



PERKINS & CO

Let's get there

Don't Fall Off the Fiscal Cliff in 2013

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The Fiscal Cliff



Sunset of Tax Cuts



Most provisions of EGTRRA/JGTRRA are set to expire at the end of 2012 including:

- › Lower tax rates (more later)
- › Bonus depreciation
- › Higher Section 179 limits (return to previous levels)
- › Payroll tax holiday
- › Suspension of phase-out of itemized deductions/exemptions
- › Indexed AMT exemption (more later)

Sunset of Tax Cuts



A reminder of the provisions already expired at the end of 2011 including:

- › 100% bonus depreciation (reduced to 50%)
- › \$500k Section 179 limits (reduced to \$139k)
- › 15-year treatment for qualified leasehold property
- › Energy efficient home construction credit
- › Election to deduct general sales tax as itemized deduction
- › Mortgage insurance premiums as itemized deduction
- › Tax-free distributions from IRAs to charities

2013 Tax Rate Increases



Without legislative action, tax rates will go **up** across the board for most tax payers:

Provision	2011	2012	2013	MFJ	Single
Rates for ordinary income	35.0%		39.6%	\$390,050+	\$390,050+
	33.0%		36.0%	\$218,450-\$390,050	\$179,400-\$390,050
	28.0%		31.0%	\$143,350-\$218,450	\$86,000-\$179,400
	25.0%		28.0%	\$71,000-\$143,350	\$35,500-\$86,000
	15.0%		15.0%	\$0-\$71,000	\$0-\$35,500
	10.0%		N/A	N/A	N/A
Long-term capital gains	15.0%		20.0%	N/A	N/A
Qualified dividends	15.0%		39.6%	N/A	N/A

The Medicare Surtax



But wait, there's more...

Starting in 2013:

3.8%

**Medicare
Surtax**

imposed on certain
investment income
on high income
taxpayers.

The screenshot shows the Medicare.gov website. At the top, there is a navigation bar with links for "Español", "A A A", "Email", and "Print". The main header features the "Medicare.gov" logo and the tagline "The Official U.S. Government Site for Medicare". A search bar is present with the placeholder text "type search term here". Below the header is a horizontal menu with buttons for "Sign Up / Change Plans", "Your Medicare Costs", "What Medicare Covers", "Drug Coverage (Part D)", "Supplements & Other Insurance", "Claims & Appeals", "Manage Your Health", and "Help Resources". The main content area has a large heading "Is my test, item, or service covered?" followed by a search input field and a "Go" button. Below this are two yellow buttons: "Find health & drug plans" and "Apply for Medicare". A banner at the bottom of the main content area contains three yellow boxes with text: "Open enrollment is from now until December 7." with a link "Review and compare your coverage options"; "Not sure what coverage you have?" with a link "Check your current enrollment"; and "Already know what plan you want for 2013?" with a link "Enroll". At the very bottom, there are three sections: "Lost / incorrect Medicare card?" with a dropdown menu and "Go" button; "Information for people like me" with a dropdown menu and "Go" button; and "Find someone to talk to" with a dropdown menu and "Go" button.

Medicare Surtax



Individual taxpayer threshold amounts

Single Taxpayer



\$200,000

**Married Filing
Jointly**



\$250,000

**Married Filing
Separately**



\$125,000

Medicare Surtax



How

For Individuals the **3.8%** surtax will be imposed on the lesser of:

- › Net investment income for the tax year, or...
- › The amount by which the modified adjusted gross income (MAGI) exceeds the threshold amount in that year

Medicare Surtax Example



Married Filing Jointly:

Husband and wife, filing jointly

Earn **\$200,000** in salaries

Plus **\$150,000** of net investment income

for **\$350,000** of total MAGI



The **3.8%** surtax applies to \$100,000 of income **since it is the lesser** of \$150,000 of net investment income or the excess over the MAGI threshold of \$250,000.

What IS investment income?



Net investment income includes the following:

- › Interest, dividends, royalties, annuities
- › Net capital gains derived from the disposition of property (other than property held in an active trade or business)

Long-term capital gains	15.0%	20.0%	23.8%
Qualified dividends	15.0%	39.6%	43.4%

- › Income derived from passive activities

Rental Income




What IS investment income?



Net investment income does not include the following:

- › Wages or salary
- › Active trade or business income
- › Rental income for Materially Participating Real Estate Professionals
- › Distributions from IRAs or qualified retirement plans
- › Income from tax-exempt municipal bonds

Earnings Statement 

Period ending: 12/18/2000
Pay date: 12/29/2000

JANE HARPER
101 MAIN STREET
ANYTOWN, USA 12345

CO. FILE DEPT. CLOCK NUMBER
ABC 123456 123456 12345 00000000 1

ACME SUPPLIES CORP.
475 KNAPP AVENUE
ANYTOWN, USA 10101

Social Security Number: 999-99-9999
Taxable Marital Status: Married
Exemptions/Allowances:
Federal: 3, 325 Additional Tax
State: 2
Local: 2

Earnings	rate	hours	this period	year to date
Regular	10.00	32.00	320.00	16,640.00
Overtime	15.00	1.00	15.00	780.00
Holiday	10.00	8.00	80.00	4,160.00
Tuition			37.43*	1,946.80
Gross Pay			\$ 462.43	23,526.80

Deductions	statutory	this period	total to date
Federal Income Tax			27.00
State Income Tax			
Local Income Tax			
Other Benefits and Information			
Group Term Life		0.51	
Loan Amt Pmt			
Vac Hrs			

Other Tax Measures included in...



The Affordable Care Act

- › 0.9% Surtax on high compensation taxpayers
- › Medical itemized deduction threshold increased to 10% from 7.5% (2013)
- › Maximum pre-tax FSA reimbursable amount reduced to \$2,500 from \$5,000 (2013)
- › Large employers (> 250 W-2s in 2011) must report value of employer-sponsored, employee health coverage on each W-2 (2012)

Tax & Investment Strategies



To consider during tax rate planning:

- › Accelerate income into 2012
- › Defer deductions into 2013
- › Roth IRA conversion
- › Delay charitable contributions until 2013

To consider during Medicare surtax planning:

- › Municipal bonds
- › Resetting cost basis
- › MPREP/grouping election

Estate & Gift Tax Changes



Estate Tax	2011	2012	2013
Top rate	35.0%		55.0%
Annual Gift Tax Exemption	\$13K		\$14K

Gift Tax	2011	2012	2013
	Estate and gift tax regime reunified for 2011-2012 (\$5 million exemption for gifts with highest rate of 35%)		\$1 million lifetime exemption (55% top rate)



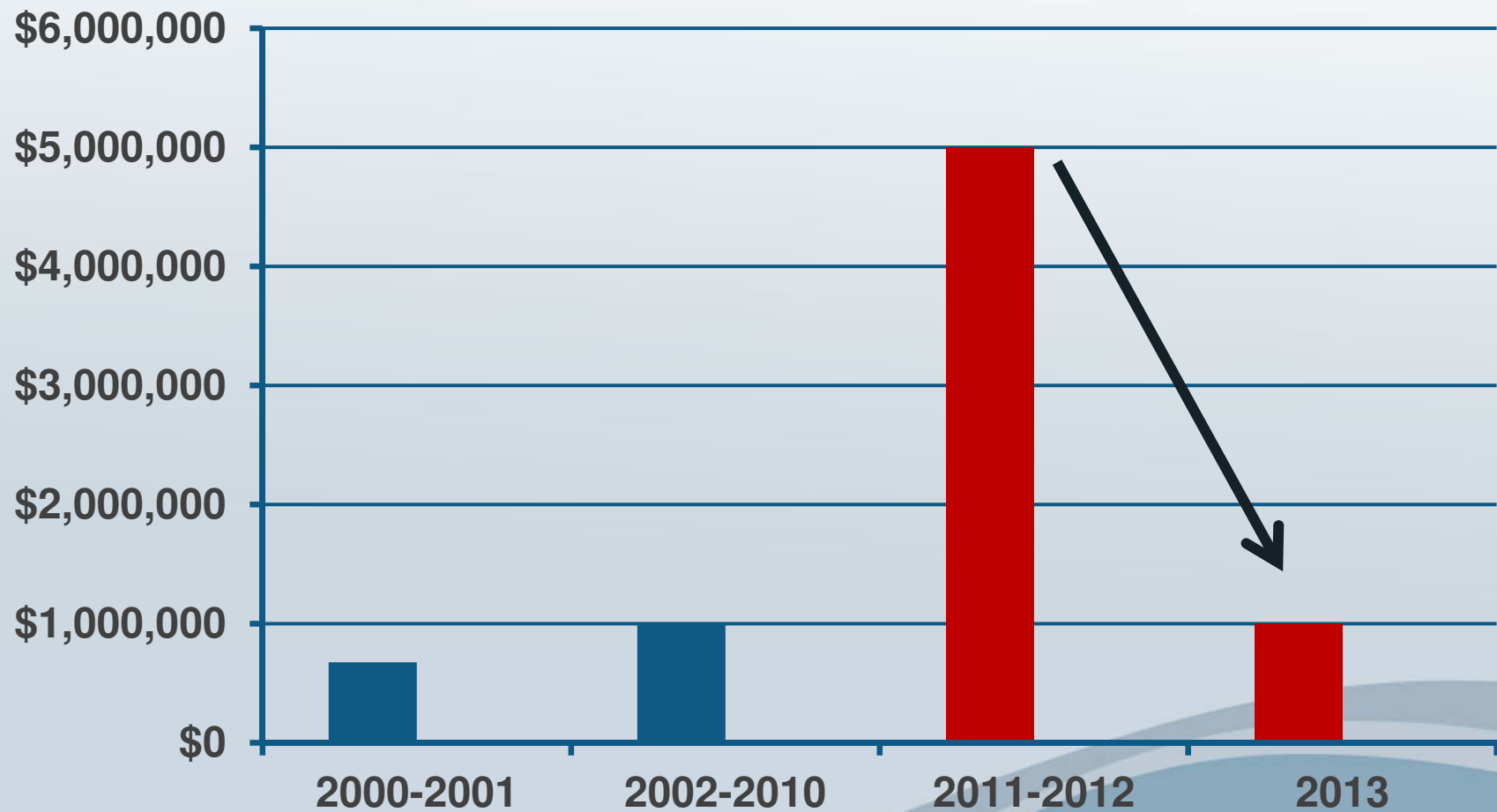
Gift & Estate Tax Update



2012

- › Oregon – maximum tax rate of 16% (\$1M exclusion)
- › Washington – maximum tax rate of 19% (\$2M exclusion)

Gift Tax Exemption



Estate Planning Strategies



Lifetime Giving Strategies:

- › Gift closely-held business interests
 - Entity interest redemptions
- › Gift fractional interests in real property
- › Gift appreciated securities
- › Gift cash

Lifetime Estate Freeze Strategies

- › Intrafamily loan
- › Partnership freeze
- › Sale to “intentionally defective grantor trust”

Estate Planning Strategies



Other considerations:

- › Valuation discounts
- › Portability of lifetime exemptions
- › Low asset values
- › Reposition asset ownership to lower tax bracket owners (3.8% Medicare tax)
- › Asset protection and preservation

Estate Planning Strategies



Don't forget:

- › Personal wealth needs
- › Basis reset upon death
- › “Clawback” estate tax calculation



Uncertain Future – 2013 & Beyond



Under the Obama Plan

Income, if AGI is: >\$250,000 for joint filers >\$200,000 for individual filers >\$125,000 for married filing separately	2013	Plus 3.8% Medicare surtax (including additional 0.9% Medicare tax)
Earned Income (salaries, etc...)	39.6%	40.5%
Capital Gains (long-term)	20.0%	23.8%
Interest, dividends, etc...	39.6%	43.4%

Uncertain Future



2013

- › Typical “extender” bill (AMT Patch)
- › Extends all Bush tax cuts thru 2013 for non “high income” taxpayers
 - “High income” > \$250k/\$200k (MFJ/S), compromise at \$1M?

Uncertain Future



2013

- › Medicare Surtax, 3.8% tax on investment income & 0.9% payroll tax on “high income” compensation
- › Estate, \$3.5M Exemption and 45% tax rate
- › Gift Tax, \$1M Lifetime Exemption and 45% tax rate

Uncertain Future



2014 & Beyond

- › Tax reform coming?
- › Increase Tax Rates
 - Individuals, “high income” taxpayers
 - International, minimum taxes on foreign profits
- › Increase Tax Base
 - Individuals, limitations on itemized deductions
 - Corporations, limitations on deductions/preference items

Other Items to Note



State Tax Update

- › Oregon
 - Corp tax rate 6.6% in 2013 (7.6% over \$10M)
 - Individual tax rate 9.9% in 2012
- › California
 - Individual tax rates 10.3-12.3% in 2012
 - Single sales factor apportionment for business in 2013

Other Items to Note



Portland/Multnomah County Update

- › Rental Real Estate
 - City of PDX, no exemptions for < 10 rentals if only business activity for 2012
 - \$50k gross receipts exemption still applicable
 - Multnomah County, no change

Other Items to Note



Portland/Multnomah County Update

- › Real Estate Brokers
 - Brokers acting as agents of a principal real estate broker exempt from City of PDX tax
 - Must be only business activity
 - Multnomah County, no change (still taxable activity)

Other Items of Note



Portland/Multnomah County Update

- › Recent Audit Activity
 - LLC owner's compensation deduction for rental real estate
 - Must provide detail of activities with hours
- › Multnomah County Property Taxes
- › City of Portland Arts Tax

Repairs & Maintenance



Status update:

- › 12/23/2011 – Temporary regulations issued
- › 1/1/2012 – Temporary regulations effective date
- › 3/7/2012 – Revenue Procedures 2012-19 & -20 issued
- › 3/15/2012 – IRS issues directive to agents to cease exams
- › 9/17/2012 – IRS expects changes to regulations prior to finalizing in 2013
- › 11/20/2012 – IRS issues Notice 2012-73

Repairs & Maintenance



Affect of new regulations:

“The temporary regulations will affect all taxpayers that acquire, produce, or improve tangible property.”



Acquisition of Production of Property



Materials and Supplies Tax Treatment

In general, materials and supplies are categorized and treated as:

- › Incidental: Carried on hand, for which no record of consumption is kept, or which physical inventories are not taken, are deductible in the year purchased
- › Non-incidental: Deductible in the year used or consumed

Acquisition of Production of Property

- › Rotable and Temporary Spare Parts: Items installed, removed and reinstalled, or used temporarily are deductible in the year the taxpayer disposes of the parts
 - Optional method under §1.162-3T(h), Example 3 illustrates “exchange” methodology
- › Does not change any other provision of the IRC, regulations or other guidance
- › A taxpayer may elect to capitalize and depreciate the cost of any material and supply

Acquisition of Production of Property



De Minimis Rule:

- › Permits taxpayers to deduct costs incurred under a capitalization threshold
- › Four requirements for safe harbor:
 - Applicable financial statement (“AFS”)
 - Written capitalization policy at beginning of year
 - Expense in AFS in accordance with written capitalization policy
 - Deduction cannot exceed ceiling for aggregate amount deducted

Acquisition of Production of Property



- › Ceiling is less than or equal to the greater of:
 - 0.1% of the federal income tax gross receipts; or
 - 2% of AFS depreciation and amortization expense
- › Not intended to prevent a taxpayer from reaching an agreement with IRS exam agent that exceeds the safe harbor ceiling

Improvement to Property



Application:

- › Determine the Unit of Property (“UOP”)
- › Apply the capitalization standards
- › Optional: Routine Maintenance safe harbor

Improvement to Property



Unit of Property - Buildings

- › Each building and its structural components is a single UOP. The capitalization standards are applied separately to the building structure and the following 8 building systems:
 - Gas distribution
 - Electrical
 - Elevators
 - HVAC
 - Building structure
 - Plumbing
 - Escalators
 - Fire protection
 - Security systems

Improvement to Property



Unit of Property – Property other than buildings

***In general:* All of the components that are functionally interdependent comprise a single UOP.**

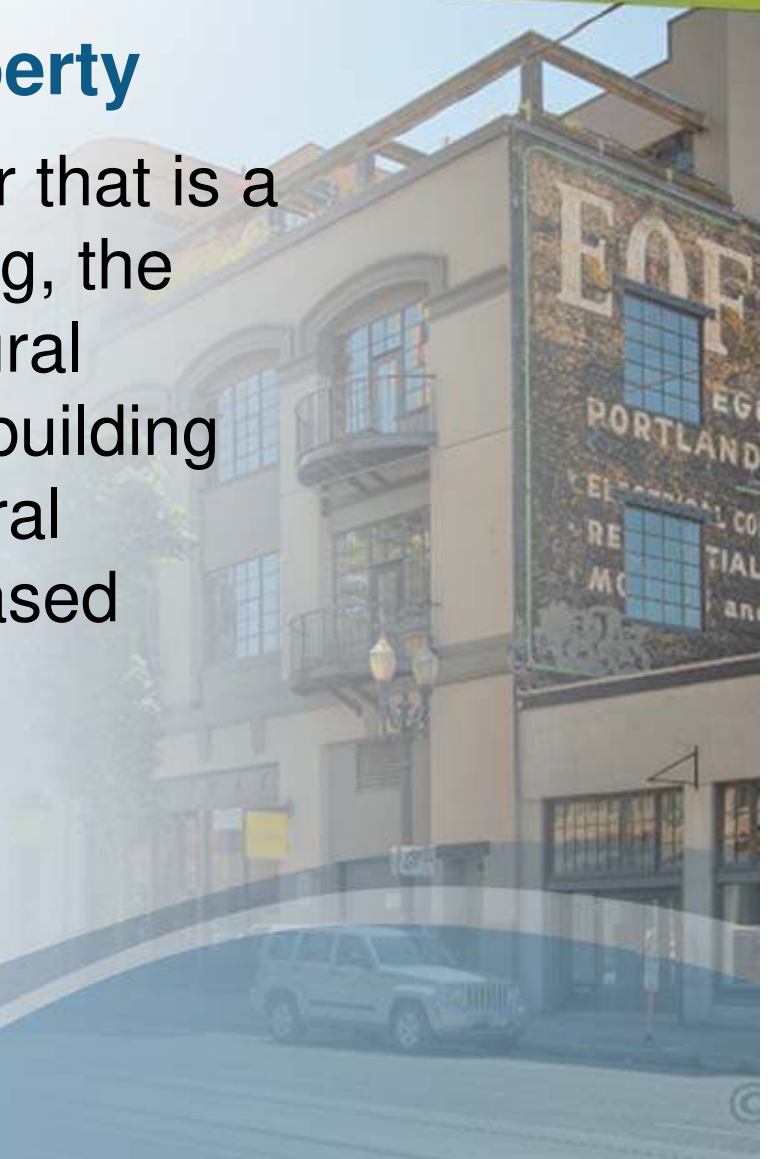
- › Components are functionally interdependent if placing in service one is dependent upon the placing in service of another component.

Improvement to Property



Unit of Property – Leased Property

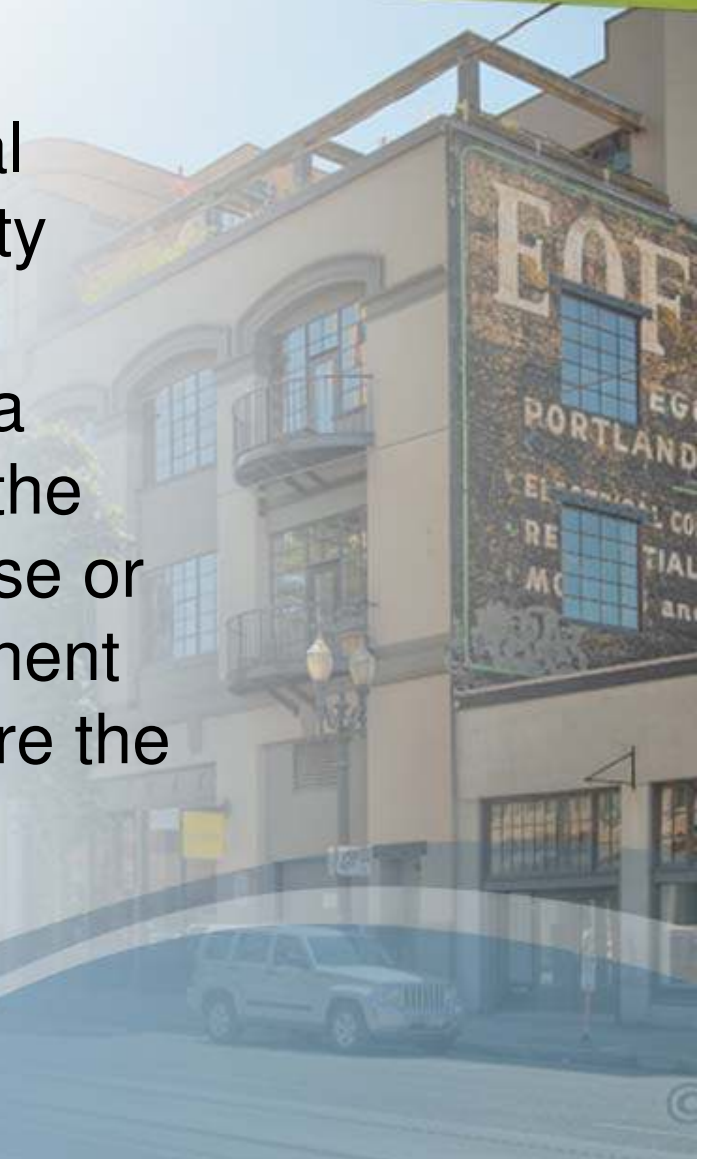
In general: In the case of a taxpayer that is a lessee of all or a portion of a building, the UOP is each building and its structural components or the portion of each building subject to the lease and the structural components associated with the leased portion.



Improvement to Property



- › In the case of a lessee of an entire building, the building or its structural components are the units of property
- › In the case of a lessee that leases a portion of a building, the portion of the building structure subject to the lease or the portion of any structural component associated with the leased space are the units of property



Improvement to Property



Capitalization Standards

***In general:* Taxpayers must capitalize amounts paid to improve tangible property if the amount paid results in a:**

- › Betterment
- › Adaption to a new and different used; or
- › Restoration

General Asset Accounts (GAA)



Election

- › Assets may be grouped in a single GAA if they have the:
 - Same depreciation method (cannot combine bonus and non-bonus)
 - Same recovery period
 - Same convention
 - Placed in service in same taxable year
- › A single asset can be placed into a GAA

General Asset Accounts (GAA)



- › If GAA elected, no loss on disposition recognized until all assets in GAA completely disposed. However, can elect to treat a component of an asset as a single asset for disposition purposes:
 - Structural components of buildings generally defined under Section 48 regs.
 - Definition of component must be consistently used for all assets
 - Election provides flexibility in determining whether to take a loss on a disposition or a repair expense, if permitted.

Accounting Method Changes



Under the regulations:

Automatic consent for method changes to comply with temporary regulations

- › Form 3115 must be attached to the timely filed (including extensions) fed tax return for the year of change
- › National Office copy of Form 3115 must be filed with IRS Ogden, UT office in lieu of IRS National Office in DC

Accounting Method Changes



- › Generally implemented with a cumulative section 481(a) adjustment
 - Cumulative effect (including any section 481(a) adjustments from prior repair method changes and 263A) must be reflected in the adjustment
 - Exception: “modified” section 481(a) adjustment for certain changes (e.g., materials and supplies, the de minimis rule) – amounts paid on or after 1/1/12

IRS Notice 2012-73



- › Optional application of temporary regulations for 2012-2013
- › Final regulations issued in 2013, effective 1/1/2014
- › Potential changes for:
 - De minimis rule
 - Dispositions
 - Routine maintenance safe-harbor

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