

## “Last minute” year-end tax-saving moves for Corporations

As year-end approaches, it would be worthwhile for practitioners to consider whether corporate clients could benefit from the following “last minute” tax-saving moves, including adjustments to income to preserve favorable estimated tax rules for 2013, deferral of certain advance payments to next year, and fine-tuning bonuses to make the most of the Code Sec. 199 domestic production activities deduction.

**Accelerating or deferring income can preserve estimated tax break.** Corporations (other than certain “large” corporations, see below) can avoid being penalized for underpaying estimated taxes if they pay installments based on 100% of the tax shown on the return for the preceding year. Otherwise, they must pay estimated taxes based on 100% of the current year's tax. However, the 100%-of-last-year's-tax safe harbor isn't available unless the corporation filed a return for the preceding year that showed a liability for tax. A return showing a zero tax liability doesn't satisfy this requirement. Only a return that shows a positive tax liability for the preceding year makes the safe harbor available.



**RIA recommendation:** A corporation (other than a “large” corporation) that anticipates a small net operating loss (NOL) for 2012 (and substantial net income in 2013) may find it worthwhile to accelerate just enough of its 2013 income (or to defer just enough of its 2012 deductions) to create a small amount of net income for 2012. This will permit the corporation to base its 2013 estimated tax installments on the relatively small amount of income shown on its 2012 return, rather than having to pay estimated taxes based on 100% of its much larger 2013 taxable income. Also, by accelerating income from 2013 to 2012, the income may be taxed at a lower rate in 2012, e.g., at 15% instead of at 25% or 34%. However, where a 2012 NOL would result in a carryback that would eliminate tax in an earlier year, the value of the carryback should be compared to the cost of having to pay only a small amount of estimated tax for 2013.

 **RIA recommendation:** Generally speaking, a taxpayer will be treated as a “large” corporation for estimated tax purposes only if it had taxable income of \$1 million or more in any one of the three preceding tax years. As a result, a corporation that didn't reach that threshold in 2010 or 2011, but expects net income of \$1 million or more in 2012 and later tax years, will have an additional incentive for deferring income into (or accelerating deductions from) 2013. If such a shifting of income or deductions lets the corporation avoid reaching the \$1 million threshold in 2012, it will be able to use the 100%-of-last-year's-tax safe harbor in 2013.

**Accrual basis business can take a 2012 deduction for some bonuses not paid till 2013.** An accrual basis corporation can take a deduction for its current tax year for a bonus not actually paid to its employee until the following tax year if (1) the employee doesn't own more than 50% in value of the corporation's stock, (2) the bonus is properly accrued on its books before the end of the current tax year, and (3) the bonus is actually paid within the first 2 1/2 months of the following tax year (for a calendar year taxpayer, within the first 2 1/2 months of 2013).

For employees on the cash basis (for income that was deferred before it was earned), the bonus won't be taxable income until the following year. The 2012 deduction won't be allowed, however, if the bonus is paid by a personal service corporation to an employee-owner, or by an S corporation to any employee-shareholder, or by a C corporation to a direct or indirect majority owner.

**Accrual-basis taxpayers can defer inclusion of certain advance payments.** Accrual-basis taxpayers generally may defer including in gross income advance payments for goods until the tax year in which they are properly accruable for tax purposes if the income inclusion for tax purposes isn't later than it is under the taxpayer's accounting method for financial reporting purposes. An advance payment is also eligible for deferral—but only until the year following its receipt—if:

**dm-t**

decoria • maichel • teague

P | 509.535.3503

F | 509.535.9391

7307 N. Division, Suite 222

Spokane, WA 99208

www.dm-t.com

# dm-t | news

- (1) including the payment in income for the year of receipt is a permissible method of accounting for tax purposes;
- (2) the taxpayer recognizes all or part of it in its financial statement for a later year; and
- (3) the payment is for (a) services, (b) goods (other than goods for which the deferral method discussed above is used), (c) the use of intellectual property (including by lease or license), (d) the occupancy or use of property ancillary to the provision of services, (e) the sale, lease, or license of computer software, (f) guaranty or warranty contracts ancillary to the preceding items, (g) subscriptions in tangible or intangible format, (h) organization membership, and (i) any combination of the preceding items.



**RIA illustration** : An accrual-basis calendar-year taxpayer received a payment on Nov. 1, 2012 for a contract under which it will repair a customer's computer equipment for two years. In its financial statements, the taxpayer recognizes 25% of the payment in 2012, 50% in 2013, and 25% in 2014. For tax purposes, under the deferral method discussed above, the taxpayer can report 25% in 2012 and defer 75% to 2013.

The deferral method cannot be used for (1) rent (unless it's for items (c), (d), or (e), above), (2) insurance premiums, (3) payments on financial instruments (e.g., debt instruments, deposits, letters of credit, etc.), (4) payments for certain service warranty contracts, (5) payments for warranty and guaranty contracts where a third party is the primary obligor, (6) payments subject to certain foreign withholding rules, and (7) payments in property to which Code Sec. 83 applies.

If an advance payment is only partially attributable to an eligible item, it may be allocated among its various parts, and the deferral rule may be used for the eligible part.

Taxpayers wishing to change to the above method may use automatic consent provisions (with certain modifications). Advance consent procedures apply in certain cases, e.g., where advance payments are allocated.

## dm-t

decoria • maichel • teague

P | 509.535.3503

F | 509.535.9391

7307 N. Division, Suite 222

Spokane, WA 99208

www.dm-t.com



**Making the most of the domestic production activities deduction.** Businesses can claim a domestic production activities deduction under Code Sec. 199 to offset income from domestic manufacturing and other domestic production activities.

The Code Sec. 199 deduction equals 9% of the smaller of—

- (a) the taxpayer's "qualified production activities income" or QPAI, for the tax year, or
- (b) the taxpayer's taxable income (modified adjusted gross income, for individual taxpayers), without regard to the Code Sec. 199 deduction, for the tax year.

Qualified production activities eligible for the deduction include items such as: the manufacture, production, growth or extraction of qualifying production property (i.e., tangible personal property such as clothing, goods, or food as well as computer software or music recordings) by a taxpayer either in whole or in significant part within the U.S.; construction or substantial renovation of real property in the U.S., including residential and commercial buildings and infrastructure such as roads, power lines, water systems, and communications facilities; and engineering and architectural services performed in the U.S. and relating to the construction of real property. (Code Sec. 199(c)(4))

However, the Code Sec. 199 deduction can't exceed 50% of the W-2 wages of the employer for the tax year. Generally, these wages are the sum of the aggregate amounts that must be included on the Forms W-2 of employees under Code Sec. 6051(a)(3) (i.e., wages subject to withholding) and Code Sec. 6051(a)(8) (elective deferrals). The wages must be allocable to the taxpayer's domestic production activities, and they include tips and other compensation as well as elective deferrals to 401(k) and other plans. (In addition, the otherwise allowable Code Sec. 199 deduction of a taxpayer with oil-related QPAI is subject to a special reduction.)



decoria • maichel • teague

P | 509.535.3503

F | 509.535.9391

7307 N. Division, Suite 222

Spokane, WA 99208

[www.dm-t.com](http://www.dm-t.com)

# dm-t | news

It is important for businesses to calculate the tentative Code Sec. 199 deduction and the W-2 deduction cap before year-end. If the deduction cap will limit the otherwise available deduction—for example, in the case of a closely held business whose owners do not draw substantial salaries—the business may want to bonus out additional compensation to maximize the Code Sec. 199 deduction. Bear in mind that in some cases, an accrual-basis corporation can deduct a bonus that is declared before year-end but not paid until the following year (see discussion above).

Taxpayers also need to factor the Code Sec. 199 deduction into other year-end tax planning strategies. For example, when determining whether to defer or accelerate income, a taxpayer must determine the marginal tax rate for each year. For this purpose, the Code Sec. 199 deduction will have the effect of decreasing the taxpayer's marginal rate.

© 2012 Thomson Reuters/RIA. All rights reserved.

**dm-t**

**decoria • maichel • teague**

P | 509.535.3503

F | 509.535.9391

7307 N. Division, Suite 222

Spokane, WA 99208

[www.dm-t.com](http://www.dm-t.com)