012 and used more than 50% in their businesses. These vehicles qualify for 50% bonus depreciation in 2012. In addition, the rules that limit the amount of annual depreciation allowed on passenger automobiles do not apply to heavy SUVs. This means heavy SUVs are eligible for 50% bonus depreciation and unrestricted first-year depreciation, on top of the $25,000 that can be expensed.

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For example, the 2012 deductions for a new $50,000 heavy SUV purchased in 2012 and used 100% for business could add up to $30,000 (50% bonus depreciation of $25,000 plus the $5,000 first-year depreciation deduction). The maximum first-year depreciation deduction for a $45,000 passenger automobile placed in service during 2012 and used 100% for business is $11,160.

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The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Tax Calendar

October 15—Personal returns that received an automatic six-month extension must be filed today and any tax, interest, and penalties due must be paid.

—Electing large partnerships that received an additional six-month extension must file their Forms 1065-B today.

December 17—Calendar-year corporations must deposit the fourth installment of estimated income tax for 2012.

College Loan Repayment Plan Application Is Simplified

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Federal college loan borrowers have several repayment plan options. One option—Income-Based Repayment (IBR)—is about to get simpler.

Under IBR, required monthly payments are capped based on income and family size. Previously, applicants had to enter their income tax data onto the application. Now, the Department of Education is collaborating with the IRS so applicants can import their tax return data directly into the IBR application and submit it online. This will allow borrowers to complete the application in one sitting.

Visit **http://studentaid.ed.gov/repay-loans/understand/plans/income-based** for more information.

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Other heavy vehicles (non-SUVs with over 6,000 pounds gross vehicle weight) qualify for even more favorable treatment under the tax laws. Not only do these vehicles escape the rules that limit the amount of annual depreciation, they also qualify for a first-year expensing deduction of up to $139,000 for 2012. However, these more favorable rules only apply to vehicles that are not classified as SUVs under the tax law definition. This definition includes:

- Vehicles equipped with a cargo area of at least six feet in interior length. The cargo area cannot be readily accessible directly from the passenger compartment, but it can be either open or enclosed by a cab. Many pickups with full-size cargo beds will qualify for this exception, but "quad cabs" and "extended cabs" with shorter cargo beds may not qualify. So when you go to the dealership, be sure to pack a tape measure.
- Vehicles that seat more than nine passengers behind the driver's seat, such as a hotel shuttle van.
- Vehicles with an integral enclosure that fully encloses the driver's compartment and load carrying device; that do not have seating behind the driver's seat; and that have no body section protruding more than 30 inches ahead of the leading edge of the windshield, such as delivery vans.

For these heavy non-SUVs, businesses will often be able to write off the full cost of the vehicle. So, the 2012 deduction for a new $50,000 heavy non-SUV purchased in 2012 and used 100% for business could add up to $50,000.

Please contact us if you have questions or want more information on this tax-saving opportunity.

Fringe Benefit Rules for 2% S Corporation Shareholders

Employee fringe benefits paid on behalf of a 2% S corporation shareholder are subject to special rules. A 2% shareholder is one who owns more than 2% of the corporation's outstanding stock on any day of the corporation's tax year, considering direct and constructive ownership. Under the family stock attribution rules, a person is considered to own the stock owned by that person's spouse, children, grandchildren, and parents. However, stock that is constructively owned by one family member cannot be reattributed to a second family member when applying the family stock attribution rules to that second family member.

While there is some uncertainty regarding which fringe benefits are subject to these special rules, they appear to apply to adoption assistance programs, cafeteria plans, employee achievement awards, group-term life insurance coverage up to $50,000, health and accident insurance plans, health savings accounts, meals and lodging furnished for the convenience of the employer, medical reimbursement plans, disability plans, moving expense reimbursements, and transportation fringe benefits.

Fringe benefits not covered by the 2% shareholder rules (which include educational assistance programs, pension plans, and work-related fringe benefits) are deductible by the corporation, up to the limits specified by the relevant IRS Code section, and are excluded from the 2% shareholder's income.

Health and accident insurance premiums paid on behalf of a 2% shareholder are reported as additional compensation to the shareholder. The value (normally cost) of the fringe benefit is added to the 2% shareholder's wages. (However, the premiums can avoid employment taxes if made under a plan for employees and their dependents, or for a class of employees and their dependents.)

Since the 2% shareholder is not considered an employee for fringe benefit purposes, he or she cannot exclude the cost of the health insurance premiums from gross income as employer-provided coverage. However, the 2% shareholder may be able to claim the self-employed health insurance deduction. The deduction is not available for calendar months in which the 2% shareholder or spouse is eligible to participate in another employer-subsidized health insurance plan. Furthermore, the deduction is limited to the 2% shareholder's earned income (i.e., the social security wages the shareholder receives from the corporation). Any portion that exceeds the earned income limitation is deductible as an itemized deduction, subject to the 7.5% (in 2012) of AGI floor for itemized medical deductions.

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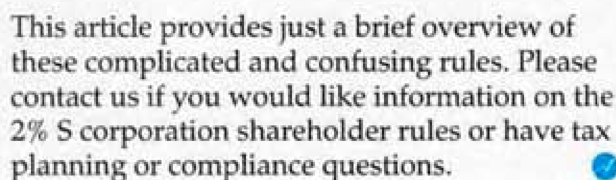
When taxable fringe benefits are included in wage income, all shareholders will share in the corporation's additional compensation deduction, according to each shareholder's percentage ownership in the corporation (under the normal per-share, per-day allocation rules). However, if one person owns all of the stock, his or her compensation is increased, but pass-through income from the S corporation is decreased by the same amount.

Fortunately, payments of health insurance premiums for shareholders will not be considered distributions for purposes of the one-class-of-stock rule. Furthermore, fringe benefit programs are not considered "governing provisions;" therefore, providing fringe benefits will not create a second class of stock unless they are part of a plan to circumvent the one-class-of-stock rule.



This article provides just a brief overview of these complicated and confusing rules. Please contact us if you would like information on the 2% S corporation shareholder rules or have tax planning or compliance questions.

Noteworthy 2013 Healthcare Provisions

The 2010 Healthcare Act included several significant tax changes scheduled to take effect next year. Listed below is information on two provisions that could impact numerous taxpayers. We have also noted what you can do before year-end to minimize the negative impact of these provisions.

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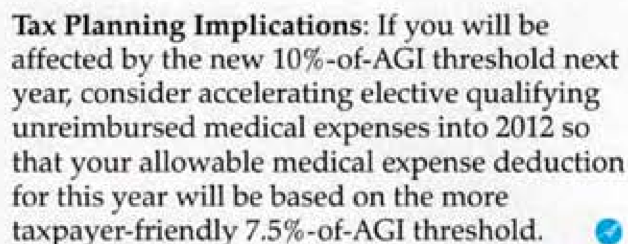
$2,500 Cap on Healthcare Flexible Spending Account (FSA) Contributions. Before the Healthcare Act, there was no tax-law limit on the amount you could contribute each year to your employer's healthcare FSA plan. That said, many plans have always imposed their own annual limits. Amounts you contribute to the FSA plan are subtracted from your taxable salary. Then, you can use the FSA funds to reimburse yourself tax-free to cover qualified medical expenses. Good deal! Starting in 2013, however, the maximum annual FSA contribution for each employee will be capped at $2,500.

Note: An employee employed by two or more unrelated employers may elect up to $2,500 under each employer's health FSA.

Tax Planning Implications: If you have an FSA plan, your employer will ask you near the end of the year to decide how much you want to contribute to your healthcare FSA for 2013. At that point, the new $2,500 contribution limit may affect you. Other than that, just make sure you use up your 2012 contribution before the deadline for doing so.

Higher Threshold for Itemized Medical Expense Deductions. Before the Healthcare Act, the allowable itemized deduction for unreimbursed medical expenses paid for you, your spouse, and your dependents equaled the excess of your qualified medical expenses over 7.5% of your adjusted gross income (AGI). Starting in 2013, the deduction threshold will be raised to 10% of AGI for most individuals. However, if either you or your spouse reaches age 65 by December 31, 2013, the new 10%-of-AGI threshold will not take effect until 2017 (in other words, the long-standing 7.5%-of-AGI threshold will continue to apply to those taxpayers for 2013–2016). Also, if you or your spouse turns age 65 in any year 2014–2016, the long-standing 7.5%-of-AGI threshold will apply for that year through 2016. Starting in 2017, the 10%-of-AGI threshold will apply to everyone.



Tax Planning Implications: If you will be affected by the new 10%-of-AGI threshold next year, consider accelerating elective qualifying unreimbursed medical expenses into 2012 so that your allowable medical expense deduction for this year will be based on the more taxpayer-friendly 7.5%-of-AGI threshold.

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