

Memo**To:** Vertical Advisors LLP Clients**From:** Peter V. DeGregori, CPA, MST, CGMA**CC:** Friends of the Firm**Date:** January 2, 2013 – Updated Based on Agreement by Congress on January 1, 2013**Re:** 2012 / 2013 Income Tax Planning / Tax Changes

Happy New Year!

This memo is a revision / update to our December 31, 2012 memo as Congress has concluded on some additional items. So if you haven't read our previous one, you can delete it and read this one. The 2012 tax return process will be delayed due to these last minute changes. The law must be written, then the IRS must update the forms.

Introduction:

I wrote most of this memo on December 21, 2012 and we are still here. So, now we will see how 2013 turns out. As you will read, our view based on working with our clients and listening to various economists, is that 2013 will be a growth year, but 2014 / 2015 might be slightly challenging as Congress will have to deal with the debt ceiling and spending cuts. Global competition still is a large factor for labor costs and states are getting even more competitive with income taxes and incentives to get more businesses in their states. We are telling our clients to be conservatively optimistic. We feel growing ones business and finances conservatively will be the best option due to the uncertainty ahead of us. And if we are wrong, our clients should end up with just more money in their banks.

Congress MUST address the national debt, so something must change, and it is likely that income taxes will increase. As we all know, Congress is still going back and forth about deciding on tax increases and spending cuts.

Most of us have had to make adjustments to our business and personal budgets to be fiscally responsibly, thus Congress should be held to the same standard. Since we don't know what the final conclusion will be at this moment, we will discuss some items of what we know will happen if nothing is changed. There are two main components: (1) The Bush tax cuts will expire on December 31, 2012 and Obama Care (formally known as the Affordable Care Act), will begin affecting US taxpayers on January 1, 2013. So, we will discuss these changes below.

Update: As of January 2, 2013, 9:00 a.m. (PST): - Congress passes fiscal cliff solution. Bill awaits President's signature. After much back and forth negotiations, fraught with the possibility of a deadlock and failure, the terms of the fiscal cliff resolution have finally been successfully negotiated. Early on January 1, 2013, the House of Representatives passed the H.R. 8, "The American Taxpayer Relief Act" bill by a vote of 257 to 167. Late the same day, the Senate followed suit by a vote of 89 to 8. The President is expected to quickly sign and enact the bill into law.

The major tax provisions are as follows:

- The income tax rate increases to 39.6% (up from 35%) for individuals making more than \$400,000 a year (\$450,000 for joint filers; \$425,000 for heads of household).
 - *See our table below. We are still waiting on how this may affect the investment tax (Obamacare tax). As of now the increase in the AGI for ordinary tax rates doesn't seem to adjust the Obamacare / investment tax calculations;*
- The two-percentage-point reduction in payroll taxes for Old Age, Survivors and Disability Insurance (OASDI) tax, commonly known as the Social Security tax, will be allowed to expire.
 - *This means beginning today, the reduced employee payroll tax amounts for social security and Medicare will revert back to the regular amount. The Employer portion was never reduced, so it will not change. See our discussion below;*
- The higher exemption amounts for alternative minimum tax (AMT)—the so-called "patch"—are made permanent, resulting in an estimated 30 million taxpayers not being subject to the AMT;
 - *The Act provides permanent alternative minimum tax (AMT) relief. The AMT is the excess, if any, of the tentative minimum tax for the year over the regular tax for the year. In arriving at the tentative minimum tax, an individual begins with taxable income, modifies it with various adjustments and preferences, and then subtracts an exemption amount (which phases out at higher income levels). The result is alternative minimum taxable income (AMTI), which is subject to an AMT rate of 26% or 28%.*

- *Prior to the Act, the individual AMT exemption amounts for 2012 were to have been \$33,750 for unmarried taxpayers, \$45,000 for joint filers, and \$22,500 for married persons filing separately. Retroactively effective for tax years beginning after 2011, the Act permanently increases these exemption amounts to \$50,600 for unmarried taxpayers, \$78,750 for joint filers and \$39,375 for married persons filing separately. In addition, for tax years beginning after 2012, it indexes these exemption amounts for inflation.*
- *Dividends and capital gains are taxed at 20% (up from 15%) for individuals making at least \$400,000 (\$450,000 for joint returns);*
 - *When accounting for Code Sec. 1411's (investment tax / Obamacare tax) 3.8% surtax on investment-type income and gains for tax years beginning after 2012, the overall rate for higher-income taxpayers will be 23.8%. (Under the EGTRRA/JGTRRA sunset provisions, long-term capital gain was to be taxed at a maximum rate of 20%, with an 18% rate for assets held more than five years, and dividends paid to individuals were to be taxed at the same rates that apply to ordinary income.) We still need clarity to see if this tax is only going to be assessed on AGI in excess of \$400,000 / \$450,000 as it seems as the investment tax applied to all income amounts.*
 - *For taxpayers whose ordinary income is generally taxed at a rate below 25%, capital gains and dividends will permanently be subject to a 0% rate. (Under the EGTRRA/JGTRRA sunset provisions, long-term capital gain of lower-income taxpayers was to be taxed at a maximum rate of 10%, with an 8% rate for assets held more than five years, and dividends were to be subject to ordinary income rates.) Taxpayers who are subject to a 25%-or-greater rate on ordinary income, but whose income levels fall below the \$400,000/\$450,000 thresholds, will continue to be subject to a 15% rate on capital gains and dividends. The rate will be 18.8% for those subject to the surtax.*

- The Personal Exemption Phase-out (PEP), which had previously been suspended, is reinstated with a starting threshold of \$300,000 for joint filers and a surviving spouse, \$275,000 for heads of household, \$250,000 for single filers, and \$150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. Under the phase-out, the total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by 2% for each \$2,500 (or portion thereof) by which the taxpayer's adjusted gross income (AGI) exceeds the applicable threshold;
- The "Pease" limitation on deductions (itemized deduction phase-out / limitation), which had previously been suspended, is reinstated with a threshold of \$300,000 for joint filers and a surviving spouse, \$275,000 for heads of household, \$250,000 for single filers, and \$150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. Thus, for taxpayers subject to the "Pease" limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which the taxpayer's AGI exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions;
- For estate, gift, and generation-skipping transfer (GST) tax purposes, for individuals dying and gifts made after 2012, there is a \$5 million exemption (adjusted for inflation);
 - However, the Act also permanently increases the top estate, gift and rate from 35% to 40%. The Act also continues the portability feature that allows the estate of the first spouse to die to transfer his or her unused exclusion to the surviving spouse. All changes are effective for individuals dying and gifts made after 2012.
- Depreciation: The following depreciation provisions are retroactively extended by the Act through 2014:
 - 15-year straight line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;
 - 7-year recovery period for motorsports entertainment complexes;
 - accelerated depreciation for business property on an Indian reservation;
 - increased expensing limitations and treatment of certain real property as Code Sec. 179 property.

- *This means the IRC section 179 amount of \$500k with a \$2M stays for 2013. Read more below.*
- This provision should allow for qualified leasehold improvements to be able to be qualified for section 179 deductions.
- special expensing rules for certain film and television productions; and
- the election to expense mine safety equipment
- The act also extends and modifies the bonus depreciation provisions with respect to property placed in service after December 31, 2012.
- •Various **Business tax breaks** were extended:
 - The Code Sec. 41 research credit is modified and retroactively extended for two years through 2013.
 - *If you are spending money on research and development, this credit can be very powerful. Don't neglect it.*
 - The temporary minimum low-income tax credit rate for non-federally subsidized new buildings under Code Sec. 42(b)(2)(A) is extended to apply to housing credit dollar amount allocations made before Jan. 1, 2014.
 - The housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds is extended two years.
 - The Code Sec. 45A Indian employment tax credit is retroactively extended for two years through 2013.
 - The Code Sec. 45D new markets tax credits are retroactively extended for two years through 2013.
 - The Code Sec. 45G railroad track maintenance credit is retroactively extended for two years through 2013.
 - The Code Sec. 45N mine rescue team training credit is retroactively extended for two years through 2013.
 - The Code Sec. 45P employer wage credit for employees who are active duty members of the uniformed services is retroactively extended for two years through 2013.

- The Code Sec. 51 work opportunity tax credit is retroactively extended for two years through 2013.
- Code Sec. 54E qualified zone academy bonds are retroactively extended for two years through 2013.
- The enhanced charitable deduction for contributions of food inventory under Code Sec. 174(e) is retroactively extended for two years through 2013.
- Allowance of the domestic production activities deduction for activities in Puerto Rico, for the first eight tax years of the taxpayer beginning after Dec. 31, 2005, and before Jan. 1, 2014.
- Exclusion from a tax-exempt organization's unrelated business taxable income (UBTI) of interest, rent, royalties, and annuities paid to it from a controlled entity under Code Sec. 512(b)(13)(E)(iv) is extended through Dec. 31, 2013.
- Treatment of certain dividends of regulated investment companies (RICs) as “interest-related dividends” is extended through Dec. 31, 2013.... Inclusion of RICs in the definition of a “qualified investment entity” under Code Sec. 897(h)(4) is extended through Dec. 31, 2013.
- The exception under subpart F for active financing income (i.e., certain income from the active conduct of a banking, financing, insurance, or similar business) under Code Sec. 953(e)(10) and Code Sec. 954(h)(9) for tax years of a foreign corporation beginning after Dec. 31, '98, and before Jan. 1, 2014, for tax years of foreign corporations beginning after Dec. 31, 2005, and before Jan. 1, 2014.
- Look-through treatment for payments between related controlled foreign corporations (CFCs) under the foreign personal holding company rules under Code Sec. 954(c)(6) is extended through Jan. 1, 2014.... Exclusion of 100% of gain on certain small business stock acquired before Jan. 1, 2014.
- Basis adjustment to stock of S corporations making charitable contributions of property under Code Sec. 1367(a) in tax years beginning before Dec. 31, 2013.
- The reduction in S corporation recognition period for built-in gains tax under Code Sec. 1374(d)(7) is extended through 2013, with a 10-year period instead of a 5-year period

- Various empowerment zone tax incentives, including the designation of an empowerment zone and of additional empowerment zones under Code Sec. 1391(d) (extended through Dec. 31, 2013) and the period for which the percentage exclusion for qualified small business stock (of a corporation which is a qualified business entity) is 60% Code Sec. 1202(a)(2) (extended through Dec. 31, 2018).
- Tax-exempt financing for New York Liberty Zone under Code Sec. 1400L(d)(2) is extended for bonds issued before Jan. 1, 2014.
- Temporary increase in limit on cover over run excise taxes to Puerto Rico and the Virgin Islands is extended for spirits brought into the U.S. before Jan. 1, 2014.
- American Samoa economic development credit, as modified, is extended through Jan. 1, 2014.
- A number of individual tax provisions have been retroactively extended through 2013. In addition, there is a five-year extension of credits that were enhanced as part of the stimulus, including the college tuition credit, the Code Sec. 32 earned income tax credit, and the Code Sec. 24 child tax credit;
- **Various energy related tax** breaks are also extended. These include:
 - **The nonbusiness energy property credit under Code Sec. 25C for energy-efficient existing homes is retroactively extended for two years through 2013. A taxpayer can claim a 10% credit on the cost of: (1) qualified energy efficiency improvements, and (2) residential energy property expenditures, with a lifetime credit limit of \$500 (\$200 for windows and skylights).**
 - Before you get excited please note that there is a current life time limitation of a credit of \$500.
 - Example: Taxpayer Y claimed a \$150 nonbusiness energy property credit for a qualified natural gas furnace in 2006. Y claimed no other nonbusiness energy property credit for any pre-2011 year.
 - For 2011, Y could claim a nonbusiness energy property credit of up to \$350 (\$500 – \$150), \$200 of which could be for windows.

- •The alternative fuel vehicle refueling property credit under Code Sec. 30C is retroactively extended for two years through 2013 so that taxpayers can claim a 30% credit for qualified alternative fuel vehicle refueling property placed in service through Dec. 31, 2013, subject to the \$30,000 and \$1,000 thresholds.
 - A qualified alternative fuel vehicle refueling property is defined by IRC 30C(c), which stated any fuel where at least 85% of the volume of which consists of one or more of the following: ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen.
 - Also any mixture which consists of two or more of the following: biodiesel, diesel fuel or kerosene and at least 20% of the volume of which consists of biodiesel determined without regard to any kerosene in such mixture.
 - Electricity
 - We are seeing more hotels / motels put in electrical charging stations to gain traffic to their facility. Those costs should qualify for this credit.
- •The credit for 2- or 3-wheeled plug-in electric vehicles under Code Sec. 30D (New qualified plug-in electric drive motor vehicle) is modified and retroactively extended for two years through 2013.
 - There seems to be a maximum credit and annual limitations.
 - The original use must begin with the taxpayer
 - Contact us for more information
- •The cellulosic biofuel producer credit under Code Sec. 40(b) is modified and extended one year through 2013.
- •The credit for biodiesel and renewable diesel under Code Sec. 40A is retroactively extended for two years through 2013.
- •The production credit for Indian coal facilities placed in service before 2009 under Code Sec. 45(e)(10) is extended one year. The credit applied to coal produced by the taxpayer at an Indian coal production facility during the 8-year period beginning on Jan. 1, 2006, and sold by the taxpayer to an unrelated person during such 8-year period and the tax year.

- •The credits with respect to facilities producing energy from certain renewable resources under Code Sec. 45 is modified and extended one year. A facility using wind to produce electricity will be a qualified facility if it is placed in service before 2014.
- •The credit for energy-efficient new homes under Code Sec. 45L is retroactively extended for two years through 2013.
- •The credit for energy-efficient appliances under Code Sec. 45M is retroactively extended for two years through 2013.
- •The additional depreciation deduction allowance for cellulosic biofuel plant property under Code Sec. 168(l)(2) is modified and extended one year.
- •The special rule for sales or dispositions to implement Federal Energy Regulatory Commission (FERC) or State electric restructuring policy for qualified electric utilities is retroactively extended for two years through 2013.
- •The alternative fuels excise tax credits under Code Sec. 6426(d)Code Sec. (5) and Code Sec. 6426(e)(3) for sales or use of alternative fuels or alternative fuel mixtures is retroactively extended for two years through 2013.

Pension Provision:

- For transfers after Dec. 31, 2012, in tax years ending after that date, plan provisions in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution under Code Sec. 408A(e).
 - This seems to allow taxpayers to roll over retirement plans to a Roth without having the roll over trigger an early distribution. Thus tax would need to be paid on the roll over amount.
 - This seems to be a revenue accelerator as the government would get the revenue now when a taxpayer converts versus when the retiree took the money on a distribution for retirement. One needs to carefully weigh this early taxation option. We generally feel that income tax should be deferred as long as possible.

Economy:

First, let's look at some economic discussions. Although we are not economists, we do work with business owners throughout the United States, and we have attended many economic conferences.

After listening to numerous economists, including Alan Beaulieu (a frequent Vistage International speaker), and economist and financial advisors from University California Irvine, and PIMCO, it seems as if the consensus is that income taxes will need to increase and spending must be reduced.

Well, as of today, we have seen the taxes increase, and the spending cuts are looming. Also, most economists that we listen to felt that 2013 will provide small growth due to the US debt and probably increase in taxation. Thus again, this is the BIG debate looming with Congress. Again these economists felt that a looming mild recession is expected in the near future (probably around 2014 / 2015) mainly due to Congress dealing with spending cuts, inflation, and increased interest rates. Thus we at Vertical Advisors are suggesting that our clients be cautiously optimistic.

This means to us that clients should take advantage of growth but be smart. Also they should be prepared to reduce costs if revenue drops. We suggest that every business owner be reviewing and analyzing monthly expected financial projections. This should allow the business owner to make better decisions. Business owners need to be smart and make smart business decisions and not emotional decisions. Too many businesses have closed due to the lack of proper financial planning and analysis. Contact us if you need help with this efficiency.

At Vertical Advisors, we are working with our clients to constantly budget for taxes, focus on the appropriate tax strategy, monitor cash flow and financial performance. This financial approach should enhance our client's financial performance and longevity. Constant review, at least monthly, can provide opportunity to make necessary adjustments and minimize failure. Now let's look at some changes:

Tax Changes:

We know the Bush tax cuts are going to expire, but let's review what that really looks like. This table now reflects the agreement by Congress to keep most of the current tax rates at the same current rate for income up to \$450,000. Here is a list of the expiration of the Bush tax cuts and the expected new rates for 2013. The AGI ranges may change slightly.

Percentage of filers	AGI Range	Current Tax Rate	Expected 1/1/2013 Tax Rates	Percentage of change	As of Jan. 1 st , 2013
19.7%	\$0 to \$17,450	10%	15%	5%	10%
36%	\$16,751 to \$68,000	10%	15%	5%	10%
16.4%	\$68,001 to \$137,300	25%	28%	3%	25%
3%	\$137,301 to \$209,250	28%	31%	3%	28%
1.2%	\$209,251 to \$373,650	33%	36%	3%	33%
.7% (a)	Over \$373,650 to \$400,000 (single) / \$450,000 (joint)	35%	39.6%	4.6%	35%
.7% (a)(b)	Over \$400,000 (single) / \$450,000 (joint)	35%	39.6%	4.6%	39.6%

Source: Tax Policy Center

- a. The historic percentage of filers available for over \$373,650 was only available. At this time, we do not know the amounts split between these AGI ranges.
- b. The amount for HOH is \$400,000 and \$225,000 for married filing separate.

Capital Gains: Currently long term capital gains are taxed at 15% federally. Beginning January 1, 2013, with the expiration of the Bush tax cuts, the long term capital gain rate increases back to 20% (18% if the investment is held for over 5 years).

- 15% rate seems to be staying for taxpayers with AGI of less than \$400,000 (single) and \$450,000 for a joint filer.
- The rate seems to increase to 20% if the AGI is over \$400,000 (single) and \$450,000 for a joint filer.
- Remember that the investment tax / Obamacare tax rate of 3.8% as discussed below still seems to apply regardless of the dividends rate of 15% or 20%.

Short term capital gains will continue to be taxed at ordinary income rates.

Dividends: Currently qualified dividends are taxed 15%, but beginning January 1, 2013 dividends will be taxed differently based on AGI amounts:

- 15% rate seems to be staying for taxpayers with AGI of less than \$400,000 (single) and \$450,000 for a joint filer.
- The rate seems to increase to 20% if the AGI is over \$400,000 (single) and \$450,000 for a joint filer.
- Remember that the investment tax / Obamacare tax rate of 3.8% as discussed below still seems to apply regardless of the dividends rate of 15% or 20%.
- If you have a C Corporation still and you have retained earnings, then you might want to consider taking a dividend by December 31, 2012.
 - Also, you should consider changing to an S Corporation. Make sure you have solid tax advice regarding complex issues.

Obamacare – Investment Income Tax: Beginning on January 1, 2013 a 3.8% Medicare tax will be imposed on the lesser of net investment income or AGI over limits discussed below.

- Obamacare (Affordable Care Act) doesn't apply to trade and business income, tax-exempt interest. Thus S Corporations shareholder allocations are currently excluded from the investment tax.
- Remember this tax can apply to taxable primary residence home sales, and rental income.

The tax law imposes a 3.8% surtax on certain passive investment income of individuals, trusts and estates. For individuals, the amount subject to the tax is the lesser of (1) net investment income (NII) or (2) the excess of a taxpayer's modified adjusted gross income (MAGI) over an applicable threshold amount.

Net investment income includes dividends, rents, interest, passive activity income, capital gains, annuities and royalties. Specifically excluded from the definition of net investment income are self-employment income, income from an active trade or business, gain on the sale of an active interest in a partnership or S corporation, IRA or qualified plan distributions and income from charitable remainder trusts. MAGI is generally the amount you report on the last line of page 1, Form 1040.

The applicable threshold amounts are shown below. These amounts didn't seem to change during the negotiations of Congress on January 1, 2013 or we haven't heard of them yet.

Married taxpayers filing jointly	\$250,000
Married taxpayers filing separately	\$125,000
All other individual taxpayers	\$200,000

A simple example will illustrate how the tax is calculated.

Example: Al and Barb, married taxpayers filing separately, have \$300,000 of salary income and \$100,000 of NII. The amount subject to the surtax is the lesser of (1) NII (\$100,000) or (2) the excess of their MAGI (\$400,000) over the threshold amount (\$400,000 - \$250,000 = \$150,000). Because NII is the smaller amount, it is the base on which the tax is calculated. Thus, the amount subject to the tax is \$100,000 and the surtax payable is \$3,800 (.038 x \$100,000).

Fortunately, there are a number of effective strategies that can be used to reduce MAGI and or NII and reduce the base on which the surtax is paid. These include (1) Roth IRA conversions, (2) tax exempt bonds, (3) tax-deferred annuities, (4) life insurance, (5) rental real estate, (6) oil and gas investments, (7) timing estate and trust distributions, (8) charitable remainder trusts, (9) installment sales and maximizing above-the-line deductions. We would be happy to explain how these strategies might save you large amounts of surtax.

Estate Tax: Tax rate was scheduled to increase from 35% to 55%, and the life time estate tax exemption will be reduced from \$5M back to \$1M. However, as discussed above, Congress agreed upon a change as stated below:

- For estate, gift, and generation-skipping transfer (GST) tax purposes, for individuals dying and gifts made after 2012, there is a \$5 million exemption (adjusted for inflation);
 - However, the Act also permanently increases the top estate, gift and rate from 35% to 40%. The Act also continues the portability feature that allows the estate of the first spouse to die to transfer his or her unused exclusion to the surviving spouse. All changes are effective for individuals dying and gifts made after 2012.

Gift Tax: Similar to the estate tax. The gift tax rate was scheduled to increase from 35% to 55% of an amount in excess of the annual exclusion but it seems as if Congress made the rate change and annual exclusion change to 40% and \$5M. So the life time gift tax exclusion amount was schedule to decreases from \$5M to \$1M but it seems as if Congress is going to keep it at the \$5M amount.

- In addition, remember there is always an annual gift exclusion amount per person. The amount for 2012 is \$13,000 and is increased to \$14,000 for 2013.

AMT: 2012 AMT Rules if there is No Retroactive “Patch”

Far more restrictive AMT rules already are in effect for 2012, and will remain so unless Congress passes a “patch” that amends the rules effective retroactively as of Jan. 1, 2012.

Most income tax publisher’s state: Congress has put a temporary patch on the AMT problem for a number of years, and most observers believe it will do so again for 2012 (and possibly 2013).

AMT exemption amount (Code Sec. 55(d)(1)). For individuals, the AMT exemption amounts for 2012 falls to \$45,000 (joint filers & surviving spouses), \$33,750 (unmarried individuals), and \$22,500 (married filing separately). By contrast, the AMT exemption amounts for 2011 were \$74,450 (joint filers & surviving spouses), \$48,450 (unmarried individuals), and \$37,225 (married filing separately).

- *Apparently Congress has agreed to fix the AMT tax for the middle class. However we have no further details.*

Social security taxes going up next year also: All employees and self-employed persons will face higher social security taxes next year due to an expiring tax break. Higher earners may also face increased tax because the Social Security wage base is increasing to \$113,700 from \$110,100 and a higher Medicare tax applies to higher earners.

The Federal Insurance Contributions Act (FICA) imposes two taxes on employers, employees, and self-employed workers—one for Old Age, Survivors and Disability Insurance (OASDI; commonly known as the Social Security tax), and the other for Hospital Insurance (HI; commonly known as the Medicare tax).

For 2013, the FICA tax rate for employers is 7.65% each—6.2% for OASDI and 1.45% for HI. For 2013, an employee pays:

- (a) 6.2% Social Security tax on the first \$113,700 of wages (maximum tax is \$7,049.40 [6.20% of \$113,700]), plus
- (b) 1.45% Medicare tax on the first \$200,000 of wages (\$250,000 for joint returns; \$125,000 for married taxpayers filing a separate return), plus
- (c) 2.35% Medicare tax (regular 1.45% Medicare tax + 0.9% additional Medicare tax) on all wages in excess of \$200,000 (\$250,000 for joint returns; \$125,000 for married taxpayers filing a separate return).

By contrast, for 2012, the current OASDI rate for employees is 4.2% (due to the current 2% reduction due to the bad economy); the OASDI rate for employers is 6.2% and the HI rate for both employers and employees is 1.45%.

For 2013, the self-employment tax imposed on self-employed people is:

- 12.4% OASDI on the first \$113,700 of self-employment income, for a maximum tax of \$14,098.80 (12.40% of \$113,700); **plus**
- 2.90% Medicare tax on the first \$200,000 of self-employment income (\$250,000 of combined self-employment income on a joint return, \$125,000 on a separate return), plus
- 3.8% (2.90% regular Medicare tax + 0.9% additional Medicare tax) on all self-employment income in excess of \$200,000 (\$250,000 of combined self-employment income on a joint return, \$125,000 for married taxpayers filing a separate return).

The self-employment tax can also apply to partnership allocations. Consider changing to an S Corporation, or utilize an S Corporation as part of your structure. Contact us for assistance.

Remember that the current 2012, the self-employment tax rate is 13.3%: 10.4% for OASDI, reflecting the two percentage point drop in the OASDI rate for employees, plus 2.9% for HI.

- *Congress has apparently agreed to allow the payroll reduction rate to expire so employee payroll withholdings as of January 1, 2013 will go back to the normal rates.*

Section 179: For tax years beginning in 2012, the maximum amount that was scheduled to be expensed under Code Sec. 179 was \$125,000 (inflation adjusted to \$139,000), and the investment ceiling was \$500,000 (inflation adjusted to \$560,000). Then for 2013, the law was supposed to allow the maximum expensing amount of \$25,000 and the investment ceiling is \$200,000.

However, as expected, Congress in this January 1, 2013 act, changed the IRC section 179 for tax years 2012 to be \$500,000 with a \$2M investment limit.

Bonus Depreciation: Summary: 50% in 2012 and for 2013:

The 50% bonus first-year depreciation allowance for qualified property under Code Sec. 168(k)(1) is currently set to expire. Congress included and extended the 50% bonus depreciation through 2013.

- *Please note that bonus depreciation is only able to be used on NEW property. Section 179 can be used on property that was purchased "used".*

Depreciation for Airplanes: Congress changed IRC section 274 and Treasury Regulation 1.274 to restrict the deductions and depreciation of an airplane when not used for business. If you have an airplane, then please contact us to discuss in more detail as the area of law is complex. A quick summary is as follows:

- Personal use of a company plane is probably not going to be deductible anymore. Which means the direct, indirect costs and depreciation is going to be significantly limited by IRC section 274.
- IRC section 274 bars a deduction for entertainment, recreation or amusement use unless the taxpayer can establish that the expense was directly related to or associated with the active conduct of its trade or business.

Other changes / expirations: These items currently expire on January 1, 2013 but revisions by the American Taxpayer Relief Act of 2012 are discussed.

- **EXTENDED: Research and Development Credit (R&D)** expired at December 31, 2011. The American Taxpayer Relief Act as discussed above extended this credit through 2013.
- **EXTENDED: 15-year write-off** period for specialized realty assets, including qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property under Code Sec. 168(e) expired on 12/31/2011. However, the qualified leasehold improvements clause / qualified restaurant property, and qualified retail improvements 15 year write off period was extended through 2013. .
- **EXTENDED: Reduced S corporation** recognition period for built-in gains tax under Code Sec. 1374(d)(7). This was the 10 year waiting period for built in gain tax for the conversion from C Corporation to S Corporation.
- **EXTENDED: Election to deduct State** and local general **sales taxes** under Code Sec. 164(b)(5) in lieu of a state and local income tax deduction was extended through 2013.
- **EXTENDED:** Treatment of **mortgage insurance premiums** as deductible qualified residence interest under Code Sec. 163(h)(3)(E) was extended through December 31, 2013.

- **EXTENDED:** Exclusion of 100% of gain on certain **small business stock** under Code Sec. 1202(a)(4). After 2011, an exclusion applies for only 50% of gain (60% for qualified business entity stock).
 - Gain generally cannot exceed \$10M.
 - Small business stock is defined as, (1) C Corporation, (2) Assets under \$50M, and other tests.
 - This can be a good area for small business owners to review if they call for the small business stock definition.
- **EXTENDED: Cancellation of Debt on Primary Residence:** IRC Section 108(e), which allows for cancellation of debt (COD) on a taxpayers qualified primary residence is scheduled to expire on December 31, 2012. However, this was extended till December 31, 2013.
- **Smaller Employer Health Insurance tax Credit:** Pursuant to IRC section 45R, qualified small employers (generally those with less than 25 full-time equivalent (FTE) employees and average FTE annual wages less than \$50,000 per employee) that purchase insurance coverage for their employees are allowed a tax credit up to 35% of the amount of the employer contributes to the cost of employees health care coverage.
 - *The key issue we see here is the average employee wage must be less than \$50,000. This has been a difficult requirement for our clients to meet.*
 - Seems to still be valid for 2012 and 2013, but we will confirm later when we receive more formal news.
- **Expectations:** *We expect minimal additional tax changes for 2013 which we see did occur but due to pressure of paying down the debt, more tax changes could occur in 2014.*

State(s) Update:

Many of our clients and small business have multiple locations within multiple states, or are planning on expansion. Thus state tax laws should be considered among other business items. Other items are infrastructure, labor cost, utility costs, work force, union or non-union, transportation and much more. Most of the following state data was derived from the Tax Foundation at www.taxfoundation.org.

The state matrix below also provides business tax climate as ranked by the Tax Foundation. The matrix below is a summary and may have averages or approximate information. The matrix is meant to be used as a gauge and not as precise information as tax law has exceptions, and complex calculations. Most tax rates below are the highest tax rate of the state. Each state most likely has reduced rates for income brackets. So, please discuss with a tax advisor.

The top ranking states were: (1) Wyoming, (2) South Dakota, (3) Nevada, (4) Alaska, (5) Florida, (6) Washington, (7) New Hampshire, (8) Montana, (9) Texas, and (10) Utah.

The 10 lowest ranked states are: (41) Maryland, (42) Iowa, (43) Wisconsin, (44) North Carolina, (45) Minnesota, (46) Rhode Island, (47) Vermont, (48) California, (49) New Jersey, and (50) New York.

Unfortunately the table below wasn't updated fully for any state tax changes done in November through December of 2012. If we know of any, we will note them below. The grading scale means that 1 is the best.

State	Tax Foundation Ranking	Corp. Tax Rate	Individual Tax Rate	Property Tax based on 2010 Median Home Value	Sales Tax Rate State only
AL	21	6.5%	5%	0.41%	4%
AK *	4	9.4%	None	1.24%	None
AZ	25	6.968%	4.54%	0.85%	6.6%
AR	33	6.5%	7%	0.57%	6%
CA *	48	8.84%	10.3% (d)	0.78%	7.25%
CO	18	4.63%	4.63%	0.61%	2.9%
CT	40	8.25%	6.7%	1.7%	6.35%
DE *	14	8.7%	6.75%	0.49%	None
DC	44	9.975%	8.95%	0.54%	6%
FL	5	5.5% (c)	None	1.09%	6%
GA	34	6%	6%	0.93%	4%
HI	37	6.4%	11% (e)	0.27%	4%
ID	20	7.4%	7.4%	0.74%	6%
IL	29	9.5%	5%	1.93%	6.25%
IN *	11	8%	3.4%	0.84%	7%
IA	42	12%	8.98%	1.34%	6%
KA(a) *	26	7%	6.45%	1.35%	6.3%

State	Tax Foundation Ranking	Corp. Tax Rate	Individual Tax Rate	Property Tax based on 2010 Median Home Value	Sales Tax Rate
KY	24	6%	6%	0.78%	6%
LA	32	8%	6%	0.43%	4%
ME	30	8.93%	8.5%	1.17%	5%
MD	41	8.25%	5.75%	0.98%	6%
MA	22	8%	5.3%	1.08%	6.25%
MI	12	6%	4.35%	1.82%	6%
MN	45	9.8%	7.85%	1.10%	6.875%
MS	17	5%	5%	0.73%	7%
MO	16	6.25%	6%	0.94%	4.225%
MT	8	6.75%	6.9%	0.85%	None
NE	31	7.81%	6.84%	1.82%	5.5%
NV	3	None	None	0.98%	6.85%
NH	7	8.5%	5%	1.92%	None
NJ	49	9%	8.97%	2.01%	7%
NM	38	7.6%	4.9%	0.66%	5.125%
NY	50	7.1%	8.82%	1.38%	4%
NC	44	6.9%	7.75%	0.81%	4.75%
ND	28	5.15%	3.99%	1.36%	5%

State	Tax Foundation Ranking	Corp. Tax Rate	Individual Tax Rate	Property Tax based on 2010 Median Home Value	Sales Tax Rate
OH *	39	(b)	5.925%	1.44%	5.5%
OK	35	6%	5.25%	0.80%	4.5%
OR	13	7.6%	9.9%	0.98%	None
PA *	19	9.99%	3.07%	1.40%	6%
RI	46	9%	5.99%	1.47%	7%
SC	36	5%	7%	0.55%	6%
SD	2	None	None	1.32%	4%
TN	15	6.5%	6% (f)	0.70%	7%
TX	9	(b)	None	1.90%	6.25%
UT	10	5%	5%	0.65%	5.95%
VT	47	8.5%	8.95%	1.61%	6%
VA	27	6%	5.75	0.77%	5%
WA	6	(b)	None	0.98%	6.5%
WV *	23	7%	6.5%	0.58%	6%
WI	43	7.9%	7.75%	1.85%	5%
WY	1	None	None	0.62%	4%

Notes:

- (a) Kansas legislation recently passed a state law exempts non-wage income from sole proprietors, partnerships, and S Corporation from state tax. Wow!
- (b) While many states collect gross receipts taxes from public utilities and other sectors, and some states label their sales tax a gross receipts tax, the matrix shows only those state gross receipts taxes that broadly tax

all business as a percentage of gross receipts: the Delaware Manufacturers & Merchants' License Tax, the Ohio Commercial Activities Tax, the Texas Margin Tax, the Virginia locally-levied Business/Professional/Occupational License Tax, and the Washington Business & Occupation Tax. Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax, while Delaware, Michigan, and Virginia have a gross receipts tax in addition to the corporate income tax.

- (c) Florida doesn't have a business tax for partnerships or S Corporations in which a C Corporation isn't involved.
- (d) See the recent income tax changes for individual CA tax rates below due to the passing of proposition 13.
- (e) Currently HI doesn't tax qualified pension income. So, this might be an island that is good for retirement.
- (f) Tax applies only to interest and dividends. Please note that TN doesn't recognize, so distributions (dividends) from S Corporations are taxed as dividends.

* See comments below for state updates.

California Update:

Proposition 30 passed at the November 2012 election. This increased California income tax retroactively to January 1, 2012.

Single Filer's Taxable Income	Joint Filers Taxable Income	HOH Filers Taxable Income	Current Marginal Tax Rate(b)	New Additional Marginal Tax Rate (b)
\$0 - \$7,316	\$0 - \$14,632	\$0 - \$14,642	1.0%	No change
\$7,316 - \$17,346	\$14,632 - \$34,692	\$14,642 - \$34,692	2.0%	No change
\$17,346 - \$27,377	\$34,692 - \$54,754	\$34,692 - \$44,721	4.0%	No change
\$27,377 - \$38,004	\$54,754 - \$76,008	\$44,721 - \$55,348	6.0%	No change
\$38,004 - \$48,029	\$76,008 - \$96,058	\$55,348 - \$65,376	8.0%	No change
\$48,029 - \$250,000	\$96,058 - \$500,000	\$65,376 - \$340,000	9.3%	No change
\$250,000 - \$300,000	\$500,000 - \$600,000	\$340,000 - \$408,000	9.3%	1.0%
\$300,000 - \$500,000	\$600,000 - \$1,000,000	\$408,000 - \$680,000	9.3%	2.0%
Over \$500,000	Over \$1,000,000	Over \$680,000	9.3%	3.0%

(Chart information provided by California official proposition 30 amendment)

- (a) *Income brackets shown were in effect for 2011 and will be adjusted for inflation in future years. Single filers also include married individuals and registered domestic partners (RDPs) who file taxes separately. Joint filers include married and RDP couples who file jointly, as well as qualified widows and widowers with dependent children.*
- (b) *Marginal tax rates apply to taxable income in each tax bracket listed. The proposed / passed additional tax rates would take effect beginning in 2012 and end in 2018. Current tax rates listed exclude the mental health tax rate of 1% for taxable income in excess of \$1 million.*

California Millionaires tax: Proposition 63, approved by voters on November 2, 2004 enacted the Mental Health Services Act that imposes an additional 1% tax on taxable income over \$1 million. The surcharge is levied effective for tax years beginning on or after January 1, 2005. The rate schedules changed by proposition 30 are not affected by this millionaire tax.

One can read that there are a lot of income tax increases coming for 2012 through December 31, 2016. This is just a summary of some items of income tax law that are expected to change. There are many more. Please discuss any of these issues with your tax advisor.

California Sales Tax: The California state sales and use tax rate increases by .25% to 7.50% effective on January 1, 2013 through December 31, 2016.

Other state updates:

- **Arizona:** Arizona legislators have approved a bill that would reduce their 6.68% corporate income tax rate to 4.9% in stages between 2015 and 2018.
- **Delaware:** In June 2011 Delaware approved a reduction in its top individual income tax rate from 6.95% to 6.75% in 2012 and 2013 and then 5.95% in 2014.
- **Indiana:** in May 2011, Indiana approved a gradual reduction in its corporate income tax, from 8.5% to 8% this year, 7.5% in 2013, 7% in 2014, and finally 6.5% in 2015. Each reduction should take effect July 1 of each year.
- **Kansas:** In May 2012, Kansas enacted significant tax changes that will take effect in 2013. The existing three-bracket income tax with a top rate of 6.45% will become a two-bracket income tax with a top rate of 4.9%. Non-wage income from sole proprietors, partnerships and S Corporations are exempted from state tax.
- **Ohio:** In June 2011, Ohio approved the repeal of the estate tax, effective January 1, 2013.

- **Pennsylvania:** Pennsylvania continues to phase out its capital stock tax. The rate is .189% in calendar year 2012 and is scheduled to fall to .089% in 2013 and 0% in 2014 and thereafter.
- **West Virginia:** West Virginia's corporate income tax rate automatically falls each year that the state rainy day fund balance is greater than 10% of general fund spending. The rate fell from 8.5% to 7.75% in calendar year 2012 and is expected to fall further to 7% in 2013 and 6.5% after 2013.

We are very pleased to see how some of the states are reducing tax rates and creating business incentives. Some states have changed law that would reduce state taxes when the state becomes more fiscally responsible.

Affordable Care Act / ObamaCare

Obamacare – Health Care portion: (Legal References: Affordable Care Act, P.L. 11-148, Joint Committee on Taxation – JCX-18-10 dated March 21, 2010 and JCX-27-10). *These are just some highlights and general overviews. The items discussed are not the full law. Please discuss with your health insurance broker / company and your tax advisor. In addition, some of the ACA were changed during the passing of the American Taxpayer Relief Act of 2012 but may have not been updated as discussed below.*

- **Large Employers - Automatic enrollment** (P.L. 111-148, Sec. 1511): With an effective date of March 23, 2010, Employers that have more than 200 employees and offer health benefits to their employees must automatically enroll new employees in one of the health benefit plans the employer offers and continue enrollment of current employees in a health benefit plan. Employees must be given adequate notice and an opportunity to opt-out of the coverage in which they are automatically enrolled.
 - Note, the IRS and DOL have delayed compliance with this provision until additional guidance is issued by the DOL and IRS.
- **Assistance for nursing mothers** in the workplace: Beginning on March 23, 2010, Employers with 50 or more employees must provide a reasonable break time and a place, other than a bathroom, for nursing mothers to use for expressing milk. Employers with fewer than 50 workers may qualify for an exception for meeting these requirements.
- **Dependent Coverage:** Effective on March 30, 2010, plans that offer health insurance coverage for dependent children must continue to offer the coverage until the child reaches age 26.

- **Form W-2 Reporting:** Employers must report the aggregate cost of employer-sponsored health coverage on Form W-2.
 - Reporting for 2011 was optional (IRS Notice 2010-69) and the IRS has provided relief for certain small employers beginning with 2012 Forms W-2.
 - **Small Employers.** The IRS has provided relief from the reporting requirements for some small employers. Employers that were required to file fewer than 250 Forms W-2 for the preceding calendar year are not required to report the aggregate cost of employer-sponsored health coverage on current year Form W-2 (IRS Notice 2012, Q&A 3).
 - The aggregate costs should be reported on form W-2 box 12, using code DD.
 - Amounts not subject to reporting requirements are accident only coverage, disability income insurance, long-term care insurance, supplemental liability insurance coverage, liability insurance, including general liability insurance and automobile insurance, workers compensation, and other similar coverage under which benefits for medical care are secondary or incidental to the other insurance benefit.
 - Note that employer contributions to HSA's are not reported in box 12 using code DD (IRS notice 2012-9, Q&A 16). However, employer contributions to these accounts are required to be reported on form W-2 in box 12 with a code HSA.
- **Related Employers:** Don't think you can create multiple companies to get out of the ACA rules. Businesses that have common ownership, generally 50% or more, common officer, or common employees (30%) are generally treated as one company for the ACA rules.
- **Over-the-counter medicines & drugs** (IRC section 220(d)(2)(A) / 223(d)(2)(A) and 106(f): Starting on or after January, 1, 2011, reimbursements for over-the-counter (OTC) medicines and drugs unless prescribed or insulin, are not allowed by health FSA or HRAs. Similarly distributions from HSAs and Archer MSAs for medicine and drugs are tax-free only if medicine or drug is prescribed or is insulin.
 - *This is a BIG change for taxpayers. Looks like we may need to get prescriptions more often.*
- **Penalties for nonmedical purpose distributions:** Distributions made on or after January 1, 2011 will be 20% for distributions from HSAs and Archers MSAs that are not used for medical purposes. Remember the over-the-counter requirements above.

- **Increased Medicare tax:** Beginning on or after January 1, 2013: An additional 0.9% Medicare tax applies to an individual's wages received in excess of \$200,000 (\$250,000 for married filing jointly; \$125,000 for married filing separately). The additional Medicare tax also applies to self-employed income as discussed above.
- **Medical Deduction – Schedule A:** Tax year beginning on or after January 1, 2013, the itemized deduction of medical expenses threshold is increased from 7.5% of AGI to 10% of AGI.
 - However if the taxpayer is age 65 or older, the increased threshold is effective for tax years beginning after 2016.
- **Excise tax on sales of certain medical devices:** Sales on or after January 1, 2012 of medical devices will incur a 2.3% excise tax. The tax is imposed on the producer, manufacturer, or importer of a medical device intended for humans.
 - *We understand this section of the ACA is being debated within Congress. It seems as if this excise tax is left intact that medical devices will get more expensive and the consumer will end up paying for it.*
- **Requirement to offer health insurance:** Pursuant to IRC section 4980H, For tax years beginning on or after January 1, 2014 applicable large employers (i.e. employers that average at least 50 full-time employees on business days in the prior calendar year) must offer minimum essential insurance coverage to all full time employees (and their dependents).
 - An employer shall not be considered to employ more than 50 full-time employees if:
 - The employer's workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year, and
 - The employees in excess of 50 employed during such 120 day period were seasonal workers.
 - A full-time employee in general means with respect to any month, an employee who is employed on average at least 30 hours of service per week.
- **Penalties Imposed on Businesses:** Pursuant to IRC section 4980H, effective on or after January 1, 2014, a large employer (50 full-time employees) may be subject to an assessable payment / penalty / excise tax if

- the employer fails to offer to its full time employees and their dependents the opportunity to enroll in a minimum essential coverage under an eligible employer sponsored plan for that month; and
- at least one full time employee has been certified to the employer as having enrolled for that month in a qualified health plan for which an applicable premium tax credit or cost sharing reduction (collectively referred to as “health coverage assistance”) is allowed or paid with respect to the employee.
- Penalty: The assessable penalty (i.e. excise tax) is \$166.67 per month with a maximum amount of \$2,000 per year. The penalty is per eligible employee.
 - *This seems to be one of the areas in which the US Supreme court ruled that the ACA penalties were a “tax” and not a fee. We have been informed that the IRS will not be enforcing the payment of the “tax”. It will be interesting to see how this excise tax will be enforced.*
 - *Also if this remains an excise tax, generally excise tax is not a deduction to arrive to federal taxable income.*
- Example: In 2014, Employer A fails to offer minimum essential coverage and has 100 full-time employees, 10 of whom receive a tax credit for the year for enrolling in a state Exchange-offered plan. For each employee over the 30-employee threshold, the employer owes \$2,000, for a total penalty of \$140,000 ($\$2,000 \times 70 (100 - 30)$). This penalty is assessed on a monthly basis.
- **Waiting Period:** For plan years beginning on or after January 1, 2014, for group health plans no waiting periods in excess of 90 days are allowed.
- **Wellness Programs:** Group medical insurance costs may be reduced if the group participants are healthier. Thus an employer can provide wellness programs that provide an employee with incentives. The incentives generally are a reduction in the premium cost of the employees’ health insurance. The typical rate reduction incentives are generally allowed up to 30%.
 - This is a complicated area of the already complicated ACA. One needs to check with their insurance agent / broker.
 - A typical example of a wellness program would be the business could pay for all or a portion of an employee’s health club membership.
 - Then the business needs to determine if those health club dues can be deductible as it typically wasn’t deductible unless it was counted as

compensation. It would be nice if any health club dues related to a wellness program were treated as a fringe benefit, meaning the cost is deductible for the business and not taxable income to the employee.

- **High-cost / Cadillac plan tax:** Beginning on or after January 1, 2018 a 40% nondeductible excise tax will be levied on the excess benefit amount of applicable employer-sponsored health plans with aggregate costs over \$10,200 for self-only coverage and \$27,500 for any other coverage. These amounts should be increased slightly for coverage that applies to retired individuals age 55 and older who are not eligible for enrollment in Medicare or entitled to Medicare benefits and for plans that cover employees engaged in high-risk professions.
- **Notification requirements:** Employers as of March 1, 2013 must notify employees (a) of the existence of an insurance exchange, (b) that the employee may be eligible for a subsidy under the exchange if the employer's share of the total cost of benefit is less than 60%; and (c) that if the employee purchases a policy through the insurance exchange, he or she may lose the employer contribution to any health benefits offered by the employer.
 - *As many of us have heard, there already a few states which are stating they will not create a state insurance exchange. So, again, we are not sure what this effect will have on ACA. However, under this section if there is no state insurance exchange, then it seems like notification would not be required.*
- **Shared responsibility penalty for employers offering minimum essential health insurance** coverage that is unaffordable or does not provide minimum value: Pursuant to IRC section 4980H(b), beginning on or after January 1, 2014, Applicable large employers that do not offer full-time employees (and their dependents) affordable minimum essential health insurance coverage that provides minimum value may be subject to a \$250 penalty (for each certified employee) for each month (i.e., \$3,000 per year per certified employee) that a full-time employee is certified to the employer as having been allowed or paid a premium assistance credit or cost-sharing-reduction subsidy. However, the total penalty paid for all affected employees is limited to the amount that the employer would have paid if it had not offered minimum essential health insurance coverage.
 - *Here is another penalty which again is confusing. It just seems like the Federal government just wants all employers to offer adequate health insurance, and they are continuously trying to put specific definitions and boundaries to minimize abuse. One really needs to work with their insurance agent / broker.*

- **Annual certification of coverage to the IRS and covered individuals.** Pursuant to IRC section 6055 and 6056, beginning on or after January 1, 2014, every person providing minimum essential coverage to a covered individual and certain applicable large employers required to offer enrollment in minimum essential coverage under an employer-sponsored plan are required to provide information statements regarding certain health insurance coverage to the IRS and the covered individual or employee.

Revenue Generators / IRS and State Examination Update:

We have seen a very large increase in tax examinations over the last five years. Obviously the federal and state governments are reallocating resources to find more money to fill up empty federal and state funds. Be aware of the following:

- **IRS** / Federal examinations continue to be much more prevalent over the last four years. The examination rates seem to have increased by 300% to 500%. We have seen IRS examinations focused on the following items:
 - Foreign Bank Accounts – There is an IRS involuntary disclosure program to consider.
 - Significant drop in taxable income
 - Large amount of bad debt expense
 - Partnership and / or S Corporation loss allocation to partner and shareholders which they are examining if the partner or shareholder has proper tax basis to take the loss. If the tax return submitted didn't have a tax basis calculation then the risk for audit is extremely high.
 - Independent Contractors versus Employee audits. They are auditing to make sure the company has properly classified independent contractors and they are specifically looking to change independent contractors to employees and collect back employment taxes, and FUTA. They are of course assessing penalties and interest.
 - There is also an IRS voluntary disclosure program.
- **States:** Various states are attacking taxpayers on similar items.
 - **State Unemployment Audits (SUI):** Many states have minimal funding left if any in their state unemployment funds. So rather than helping business

owners hire more employees, some states are auditing companies and trying to collect past unemployment taxes.

- A handful of states are auditing businesses independent contractors. They are trying to argue that the independent contractor should have been an employee under state law, and thus they will assess the taxpayer for past due state income tax and more importantly past due state unemployment insurance. Of course they are assessing penalties and interest.
- They have focused on certain industries. They are focusing on industries that require licenses. For example they have focused on contractors and their subcontractors that are treated as independent contractors. If the independent contractor / sub-contractor aren't properly licensed, they will take the position that due to licensing requirements, the independent contractor must be an employee to provide the services.

There are definitely a lot of things to be keep knowledgeable about, so stay tuned. However, we can't let tax laws and Congress slow down our business plan. We do need to be smart about the future. We unlike Congress can continue to be fiscally responsible and be smart about growth. We suggest everyone be cautiously optimistic.

Remember to contact us if we can be of assistance.

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