Fourth Quarter 2011

Ideas for Your Success

Year end tax planning: Less uncertainty than last year, but complications still abound

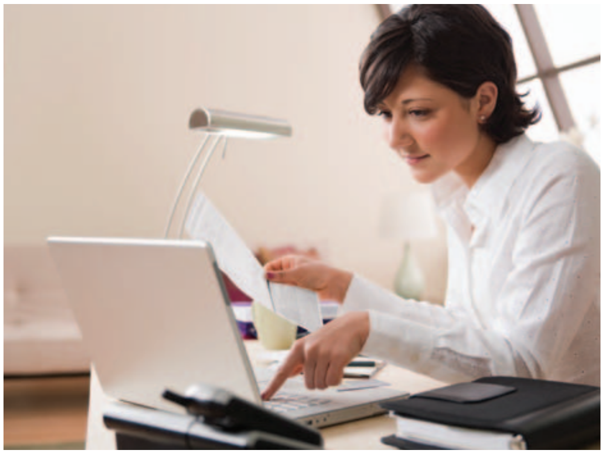
After the uncertainty surrounding 2010 tax laws last year made year end tax planning so difficult, this year it will be easier, right? To some extent, it is more straightforward, because current tax rates and many breaks are in place until the end of 2012.

However, complications still abound. For example, you must take the alternative minimum tax (AMT) into account. Why? Because unless Congress takes action, there's a greater chance you'll be subject to the AMT in 2012 — which could affect the actions you should take in 2011.

Influence of the AMT

A core strategy in year end tax planning is timing your income and expenses to your tax advantage. But before you can begin, you and your tax advisor must determine whether you'll likely be subject to the AMT this year or next. Under the AMT, taxable income is determined differently and is subject to different rates. You must pay the AMT if your AMT liability exceeds your regular tax liability.

The AMT system isn't adjusted for inflation as the regular tax system is. So, absent long-term relief, Congress must continue to pass "patches," which increase the AMT exemption. The current patch is in place for 2011, but, as of this writing, not for 2012. If Congress decides not to extend the patch, a greater number of taxpayers could be subject to the AMT next year.



"Before timing your income and expenses, determine whether you'll likely be subject to the AMT this year or next."

If you must pay the AMT, some of your deductions will be of limited, or perhaps no, benefit — examples include state and local income tax deductions and property tax deductions. The AMT can affect how you should time payment of these expenses, so consult with your tax advisor before you make any moves.

Income and expense timing

If it looks as if you won't be subject to the AMT this year or next, you'll need to determine if you'll likely be subject to the same or a different marginal *regular* income tax rate next year. This will be easier than last year because rates are scheduled to be the same for 2011 and 2012. So you just need to consider whether any changes to your financial situation might cause you to fall into a different tax *bracket*.

If you'll probably remain in the same bracket or move to a lower bracket, consider deferring income to 2012 and accelerating deductible expenses into 2011. Doing so will defer tax, which is usually beneficial. If you might be moving into a higher tax bracket, it's advisable to do the opposite — accelerate income into 2011 and defer deductible expenses to 2012.

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Ideas for Your Success

Is your business healthy?

Check its financial status with a year end budget review

Year end typically puts people in a reflective mood. Business owners can take a breath and consider such questions as: How did your company perform this year? The economy took a roller coaster ride of ups and downs; did your cash flow take a similar ride? Conducting a year end budget review can give you a clear picture of your business's financial health at the turn of the new year.

Did you make a profit?

Generally, a business budget will have three primary components: an income statement, a cash flow statement and a balance sheet.

The income statement typically shows sales, margins, operating expenses, and profits or losses. Like many business owners, you may naturally be drawn to the profit part — otherwise known as the bottom line. If it looks as if you'll post a profit this year, determine what you did right and whether you should pursue these actions more aggressively or take a "hold steady" approach.

And if you anticipate a loss year, ask a similar question: Should you actively try to pull your business out of its current financial predicament or should you dig in and wait it out by staying within your margins and controlling operating expenses?

Was your cash flow steady?

In terms of pure survival, the most important part of a budget review may be an examination of your cash flow statement. A typical cash flow statement comprises three sections: operating activities, investing activities and financing activities.

After looking carefully at all three sections, check to see whether you have as much available cash as you expected to when you set up your budget. A number of things may have thrown off your earlier projections.

For starters, there's the question of taxes. Often, businesses hold funds allocated for income and other taxes for an interim period until a payment is made to the appropriate governmental body. If these funds aren't clearly marked as being held for tax liabilities, you may overestimate available cash.

Have you made any major asset purchases this year? If so, such a transaction could have major implications on whether you've stayed within budget. Maybe you hadn't budgeted for a new piece of equipment that you absolutely had to buy after the old one failed.

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Another major factor of cash flow is how quickly you collect your receivables. Your customers' failure to pay on time won't excuse you from having to pay your suppliers for purchases you've made.

Is your balance sheet strong?

After looking at your company's profitability and cash flow, use your balance sheet to get a sense of the financial condition of your business on the date you prepared your budget to compare it against its current financial condition.

For instance, perhaps you're seeing substantially more debt on your balance sheet than you anticipated. In this case, you'll likely need to curtail discretionary expenses (such as bonuses) in your budget and create a plan for paying off or refinancing that debt as quickly as is reasonably possible.

Perhaps the easiest way to get a sense of whether your budget served its purpose over the course of the year is to dig out your business plan. Draw on your mission statement and business plan to determine whether you've won or lost the budget battle this year.

Budget for next year

Creating and sticking to an annual budget is easier said than done during years when the economy is unpredictable and demand may be low. That said, today's business conditions require you to develop a sound budget and review it monthly to ensure you're not surprised next year at this time.

Write off bad business debt, correctly

Bob owns a successful auto repair business. Last year, he decided to provide a sizable loan to his muffler supplier to help that business stay afloat. Unfortunately, the supplier went out of business a few months later. Dismayed, Bob found some solace in the thought that he could write off the bad business debt at tax time. But Bob later learned that, because he hadn't tried to collect on the loan before year end, he couldn't write off the bad debt on that year's tax return.

Bob isn't alone in thinking a business owner can claim a bad debt deduction anytime a loan or other obligation becomes uncollectible — the provision is often misunderstood. Thus, it's important to know the circumstances under which you can claim a bad debt tax deduction.

Qualifying for the deduction

A business bad debt is a loss from the worthlessness of a debt that was created or acquired in your trade or business, or was closely related to your trade or business when it became partly or totally worthless. The most common bad debts involve credit sales to customers for goods or services. Other examples include loans to customers or suppliers that are made for business reasons and have become uncollectible, business-related guarantees of debts that have become worthless, and debts attributable to an insolvent partner. Keep in mind that the IRS often scrutinizes loans to be sure they're legitimate. For example, it might deny a bad debt deduction if it determines that a loan to a corporation was actually a contribution to capital.

There's no standard test or formula for determining whether a debt is worthless; it depends on the facts and circumstances of each case. To qualify for the deduction, you must show that you've taken reasonable steps to collect the debt and there's little likelihood it will be paid. You don't have to wait until the debt is due if the debtor's bankruptcy or other circumstances have rendered it worthless.

Accounting method matters

For a debt to qualify for a bad debt deduction, you generally must have previously included the amount in your gross income. If your business uses the *cash* method of accounting for tax purposes, you don't report income until you receive payment. So you can't claim a bad debt deduction simply because someone failed to pay a bill. But you may be able to claim a bad debt deduction if you've made a business-related loan that has become uncollectible.

If your business uses the *accrual* method, you report income as you earn it. So you can take a bad debt deduction if you previously included the entire uncollectible amount in your gross income.

Time is running out!

In the opening example, Bob made the mistake of not trying to collect the debt before the end of the year. If you have uncollected business debt, now is the time to try to collect it. If you do so and are unable to collect, ensure you document your efforts for the IRS. Your tax advisor can help you determine if claiming a deduction is warranted.

Taking advantage of online financial resources

Do you remember what life was like before the Internet became a fixture in our lives? It certainly wasn't as easy to manage your personal finances or access financial information and strategies.

Managing personal finances online is second nature to some, while others remain leery about the security of Internet-based transactions. If you're on the fence about banking online, know that banks and other financial institutions have responded to customers' needs and concerns by building robust and secure websites. Many banks' online services allow you to:

- Check account balances and view cleared checks,
- Receive a variety of e-mail account alerts, such as when a direct deposit has been made or an account balance drops below a set amount,
- Transfer funds between accounts, and
- Pay bills.

Keep in mind that there may be a fee for some services.

If you're interested in educating yourself on financial strategies, one online option you may not have considered is listening to podcasts. A podcast is essentially a radio show saved as an audio file you can download. Initially associated with Apple's iPod, podcasts are compatible with other mobile devices as well as traditional computers.

Numerous personal financial podcasts are available, including those produced by the *Wall Street Journal,* Kiplinger.com and Bloomberg.com. While listening to a podcast or simply surfing the Web, you may learn about a financial strategy or tool you'd like to employ.

Be aware that not all of the vast amount of personal financial information available on the Web is credible. So be sure to consider the source. And, before taking any action, talk to your financial advisor to determine the best course for your situation.

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Income items you may be able to control include bonuses, retirement plan distributions if they aren't required, income received from U.S. Treasury bills and income from consulting or other self-employment income.

Expense items you may be able to control include state and local income taxes, mortgage interest, charitable contributions and real estate taxes.

Don't be fooled

Even though there's more certainty this year than last when it comes to year end tax planning, don't be fooled into thinking that planning isn't complicated. In fact, timing income and expenses to your advantage can be tricky. And with perhaps a greater possibility that you'll be subject to the AMT next year, your tax advisor should be the person you're sitting next to when devising your year end tax plan.

Deduction focus: Health care tax breaks

Did you know that, if your 2011 health care expenses that aren't reimbursable by insurance exceed 7.5% of your adjusted gross income (AGI), you can deduct the excess amount? To exceed the floor, consider "bunching" nonurgent medical procedures, dental services and other controllable expenses into one year. Eligible expenses also may include health insurance premiums, prescription drugs and, subject to age-based limits, long-term care insurance premiums.

If your spouse has higher medical expenses and a lower AGI, consider filing separately. Doing so may allow your spouse to exceed the AGI floor and deduct medical expenses that wouldn't be deductible if you filed jointly. However, check that this strategy won't trigger the alternative minimum tax (AMT): The AMT exemption for separate returns is much lower than for joint returns. Plus, the AMT floor for deducting medical expenses is 10%.