Supplement to J.K. Lasser's Small Business Taxes 2013

By Barbara Weltman

The tax law is not static, and there have been a number of changes affecting 2012 returns, as well as returns in 2013. Since publication of the 2013 edition of *J.K. Lasser's Small Business Taxes*, Congress has enacted the American Taxpayer Relief Act. The courts and the IRS have also made decisions and rulings on many tax items that can impact your 2012 return. Here are key developments, some of which can apply to your 2012 return. Also, factor in 2013 changes if they affect your tax planning for 2013.

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

Chapter 1—Business Organization

Examples of tax definitions of small business. For 2012 (and 2013), for purposes of the first-year expense election, it means equipment purchases of no more than $2 million. Above this purchase limit, the first-year expense deduction begins to phase out.

Forms and schedules. Because of the late enactment of the American Taxpayer Relief Act, the IRS had not updated many of its forms and schedules for the 2012 return. Find final versions of forms and schedules at www.irs.gov/Forms-&-Pubs.

Audit rates. The audit rates for the government's fiscal year ending September 30, 2012, 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 2014 edition of the book.

Chapter 4—Income or Loss from Business Operations

Income from farming. The IRS has extended the livestock replacement period for certain drought-affected areas. Counties for 2012 can be found in Notice 2012-62.

Built-in capital gains for S corporations. The built-in gains period in which sales of certain appreciated property trigger tax at the corporate level usually is 10 years. The American Taxpayer Relief Act shortened it to 5 years for 2012 and 2013.

Limit on business losses—S corporations. If an S corporation donates appreciated property to charity in 2012 (or 2013), the shareholder reduces his or her basis by the allocable share of the property's adjusted basis (not the corporation's charitable deduction based on the property's fair market value).

Chapter 5—Capital Gains and Losses

Sales of qualified business stock—excluding gain. The 100% exclusion for stock issued after September 27, 2010, expired on December 31, 2011. However, it has been retained for stock issued in 2012 and 2013. To qualify for the exclusion, qualified small business stock must be held more than 5 years.

Tax rates on capital gains. For 2012, owners in the 10% or 15% tax bracket pay no tax on their share of capital gains. Starting in 2013, owners who are in the new top income tax bracket of 39.6% will pay 20% on their share of capital gains; owners in lower brackets will continue to enjoy the zero or 15% rate, depending on their tax bracket. Gain from installment sales made prior to 2013 related to payments received after 2012 will be taxed at the owner's applicable rate for the year of receipt (i.e., zero, 15%, or 20%).

Involuntary conversions. You can elect to postpone gain resulting from an involuntary conversion by acquiring replacement property within a set limit. Usually, this means the end of the 2 years following the close of the year in which the gain was realized. However, in certain several storm situations, such as Hurricane Katrina, Congress provided more time (e.g., 5 years for Katrina victims). It has been proposed that Congress extend the replacement period for victims of Hurricane Sandy, but nothing has been finalized.

Chapter 7—Employee Compensation

Deductible compensation—employees versus independent contractors. The IRS launched a Voluntary Classification Settlement Program (VCSP) in 2011, which allows employers to reclassify workers as employees at a cost of 10% of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year. The IRS has now liberalized the program (employers no longer need to consent to extend the statute of limitations) and temporarily (through June 30, 2013) will allow employers who failed to issue required Forms 1099 to participate. Such employees, however, will pay 25%, rather than 10% of the liability.

Adoption assistance. The dollar limit on the exclusion for employer assistance for adoption costs in 2013 is $12,970.

Employee use of company car. For purposes of valuing employee use of a company car in 2013, the IRS standard mileage rate is 56.5 cents per mile.

Employers using the cents-per-mile valuation rule for employee use of a company car can do so in 2013 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).

The fixed and variable rate allowance (FAVR) in 2013 is limited to a standard automobile cost not exceeding $28,100 ($29,900 for trucks and vans).

Qualified transportation fringe benefits. The American Taxpayer Relief Act restored parity between free parking and other transportation fringe benefits for 2012 and 2013. This means that transportation fringe benefits are excludable in 2012 at the rate of $240 per month and in 2013 at the rate of $245 per month.

Employers must use the restored parity amount for transit passes and van pooling provided in 2012. This means that the correct amount must be reflect on employees' W-2s (furnished to employees in 2013) and on the employers' Form 941 for the fourth quarter of 2012 (filed in 2013).

Work opportunity credit. The credit had been set to apply in 2012 only to certain veterans. However, Congress extended the credit for all of the targeted groups for 2012 and 2013.

The IRS has yet to issue guidance on what employers must do to meet the requirement of submitting Form 8850, *Pre-Screening Notice and Certification Request,* to the state workforce agency within 28 days of hiring a worker since this time period has long expired for some new employees. In the past, when a similar situation arose, the IRS gave employers until some time later in the year (the last time it was May 22) to submit the forms in order to take the tax credit on their return. Check for IRS relief in the matter.

Empowerment zone employment credit. The 20% credit for hiring certain workers expired at the end of 2011. However, Congress extended this break for 2012 and 2013.

Indian employment credit. The 20% credit for hiring certain employees expired at the end of 2011. However, Congress extended this break for 2012 and 2013.

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, Congress extended this break for 2012 and 2013.

Chapter 8—Travel and Entertainment Expenses

Business travel per diem rates. The maximum federal per diem rate for travel starting October 1, 2012, through September 30, 2013, 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). These rates are unchanged from the prior 12-month period. However, certain areas have different rates. These rates can be found at www.gsa.gov (click on Per Diem Rates).

The high-low substantiation rates for areas within CONUS for the period October 1, 2012, through September 30, 2013, are $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 unchanged from the prior 12-month period. No new areas have been added to the high-cost list.

Chapter 9—Car Expenses

Section 179 deduction. The dollar limit for 2012 (and 2013) is $500,000. It had originally been set to be $139,000 in 2012. This limit is subject to the applicable dollar limit for cars, trucks and vans. However, the $25,000 limit for heavy SUVs continues to apply.

The first-year dollar limit (see Table 9.5) reflects an $8,000 additional amount for new vehicles because of bonus depreciation. This additional amount will also apply in 2013 for the purchase of new vehicles.

Standard mileage rate. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for 2013; it is 56.5 cents per mile (one penny more than in 2012).

Those who own their vehicles and use the standard mileage rate for 2013 must reduce the vehicle's basis by 23 cents per mile (the same as in 2012).

Credit for electric vehicles. The credit of up to $7,500 for highway-legal electric vehicles (such as the Chevy Volt and Nissan Leaf) continues to apply. However, the credit for low-speed vehicles had expired at the end of 2011. This credit has been extended for 2-wheel and 3-wheel vehicles (but not for 4-wheel vehicles) acquired before 2014.

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 were set to be effective in tax years beginning on or after January 1, 2012. However, late in 2012, the IRS postponed the effective date until 2014. However, businesses can opt to use the temporary and proposed regulations (which contain many favorable safe harbors and de minimis rules) for 2012 and 2013.

Environmental cleanup costs. The opportunity to expense rather than capitalize cleanup costs (so-called "Brownfield" remediation costs) expired at the end of 2011. This break has *not* been extended.

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. Bonus depreciation at the rate of 50% (not 100%) has been extended for 2012 and 2013.

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 have been extended by Congress for 2012 and 2013.

Chapter 13—Taxes and Interest

Self-employment tax. The Social Security wage base limit, which applies for self-employment taxes, is $113,700 in 2013. The tax rate for the Social Security portion of self-employment tax is 12.4% on net earnings up to this dollar limit. The tax rate for the Medicare portion of self-employment tax is 2.9% on all net earnings. The tax deduction is limited to one-half of this amount.

For those with net earnings over the applicable threshold amount ($200,000 for singles; $250,000 for joint filers), there is a Medicare surtax of 0.9% on excess earnings. This applies only to the so-called employee portion, so it is *not* deductible.

Employment taxes—FICA. The wage base for the Social Security portion of FICA in 2013 is $113,700. The rate for the employee's Social Security portion of FICA is 6.2%. The so-called payroll tax holiday that applied for 2011 and 2012 was *not* extended for 2013.

Employment taxes—FUTA tax. The Department of Labor has released its list of 2012 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. For example, an additional 0.6% additional FUTA amount translates into $42 per employee earning $7,000 or more. The FUTA tax is fully deductible.

Table 13-1 Credit Reduction States for 2012 FUTA

Arizona (0.3%)	Georgia (0.6%)	New York (0.6%)
Arkansas (0.6%)	Indiana (0.9%)	North Carolina (0.6%)
California (0.6%)	Kentucky (0.6%)	Ohio (0.6%)
Connecticut (0.6%)	Missouri (0.6%)	Rhode Island (0.6%)
Delaware (0.3%)	Nevada (0.6%)	Vermont (0.3%)
Florida (0.6%)	New Jersey (0.6%)	Wisconsin (0.3%)

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

First-year expensing. The expensing limit for 2012 and 2013 has been retained at $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.

The additional first-year expensing for property in empowerment zones has been extended through 2012 and 2013. However, special breaks for the DC zone have not.

The opportunity to expense film and television production costs expired at the end of 2011; it, too, has been extended through 2012 and 2013.

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

Bonus depreciation. See Chapter 12.

Modified accelerated cost recovery system—recovery periods. The 7-year recovery period for motorsports entertainment complexes has been extended for 2012 and 2013.

Research and experimentation costs. The research credit, which expired at the end of 2011, has been extended for 2012 and 2013.

Chapter 16—Retirement Plans

Contribution limits. Various limits have been increased for 2013:

- 401(k) plan elective deferrals: $17,500 (plus $5,500 for those age 50 and older by December 31, 2013).
- Savings incentive match plan for employees (SIMPLE) elective deferrals: $12,000 (plus $2,500 for those age 50 and older by December 31, 2013).
- Defined contribution plans (profit-sharing plans and simplified employee pension plans [SEPs]): up to $51,000.
- Defined benefit (pension) plans: up to $205,000.
- Compensation taken into account in figuring contributions and benefits: $255,000.
- IRAs: $5,500 (plus $1,000 for those age 50 or older by December 31, 2013).

Chapter 17—Casualty and Theft Losses

Disaster losses. There have been proposals to provide special relief for victims of Hurricane Sandy. Check for developments at the IRS at www.irs.gov/uac/Newsroom/Help-for-Victims-of-Hurricane-Sandy.

Chapter 18—Home Office Deductions

Optional deduction. Starting in 2013, you can choose to deduct an IRS-set standard amount instead of your actual expenses. The standard amount is $5 per square foot, up to 300 square feet (for a top deduction of $1,500). Taking the optional deduction eliminates any depreciation allowance. However, you can continue to deduct personal expenses, such as mortgage interest, real estate taxes, and casualty losses.

You must have gross income from the home office activity at least equal to the amount you want to deduct. The amount by which the optional deduction exceeds gross income cannot be deducted; it cannot be carried forward (as you can with unused actual expenses).

Chapter 19—Medical Expenses

Deducting medical insurance. Starting in 2014, employers (other than small employers) are required to provide affordable health coverage or pay a penalty ("the employer mandate"). This applies to employers with more than 50 full-time (more than 30 hours per week) employees. Borderline employers (those with about 45 to 55 employees) may be seeking ways to avoid the employer mandate because they cannot afford the insurance premiums. They have been:

- Not hiring new workers to stay below the 50-employee limit.
- Cutting hours of existing or new workers so they do not count as full-time employees.
- Using independent contractors instead of employees to do work.

If you are a borderline employer and the cost of employee health coverage in 2014 is daunting, discuss your options with an insurance agent and your tax advisor. Note that the IRS is likely to continue scrutinizing worker classification.

Small employer health care credit. Small employers that pay more than half the cost of employees' medical insurance may be eligible for a tax credit. The credit is reduced if premiums are more than the average premiums for the small group market in your state. The IRS has released the average premiums for small group markets in states for 2012. Here are the updated figures:

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

State	Employee-only coverage	Family coverage
Alabama	$5,084	$12,727
Alaska	7,321	15,774
Arizona	4,864	11,864
Arkansas	4,460	10,244
California	4,999	12,161
Colorado	5,308	13,014
Connecticut	5,955	15,273
Delaware	6,272	14,354
District of Columbia	6,017	15,140
Florida	5,462	13,013
Georgia	5,481	12,206
Hawaii	4,938	12,270
Idaho	4,690	10,427
Illinois	5,760	14,125
Indiana	5,414	12,386
Iowa	4,818	11,531
Kansas	4,959	12,163
Kentucky	4,660	11,387
Louisiana	5,300	12,446
Maine	5,413	12,837
Maryland	5,289	13,188
Massachusetts	6,110	16,269
Michigan	5,334	12,936
Minnesota	5,360	13,589
Mississippi	4,997	11,667

Missouri	5,089	11,975
Montana	5,148	11,197
Nebraska	5,325	12,511
Nevada	5,028	11,793
New Hampshire	6,030	15,026
New Jersey	6,063	14,470
New Mexico	5,527	12,909
New York	5,849	14,688
North Carolina	5,352	12,251
North Dakota	4,806	11,939
Ohio	4,987	12,143
Oklahoma	5,042	11,836
Oregon	5,130	12,197
Pennsylvania	5,400	13,357
Rhode Island	6,151	14,959
South Carolina	5,244	12,243
South Dakota	5,037	12,136
Tennessee	5,113	11,520
Texas	5,222	12,803
Utah	4,744	12,072
Vermont	5,678	13,099
Virginia	5,263	12,884
Washington	4,904	11,703
West Virginia	5,679	13,112
Wisconsin	5,575	14,387
Wyoming	5,657	13,688

Health savings accounts. The contribution limits for 2013 increased to $3,250 for self-only coverage and $6,450 for family coverage. Those age 55 or older by the end of 2013 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 2013, this means that the plan has a minimum deductible of $1,250 for self-only coverage and $2,500 for family coverage.

Archer medical savings accounts. The annual deductible in 2013 for a self-only plan is not less than $2,150 and not more than $3,200; the out-of-pocket annual expense limit is

$4,300. The annual deductible for family coverage is not less than $4,300 and not more than $6,450; the out-of-pocket annual expense limit is $7,850.

Chapter 20—Deductions for Farmers

Extended filing deadline. Farmers and fishermen can avoid estimated tax penalties by filing their tax returns by a set date (usually March 1). For 2012 returns, no estimated tax penalties will be imposed if returns are filed by April 15, 2013.

Depreciation. See Chapter 14.

Chapter 22—Miscellaneous Business Deductions

Moving expenses. For 2013, the standard mileage rate for driving a personal vehicle for moving purposes is 24 cents per mile.

Personal education incentives for 2013:

- ***Lifetime learning credit.*** The modified adjusted gross income limit on eligibility for the credit increases to $53,000 to $63,000 ($107,000 to $127,000 on a joint return).
- ***Above-the-line deduction for tuition and fees.*** This break expired at the end of 2011 but has been extended for 2012 and 2013.
- ***Student loan interest.*** The modified adjusted gross income limit on eligibility for the deduction is unchanged at $125,000 to $155,000 on a joint return; the limit for singles remains at $60,000 to $75,000.

The American Opportunity credit was set to expire at the end of 2012, but has been extended through 2017.

Charitable contributions. Enhanced deductions for donations of food, books, and computer equipment expired at the end of 2011; only the enhanced deduction for food inventory has been extended for 2012 and 2013.

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 2013.

The enhanced deduction for conservation easements, which expired at the end of 2011 but has been extended for 2012 and 2013. The enhanced deduction allows farmers and ranchers to claim a charitable contribution deduction for donations of conservation easements of 100% of their contribution basis.

Legal and professional fees. If you win a dispute with the IRS in which the government was not substantially justified, you may be able to recover costs up to a set dollar amount. For 2013, the dollar amount is $190 per hour.

Meal costs for day care providers. For 2013, the deduction for standard meals and snack rates have been increased slightly:

Breakfast:

- States other than Alaska and Hawaii: $1.27
- Alaska: $2.03
- Hawaii: $1.48

Lunch and dinner:

- States other than Alaska and Hawaii: $2.38
- Alaska: $3.86
- Hawaii: $2.79

Snacks:

- States other than Alaska and Hawaii: $0.71
- Alaska: $1.15
- Hawaii: $0.83

Chapter 23—Roundup of Tax Credits

Employment-related credits:

- ***Work opportunity credit.*** The credit expired at the end of 2011 (for all targeted groups except for certain veterans), but has been extended for 2012 and 2013 (for all groups).
- ***Empowerment zone employment credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.
- ***Indian employment credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.
- ***Employer differential wage payment credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.

Capital construction-related credits:

- ***New markets credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.
- ***Energy-efficient home credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.

Other tax credits:

- ***Research credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.
- ***Low-sulfur diesel fuel production credit.*** The credit expired at the end of 2011 but has been extended for 2012 and 2013.

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 indicated informally that it 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. Rules were supposed to be issued in early 2013. Check for developments on www.barbaraweltman.com.

Chapter 28—Alternative Minimum Tax

Exemption amounts. There has been a permanent УpatchФ for alternative minimum tax (AMT) exemption amounts in the form of an annual adjustment for inflation. The exemption amounts for 2012 and 2013 are:

Filing status	2012 exemption	2013 exemption
Single/head of household	$50,600	$51,900
Married filing jointly/surviving spouse	$78,750	$80,800
Married filing separately	$39,375	$40,400

Exemption phase-out. Starting in 2013, the exemption amounts start to phase out when alternative minimum taxable income (AMTI) exceeds $115,400 for singles and heads of households, $153,900 for married filing jointly and surviving spouses, and $76,950 for married filing separately.

Tax credit offsets to the AMT. The ability to use nonrefundable personal tax credits, such as the lifetime learning credit and the dependent care credit, to offset not only regular income tax, but also the alternative minimum tax expired at the end of 2011; this favorable rule has been made permanent. Thus, nonrefundable credits can be used to offset both regular tax and the AMT.

Chapter 29—Other Taxes

Other income-based taxes. The Metropolitan Commuter Transportation Mobility tax that had applied in the New York City and 7 surrounding counties has been eliminated. Businesses and self-employed individuals that paid the tax may be entitled to refunds.

Social Security and Medicare taxes. The 2013 wage base for the Social Security tax portion of FICA and self-employment tax increased to $113,700. Note that the 0.9% Medicare surtax applies only to employees (and the УemployeeФ portion of self-employment tax).