Supplement to J.K. Lasser's Small Business Taxes 2012

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The tax law is not static, and there have been a number of changes affecting 2011 returns, as well as returns in 2012. Since publication of the 2012 edition of *J.K. Lasser's Small Business Taxes*, Congress has enacted the Three Percent Withholding Repeal and Job Creation Act and the Temporary Payroll Tax Cut Continuation Act. The courts and the IRS have also made decisions and rulings on many tax items that can impact your 2011 return. Here are key developments, some of which can apply to your 2011 return. Also, factor in 2012 changes if they affect your tax planning for 2012.

The changes presented in this Supplement are tied to the chapters in the book.

Chapter 1—Business Organization

Series LLCs. In addition to the 8 states listed in the book, Texas now permits series LLC.

Audit rates. The audit rates for the government's fiscal year ending September 30, 2011, have been released. Generally, rates increased only on higher-income taxpayers; for the most part they were unchanged for entities. A complete table will be included in the 2013 edition of the book.

Chapter 4—Income or Loss from Business Operations

Reporting income from Form 1099-K. Merchant card and third-party payment providers must report transactions that total more than $20,000 for at least 200 transactions. All business-related tax forms have a special line for this information. However, instructions say "enter zero" on this line. Include the income from these transactions along with other gross receipts. Adjust the income reported by any returns, refunds, allowances, cash-backs, or other amounts that reduced the revenue from these transactions.

Real estate professionals. Individuals with full-time jobs are not automatically precluded from qualifying as real estate professionals. Such individuals merely have to meet the two tests for real estate professionals.

Income from farming. The IRS has extended the livestock replacement period for certain drought-affected areas. Counties for 2011 can be found in Notice 2011-79.

Withholding on government contractors. There was supposed to be withholding at the rate of 3% on payments to local, state, and federal contractors earning more than $10,000. The withholding rule, which originally was set to apply for 2011, had been postponed several times; it has been repealed entirely.

Chapter 5—Capital Gains and Losses

Sales of qualified business stock—excluding gain. The 100% exclusion for stock issued after September 28, 2010, expired on December 31, 2011. However, Congress may extend this tax break. If it does not, then stock issued after December 31, 2011, has a 50% exclusion, as long as it is held more than 5 years on the date of sale.

Chapter 7—Employee Compensation

Deductible compensation—employees versus independent contractors. The IRS has launched a Voluntary Classification Settlement Program (VCSP), which allows employers to reclassify workers as employees at a cost of 10% of the prior year's employment taxes. This program does not replace existing Sec. 530 relief, which has no tax cost if workers are reclassified. Details of the VCSP can be found at www.irs.gov/businesses/small/article/0,,id=246014,00.html.

Employee use of company car. For purposes of valuing employee use of a company car in 2012, the IRS standard mileage rate is 55.5 cents per mile.

Employers using the cents-per-mile valuation rule for employee use of a company car can do so in 2012 only if the value of the car on the first day it is made available to the employee does not exceed $21,100 ($21,900 for a truck or van).

Qualified transportation fringe benefits. In 2012, the exclusion for employer-paid parking is limited to $240 per month and the exclusion for monthly transit passes and van pooling is limited to $125 per month. However, Congress is considering a bill to restore parity between free parking and other transportation fringe benefits for 2012.

Empowerment zone employment credit. The 20% credit for hiring certain workers expired at the end of 2011. However, this tax break could be extended by Congress for 2012.

Indian employment credit. The 20% credit for hiring certain employees expired at the end of 2011. However, this tax break could be extended by Congress for 2012.

Employer wage credit for activated workers. The 20% credit for wage differential payments by small employers made to employees called to active duty expired at the end of 2011. However, this tax break could be extended by Congress for 2012.

Chapter 8—Travel and Entertainment Expenses

Business travel per diem rates. The maximum federal per diem rate for travel starting October 1, 2011, through September 30, 2012, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $123 per day ($77 for lodging and $46 for M&IE). A number of the rates to certain areas have changed. These rates can be found at www.gsa.gov (click on "Per Diem Rates").

The high-low substantiate rates for high-cost and all other areas within CONUS for the period October 1, 2011, is $242 for travel to high-cost localities and $163 for travel to all other areas with CONUS. Of these rates, the meal portion is $65 for high-cost areas and $52 for all other areas within CONUS. These rates are slightly higher than the rates for the prior 12-month period. Note that while no new areas have been added to the high-cost list, five areas have been removed and the period of the year for which others qualify as high-cost areas have been changed.

Conventions—foreign conventions. The list of countries in which foreign conventions are not treated as being held outside the North American Area has been expanded to include Panama (for conventions as of April 18, 2011).

Chapter 9—Car Expenses

Standard mileage rate. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for 2012; it is 55.5 cents per mile.

Those who own their vehicles and use the standard mileage rate for 2012 must reduce the vehicle's basis by 23 cents per mile.

Chapter 10—Repairs, Maintenance, and Energy Improvements

Repairs versus improvements. Temporary regulations designed to clarify when costs can be immediately deducted rather than capitalized have been released. This is the third time that the IRS has tried to create definitions for this purpose. These temporary regulations contain various safe harbors to help simplify tax reporting.

The temporary regulations are generally effective tax years beginning on or after January 1, 2012. The IRS has said it will provide procedures under which businesses can obtain automatic consent for a change accounting method provided in the temporary regulations.

Environmental cleanup costs. The opportunity to expense rather than capitalize cleanup costs (so-called "Brownfield" remediation costs), which had expired at the end 2011. However, this tax break may be extended by Congress for 2012.

Chapter 12—Rents

Qualified leasehold improvements. Leasehold improvements qualify for bonus depreciation. Improvements made after September 8, 2010, and before January 1, 2012, qualify for 100% bonus depreciation. Qualified restaurant and retail improvements do not qualify for this bonus depreciation unless they also qualify as leasehold improvements. The 100% bonus depreciation may be extended for 2012; if not, then the limit is 50%.

Qualified leasehold, restaurant, and retail improvements had a 15-year recovery period through December 31, 2011. They may also qualify for $250,000 first-year expensing through December 31, 2011; the expensing option permits an immediate deduction if there was sufficient taxable income. These tax breaks may be extended by Congress for 2012.

Chapter 13—Taxes and Interest

Employment taxes—FICA. The wage base for the Social Security portion of FICA in 2012 is $110,100. The 4.2% rate for the employee's Social Security portion of FICA applies for the first 2 months of 2012 (through February 29, 2012and it is likely that this

2 percentage point reduction from the usual 6.2% tax rate will be extended for all of 2012. Check with jklasser.com for an update.

Employment taxes—FUTA tax. The Department of Labor has released its list of 2011 FUTA "credit reduction states." Employers in these states (see Table 13-1, below) have a reduced credit for state unemployment taxes. Affected employers pay an additional FUTA amount as indicated in Table 13-1. The 0.3% additional FUTA amount translates into $21 per employee earning $7,000 or more. The FUTA tax is fully deductible.

Table 13-1 Credit Reduction States for 2011 FUTA

Arkansas (0.3%)	Kentucky (0.3%)	New York (0.3%)
California (0.3%)	Michigan (0.9%)	Ohio (0.3%)
Connecticut (0.3%)	Minnesota (0.3%)	Pennsylvania (0.3%)
Florida (0.3%)	Missouri (0.3%)	Rhode Island (0.3%)
Georgia (0.3%)	North Carolina (0.3%)	Virginia (0.3%)
Illinois (0.3%)	New Jersey (0.3%)	Wisconsin (0.3%)
Indiana (0.6%)	Nevada (0.3%)	

Chapter 14—First-Year Expensing, Depreciation, Amortization, and Depletion

Depreciation. No depreciation can be claimed for an asset that is not ready for use in your business. Thus, an S corporation operating freight business could not depreciate the cost of an airplane it purchased but never used in the business, or could use in the business; no one had a pilot's license and there were no "standby" pilots to fly the plane+.

First-year expensing. The expensing limit for 2010 and 2011 is $500,000. The limit phases out when purchases for the year exceed $2 million. Thus, no expensing can be used if purchases for the year exceed $2.5 million.

Looking ahead, the expensing limit for 2012 is set to be $139,000 ($125,000 adjusted for inflation). The phase-out starts when purchases for the year exceed $560,000. In 2013, the limit reverts to $25,000, with a phase-out beginning at $200,000, unless Congress again extends the law.

The additional first-year expensing for property in empowerment zones and the DC zone expired at the end of 2011; it may be extended through 2012.

The opportunity to expense film and television production costs expired at the end of 2011; it may be extended through 2012.

15-year amortization of qualified leasehold, restaurant, and retail improvements. See Chapter 12.

Bonus depreciation. See Chapter 12.

Chapter 16—Retirement Plans

Contribution limits. Various limits have been increased for 2012:

- 401(k) plan elective deferrals: $17,000 (plus $5,500 for those age 50 and older by December 31, 2012).
- Savings incentive match plan for employees (SIMPLE) elective deferrals: $11,500 (plus $2,500 for those age 50 and older by December 31, 2012) (no change here).
- Defined contribution plans (profit-sharing plans and simplified employee pension plans [SEPs]): up to $50,000.
- Defined benefit (pension) plans: up to $200,000.
- Compensation taken into account in figuring contributions and benefits: $245,000.

Chapter 17—Casualty and Theft Losses

Disaster losses. The IRS has a new landing page entitled *Disaster Assistance and Emergency Relief for Individuals and Businesses* at www.irs.gov/businesses/small/article/0,,id=156138,00.html. Here you will find helpful links to publications and other disaster-related information.

Chapter 18—Home Office Deductions

Exclusive use. There have been several cases that help to define "exclusive use," which is mandatory for claiming a home office deduction. It appears that merely walking through a room used as a home office does not prevent a taxpayer from meeting the exclusive use test. However, even occasional use by family, relatives, or other guests prevents a taxpayer from meeting the exclusive use test.

Chapter 19—Medical Expenses

Table 19.1. The IRS has released the average premiums for small group markets in states for 2011. Here are the updated figures:

Table 19-1 Average Premiums by State for the Small Group Market

State	Employee-only coverage	Family coverage
Alabama	$4,778	$12,084
Alaska	6,729	14,701
Arizona	4,614	11,063
Arkansas	4,378	9,849
California	4,740	11,493

Colorado	5,007	12,258
Connecticut	5,640	14,097
Delaware	5,902	13,411
District of Columbia	5,721	14,024
Florida	5,218	12,550
Georgia	5,085	11,440
Hawaii	4,622	11,529
Idaho	4,379	10,066
Illinois	5,565	13,176
Indiana	5,262	12,097
Iowa	4,694	11,051
Kansas	4,693	11,909
Kentucky	4,456	10,560
Louisiana	5,143	11,911
Maine	5,261	12,255
Maryland	5,073	12,530
Massachusetts	5,900	15,262
Michigan	5,195	12,539
Mississippi	5,433	10,501
Missouri	4,787	10,860
Montana	4,923	10,789
Nebraska	5,130	12,057
Nevada	4,781	10,836
New Hampshire	5,858	14,523
New Jersey	5,868	14,093
New Mexico	5,146	12,328
New York	5,589	13,631
North Carolina	5,136	11,949
North Dakota	4,545	11,328
Ohio	4,706	11,627
Oklahoma	4,922	11,200

Oregon	4,881	11,536
Pennsylvania	5,186	12,671
Rhode Island	5,956	14,553
South Carolina	5,036	11,780
South Dakota	4,733	11,589
Tennessee	4,744	11,035
Texas	5,172	12,432
Utah	4,532	11,346
Vermont	5,426	12,505
Virginia	5,060	12,213
Washington	4,776	11,151
West Virginia	5,356	12,724
Wisconsin	5,284	13,911
Wyoming	5,430	12,867

Health savings accounts. The contribution limits for 2012 increased to $3,100 for self-only coverage and $6,250 for family coverage. Those age 55 or older by the end of 2012 can add another $1,000 for the year.

To contribute to a health savings account, the person must be covered by a high-deductible health plan. For 2012, this means that the plan has a minimum deductible of $1,200 for self-only coverage and $2,400 for family coverage (the same deductible that applied for 2011).

Archer medical savings accounts. The annual deductible in 2012 for a self-only plan is not less than $2,100 and not more than $3,150; the out-of-pocket annual expense limit is $4,200. The annual deductible for family coverage is not less than $4,200 and not more than $6,300; the out-of-pocket annual expense limit is $7,650.

Future health care changes. The National Federation of Independent Business (NFIB), along with 26 state attorneys general, filed suit to challenge the constitutionality of the Patient Protection and Affordable Care Act. The U.S. Supreme Court is reviewing the matter and will hand down a decision by the end of June 2012. Track developments about this case at www.supremecourt.gov/Search.aspx?FileName=/docketfiles/11-393.htm and at www.barbaraweltman.com.

Chapter 20—Deductions for Farmers

IRS information. The IRS has created a landing page for updating its Publication 225, *Farmers' Tax Guide*. This can be found at http://www.irs.gov/formspubs/article/0,,id=242869,00.html.

Depreciation. See Chapter 14.

Chapter 22—Miscellaneous Business Deductions

Moving expenses. For 2012, the standard mileage rate for driving a personal vehicle for moving purposes is 23 cents per mile.

Personal education incentive:

- ***Lifetime learning credit.*** The modified adjusted gross income limit on eligibility for the credit increases to $52,000 to $62,000 ($104,000 to $124,000 on a joint return).
- ***Above-the-line deduction for tuition and fees.*** This break expired at the end of 2011; it may be extended for 2012.
- ***Student loan interest.*** The modified adjusted gross income limit on eligibility for the deduction increases $125,000 to $155,000 on a joint return; the limit for singles remains at $60,000 to $75,000.

Charitable contributions. Enhanced deductions for donations of food, books, and computer equipment, which had expired at the end of 2011; Congress may extend them for 2012.

In 2011, S corporation shareholders could take into account their prorated share of corporate donations, even if they exceed the shareholders' basis in their S corporation stock. This break expired at the end of 2011, but has been extended through 2012.

The enhanced deduction for conservation easements, which expired at the end of 2011; it could be extended through 2012. If extended, then farmers and ranchers can claim a charitable contribution deduction for 2012 donations of conservation easements of 100% of their contribution basis.

Legal and professional fees. A deduction was allowed for legal fees to defend against a claim of infringement of intellectual property. However, the party suing for infringement cannot claim a deduction; the costs are added to the basis of the intellectual property.

Meal costs for day care providers. For 2012, the deduction for standard meals and snack rates have been increased slightly:

Breakfast:

- States other than Alaska and Hawaii: $1.24
- Alaska: $1.97
- Hawaii: $1.44

Lunch and dinner:

- States other than Alaska and Hawaii: $2.32
- Alaska: $3.76
- Hawaii: $2.71

Snacks:

- States other than Alaska and Hawaii: $0.69
- Alaska: $1.12
- Hawaii: $0.81

Chapter 23—Roundup of Tax Credits

Employment-related credits:

- ***Work opportunity credit.*** The credit had been set to run only through August 31, through December 31, 2011. However, two new targeted groups have been added from November 22, 2011, through December 31, 2012, for returning heroes and wounded warriors (certain post-9/11 veterans). The credit limits are:
    - Returning heroes: 40% of the first $6,000 of wages (top credit of $2,400) for hiring a veteran who has been unemployed at least 4 weeks but less than 6 months in the year preceding the hiring date ; 40% of the first $14,000 of wages (top credit of $5,600) for hiring a veteran who has been unemployed at least 6 months in the prior 1-year period.
    - Wounded warriors (those with a service-related disability): 40% of the first $12,000 of wages (a top credit of $4,800) for hiring any such veteran within a year of release from active duty; 40% of the first $24,000 of wages (top credit of $9,600) for hiring a veteran with service-connected disabilities who has been unemployed at least 6 months in the year preceding the hiring date.
- ***Empowerment zone employment credit.*** The credit expired at the end of 2011; it may be extended through 2012.
- ***Indian employment credit.*** The credit expired at the end of 2011; it may be extended through 2012.
- ***Employer differential wage payment credit.*** The credit expired at the end of 2011; it may be extended through 2012.

Capital construction-related credits:

- ***New markets credit.*** The credit expired at the end of 2011; it may be extended through 2012.
- ***Energy-efficient home credit.*** The credit expired at the end of 2011; it may be extended through 2012.

Other tax credits:

- ***Research credit.*** The 20% credit expired at the end of 2011; it may be extended through 2012.

Chapter 24—Income and Deduction Strategies

Audit-proofing your return. While there is no way to completely prevent the IRS from selecting your return for audit, take care to report all income and use other measures to minimize selection.

The IRS has expanded its Audit Technique Guide for cash-intensive businesses (e.g., laundromats, certain convenience stores) for minimum income probes (Chapter 4). The guide now includes instructions to IRS examiners reviewing returns of taxi drivers.

Note that starting in April 2012, the IRS has indicated informally that is will begin random audits under the National Research Program of Form 1120 (for C corporations). It has not yet indicated which year or years will be reviewed.

Chapter 25—Strategies for Opening or Closing a Business

Other financing—crowdfunding. There is legislation pending that would change SEC rules to permit companies to raise capital in small increments (e.g., up to $1,000, or $10,000) without having to comply with the usual SEC rules. Check for developments on www.barbaraweltman.com.

Moving. The IRS has announced a new form that businesses should use to report a new address or change of location. Form 8822-B should be available by March 2012.

Chapter 28—Alternative Minimum Tax

Exemption amounts. There has been no "patch" announced for alternative minimum tax (AMT) exemption amounts for 2012, but likely it will be done.

Tax credit offsets. Nonrefundable personal tax credits, such as the lifetime learning credit and the dependent care credit, could be used to offset not only regular income tax, but also the alternative minimum tax through 2011. After 2011, the only nonrefundable personal credits that can offset AMT will be the adoption credit, the child tax credit, and the retirement saver's credit unless Congress continues the current rule.

Chapter 29—Other Taxes

State income taxes. Your obligation for state income taxes usually depends on whether you have a nexus to a state (typically a physical presence). However, states are moving toward commercial or financial nexus as a basis to impose state income tax. Here are some taxes to be aware of:

Doing business with consumers and companies in other states may expose you to taxes that you never dreamed of. States are reaching out across their borders to grab revenue from out-of-state businesses in any way they can. Here are 3 traps you may encounter.

- ***Sourcing of services revenue.*** This is a tax on services performed out of state that benefit businesses within the state that imposes the tax. For example, an advertising firm based in Connecticut provides services for a business in

California. The State of California imposes a tax, to be paid by the Connecticut firm, on the services that benefit the California business. Believe it or not, a business can be subject to double taxation—income tax on revenue earned in their state plus the sourcing of services tax on the benefits received in another state. There is no credit that can be claimed for the out-of-state taxes; they are, however, deductible. So far, this type of income tax applies in: California (beginning in 2011 for certain taxpayers), Georgia, Illinois, Iowa,; Maine, Maryland, Michigan, Minnesota, Ohio, Oklahoma, Utah, Washington, and Wisconsin.

- ***Gross receipts tax.*** This is a tax on all business-to-business transactions within the state. Unlike an income tax, there are no deductions or other write-offs to reduce the tax exposure. Currently, this tax is imposed in Arizona (transaction privilege tax), Delaware, Hawaii (general excise tax), New Mexico, Ohio (commercial activity tax), Oregon (business and occupation tax), Pennsylvania, Texas (margin tax), Washington (called a business and occupation tax), and West Virginia (to a very limited extent).

Social Security and Medicare taxes. The 2012 wage base for the Social Security tax portion of FICA and self-employment tax increased to $110,100.

The 2 percentage point reduction in the employee share of Social Security taxes that applied in 2011 was extended for the first 2 months of 2012 (through February 29, 2012). Thus, instead of withholding 6.2% from employees, the withholding rate is 4.2%. This reduction is reflected in new withholding tables (see IRS Publications 15 and 15-A). Congress is likely to extend the reduction for the rest of 2012. Check jklasser.com for an update.

Employment tax audits. Starting in February 2010, the IRS will conduct random employment tax audits under the National Research Program. About 2,000 businesses will be randomly selected each year (2010, 2011, and 2012) to help the IRS gather information so they can better police employment taxes in the future. Companies from all industries and of all sizes may be selected. The IRS notes that this random audit program will be similar to the one they conducted for S corporations a few years ago.

Form W-2 reporting. Employers were supposed to report the value of health care for employees in 2011, whether paid by the employer, employee, or a combination of both; the IRS has made this reporting voluntary for 2011. Starting in 2012, large employers will have to begin this reporting, but small employers (250 or fewer W-2s) do not have to report in 2012 (likely small employers will have to begin reporting for 2013).

Self-employment tax. The 2 percentage point reduction in the employee-equivalent of the Social Security portion of self-employment tax applied for all of 2011; this has been extended for the first 2 months of 2012 (through February 29, 2012). This reduction could be extended for the balance of the first quarter of 2012, or through all of 2012. Self-employed individuals should adjust their 2012 quarterly estimated tax payments to enjoy the 2 percentage point tax savings.

Chapter 30—Filing Income Tax Returns and Paying Taxes

Filing deadlines. The due date for filing 2011 returns by individuals and partnerships reporting on a calendar basis is April 17, 2012. The extended due date for these returns is October 15, 2012.

Appendix A—Information Returns

Form 1099-MISC. Businesses were supposed to report goods and services of $600 or more paid to any other business (including corporations). This rule was repealed. Reporting is required only for payments of $600 or more to:

- Independent contractors
- Attorneys and law firms (even if incorporated)
- Health care providers
- Lessors (for rented/leased property)