



# Tax Update for the N.E. ACA Conference

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# Katz Nannis + Solomon, PC

- ◆ Boutique, regional CPA firm focused on entrepreneurial companies with an emphasis on technology –Much more than taxes!
- ◆ Work mostly with Angel and Venture backed Companies, Funds and family offices
- ◆ Work on Audits, Reviews and Corp. tax planning and set up
- ◆ Assist in negotiations and sales of companies at Exit
- ◆ Qualified professionals in tax and audit that know equity, revenue recognition and provide creative tax planning ideas
- ◆ We focus on the types of Companies YOU invest in and we can help them AVOID disasters down the road
- ◆ 45 Professionals, located on RT. 128 in Needham
- ◆ Will meet with any of your companies in an introductory meeting free of charge



A man with dark, wavy hair, wearing a dark pinstripe suit, a light blue shirt, and a dark blue tie with white polka dots, is smiling broadly and gesturing with his right hand. He is looking towards a woman whose back is to the camera. The woman has blonde hair and is wearing a grey blazer over a light blue shirt. The background is a bright, out-of-focus indoor setting. A large, light blue curved graphic element is in the top left corner.

## TAX PLANNING BASICS

**Tax planning shouldn't  
be just a year end  
activity**

**Keep in mind that the  
Bush Tax Cuts expire in  
2012.**

# It all happens in 2013

- ◆ Rates go up
- ◆ **New Surtax on investment income-"Unearned income Medicare Contribution tax" =3.8% of the lesser of 1) net investment income or 2) the amount by which modified AGI exceeds \$250,000(mfj)**
- ◆ **An additional .9% on Wages if they are over \$250,000 (Instead of 1.45% now 2.35% of Medicare tax)**
- ◆ Long-term capital gains and qualified dividends taxed higher rates
- ◆ Estate taxes potential much higher

# KNS OUTLOOK OF INCREASE IN RATES (and don't forget state taxes!)

## OUTLOOK OF HOW TAX RATES WILL INCREASE FOR PERSONAL INCOME FROM 2011 TO 2013 IF CONGRESS DOES NOTHING

	<u>WAGES</u>	<u>LTCG</u>	<u>QUALIFIED DIVIDENDS</u>	<u>PASSIVE INCOME</u>	ACTIVE INCOME FROM <u>GP</u>	FROM <u>S CORP</u>
HIGHEST TAX BRACKET	35.00%	15.00%	15.00%	35.00%	35.00%	35.00%
MEDICARE/SE TAX ON EARNED INCOM	1.45%	0.00%	0.00%	0.00%	2.90%	0.00%
2011 AND 2012 HIGHEST MARGINAL RATES	36.45%	15.00%	15.00%	35.00%	37.90%	35.00%
EXPIRATION OF TAX CUTS IN 2013	4.60%	5.00%	24.60%	4.60%	4.60%	4.60%
2013 HIGHEST MARGINAL RATES	41.05%	20.00%	39.60%	39.60%	42.50%	39.60%
NEW MEDICARE/HI TAX EFFECTIVE IN 2013	0.90%	3.80%	3.80%	3.80%	0.90%	0.00%
2013 TOP RATE	41.95%	23.80%	43.40%	43.40%	43.40%	39.60%
INCREASE FORM 2011 TO 2013	5.50%	8.80%	28.40%	8.40%	5.50%	4.60%

# **The Rates ARE GOING UP!!!**

**Through 2012, long-term capital gains rate and qualified**

**Dividends will remain at 15%**

**In 2013 they will increase to 20% and all dividends  
will be at your highest marginal rate(39.6%VS 15% TODAY)**

# AMT-GUESS WHAT-YOU ARE NOT ALONE!!!

- ◆ State and local income tax deductions
- ◆ Real estate and personal property tax deductions
- ◆ Interest on home equity loan or line of credit not used to buy, build or improve your principal residence
- ◆ Miscellaneous itemized deductions subject to 2% of AGI floor
- ◆ Long-term capital gains and dividend income
- ◆ Accelerated depreciation adjustments and related gain or loss differences when assets are sold
- ◆ Tax-exempt interest on certain private-activity municipal bonds
- ◆ Incentive stock option exercises

# Avoiding AMT or reducing its impact

- ◆ Planning for AMT will be a challenge until Congress passes long-term relief
- ◆ AMT system isn't regularly adjusted for inflation
- ◆ Congress legislates adjustments, typically as a "patch" 2012 not yet





# Employment taxes

## ◆ Social Security and Medicare taxes

- Apply to earned income, such as salary and bonuses

## ◆ For 2012

- At least through **February 29<sup>th</sup>** tax is still at 4.2%
- If not extended, Social Security tax will be back to 6.2%
- May be a recapture provision of the 2%
- Maximum taxable wage base for Social Security taxes is \$110,100

STAY TUNED ON THIS ONE-SHOULD BE ANY DAY NOW.....

**Warning!** All earned income is subject to the 2.9% Medicare tax

# Owner-employees

## ◆ Partnerships and limited liability companies

- Trade or business income is subject to self-employment tax
  - Even if income isn't actually distributed to you
  - Income isn't taxed if you're limited partner or LLC member

## ◆ S corporations

- Only income received as salary subject to employment tax
- Reduce tax by keeping salary low and increase distributions of company income (generally not taxed at corporate level)
- To avoid back taxes and penalties, salary must be "reasonable"

## ◆ C corporations

- Only income received as salary is subject to employment tax

# KN+S IDEAS FOR ANGELS AND INVESTORS IN START UPS

## ◆ HAVE A GREAT TAX ADVISOR AND BUSINESS PARTNER HELPING YOU-ITS GOING TO COUNT MORE THAN EVER AFTER THIS YEAR

- For instance-should you start to convert some of your corporate bonds to tax free bonds to avoid the 3.8% tax on investment income.....
  - What will this do to the market place??

# Capital gains tax and timing

Time – not timing – is generally the key to long-term investment success



Timing can have a dramatic impact on tax consequences of investment activities

# Loss carryovers

## ◆ Capital losses are netted against capital gains to determine capital gains tax liability

- Deduct up to \$3,000 of losses per year against ordinary income
- Carry forward excess losses to future years(NO LIMIT)
- Lot of planning should be done between your CPA and financial advisor

## ◆ Determine if you have excess losses

- Time sales of other investments before year end to achieve your tax-planning goals



## ANGELS-FYI-Small business Loss benefits(1244 stock)

- ◆ If you invest in a Small Business (domestic corp., original issue to you, capital invested at time < \$1mm, active trade or business)
  - UP TO \$50,000 OR \$100,000 SINGLE AND MFJ RESPECTIVELY CAN BE TREATED AS AN  
**ORDINARY LOSS(NOT A CAP LOSS!)**

# Small business stock- 1202 STOCK

## ◆ Enjoy preferential tax treatment

- Convert capital losses to ordinary losses
- Defer tax on gain
- Exclude up to 50% of gain (must hold the stock for at least five years)
- What types of Corps qualify?
- Depending on acquisition date, exclusion may be 75% or 100%(AT END OF 2011)
- Rolls back to 50% in 2012
  - AT THE 50% EXCLUSION THE REAL BENEFIT GOES AWAY DUE TO AMT!!!
- PS-THE PAYROLL TAX EXTENDER HAS THIS 100% EXCLUSION TIED TO THE BILL!! STAY TUNED



# ANGELS-DID YA KNOW ABOUT SECTION 1045 ROLLOVER GAINS? LETS CHAT

- ◆ In the case of of any sale of a qualified small business stock(<\$50mm capitalization and active trade/business-c corp) that you have held for more than 6 months
  - You can
- ◆ Rollover the gain into the cost of any new qualified small business
  - If you
- ◆ Invest in the new business within 60 days
  - You can invest in several small business companies-doesn't have to be just 1!
  - Your fund or partnership can be eligible to do this!
- ◆ Make election on your Schedule D by writing
  - “section 1045 rollover” on the line showing the gain and then back out the gain on a separate line!

# Understanding depreciation

## ◆ MACRS

- Generally more advantageous than straight-line method
- Larger deduction in early years of asset's life

## ◆ Bonus depreciation

- **50%** bonus depreciation for qualified assets placed in service from Jan. 1, 2008, through Sept. 8, 2010
- **100%** bonus depreciation for assets placed in service from Sept. 9, 2010, through Dec. 31, 2011
- **50%** bonus depreciation for assets placed in service from Jan. 1, 2012, through Dec. 31, 2012

## ◆ No bonus depreciation after Dec. 31, 2012

# Section 179 expensing election

## ◆ Allows you to write off rather than depreciate asset purchases

- Deduct up to \$500,000 of purchases
- Deduction phases out dollar-for-dollar when 2011 asset purchases exceed \$2 million
- Limits are scheduled to go down in 2012 (\$139,000)
- Only Section 179 expensing can be applied to *used* assets





# Manufacturers' deduction and R&d Credits

## ◆ MFG DEDUCTION

- Deductible amount is 9% of the lesser of qualified production activities income or taxable income, limited by W-2 wages paid
- Available also to businesses engaged in *nonmanufacturing* activities, such as
  - Construction and EngineeringEngineering
  - Architecture
  - **Computer software production(many miss this!)**
  - Agricultural processing
- Deduction can be used against the AMT

## ◆ R&D Credit-RIGHT NOW EXPIRED IN 2012 BUT STAY TUNED ANGELS-IN THE EXTENDER BILL

- Often overlooked
- Improvements or enhancements to new or existing products

# More tax breaks

## ◆ NOL deduction

- NOL can be carried back two years to generate current tax refund
- Any loss that's not absorbed is carried forward up to 20 years
- Additional rules apply

## ◆ Tax credits

- Research credit extended through 2011
  - Elections exist to make it refundable
- Work Opportunity credit extended through 2011
  - Equals 40% of first \$6,000 of wages paid to qualified employees
  - \$12,000 for wages paid to qualified veterans
- HIRE Act retention credit available through 2011
  - Workers must be retained for 52 consecutive weeks

# Health care tax credit

## ◆ Through 2013

- Available for employers with 10 or fewer FTEs, who on average earn less than \$25,000 per year
- Partial credits available to businesses with fewer than 25 FTEs, who on average earn less than \$50,000

## ◆ Credit amount

- Maximum credit is 35% of premiums paid by employer
- Employer must contribute at least 50% of total premium



# Exit planning

Strategy to pass responsibility for running the company, transferring ownership and extracting money from the business



**Warning!** Requires planning well in advance of the transition

# Sale or acquisition

- ◆ **Tax consequences can have a major impact on the transaction's success ... or failure**
- ◆ **Common types of transactions**
  - Asset or stock sale
    - TRENDS WE HAVE SEEN?
  - Taxable sale vs. tax-deferred transfer



# Executive compensation

## ◆ Incentive stock options

- Buy company stock in the future at fixed price equal to or greater than stock's FMV at grant date
- Don't provide benefit until stock appreciates in value
- Key tax consequences
  - Owe no tax when ISOs are granted
  - Owe no regular income tax when you exercise the ISOs
  - Additional tax consequences may occur depending on when you sell the stock
- DON'T FORGET THAT 409a VALUATION? MUST YOU GET IT? YES

**Warning!** In the year of exercise, a tax “preference” item is created on the difference between the stock's FMV and the exercise price; this can trigger the AMT. A future AMT credit may lessen this AMT “hit.”

# Executive compensation

## ◆ Nonqualified stock options

- Tax treatment differs from ISOs
- NQSOs create compensation income on bargain element when exercised
- Don't create an AMT preference item
- May need to make estimated tax payments or increase withholding to cover tax on the exercise
- Consider state tax estimated payments

# Executive compensation

## ◆ Restricted stock

- Granted subject to substantial risk of forfeiture
- Income recognition normally deferred until stock is no longer subject to risk or you sell it
- You pay ordinary-income taxes based on stock's FMV when restriction lapses
- Consider using Sec. 83(b) election to recognize ordinary income when you receive stock
  - Make election within 30 days after receiving stock
  - Allows you to convert future appreciation from ordinary income to long-term capital gains income
  - Defers it until you sell the stock

**Keep in mind:** Any taxes you pay can't be refunded if you forfeit the stock or its value decreases

# Transfer tax exemptions and rates

What will happen in 2013 really?

Will there be a claw back?? hmmm-maybe?

Take advantage of the \$5mm exemption limit NOW in 2012!!!! Talk to your estate attorney now or talk to KNS!

	2009	2010	2011	2012	2013
Gift tax exemption	\$ 1 million	\$ 1 million	\$ 5 million	\$ 5 million <sup>1</sup>	\$ 1 million
Estate tax exemption <sup>2</sup>	\$3.5 million	\$ 5 million <sup>3</sup>	\$ 5 million	\$ 5 million <sup>1</sup>	\$ 1 million
GST tax exemption	\$3.5 million	\$ 5 million	\$ 5 million	\$ 5 million <sup>1</sup>	\$ 1 million <sup>1</sup>
Highest estate and gift tax rates and GST rate	45%	35% <sup>3</sup> (0% GST tax)	35%	35%	55% <sup>4</sup>

<sup>1</sup> Indexed for inflation.

<sup>2</sup> Less any gift tax exemption already used during life. For 2011 and 2012, these amounts are "portable" between spouses.

<sup>3</sup> Estates can elect to follow the pre-2010 Tax Relief act regime (estate tax repeal + limited step-up in basis).

<sup>4</sup> The benefits of the graduated gift and estate tax rates and exemptions are phased out for gifts/estates over \$10 million.



## OTHER ISSUES TO KEEP IN MIND

- ◆ CHOICE OF ENTITY NOW? C CORPS BACK IN VOGUE?
- ◆ BE WARY OF WARRANTS ISSUED AND TRICKS ON ACCOUNTING FOR THOSE
- ◆ IS YOUR 409A VALUATION UP TO DATE? HOW OFTEN DO I NEED TO UPDATE?
- ◆ IS DEFERRED OFFICER SALARY REALLY OK TO USE? ISSUES?
- ◆ IS CONVERTIBLE DEBT INTEREST TAXABLE WHEN I CONVERT TO STOCK?
- ◆ OTHER QUESTIONS?



A modern office interior with large windows and a curved desk. A person is standing in the background, and a laptop is open on the desk in the foreground.

**Thank you  
for attending**

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**If you want a copy of this presentation  
please see us at the break or give us a  
business card!!!**