More Tax Questions Than Answers

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Will this be the last year of the Bush-era tax cuts? A number of the tax provisions that affect lawn care and landscape businesses – and their owners – either expired at the end of 2011, or are scheduled to expire at the end of this year. They include the Bush-era tax cuts, the alternative minimum tax (AMT) patch, the temporary payroll tax cut, and other temporary provisions, many of which are commonly referred to as "tax extenders."

Although Congress may retroactively reinstate some or all of these provisions, an agreement before the November election seems unlikely. The biggest "hit" facing turf care professionals, at least in terms of estimated tax savings, include the write-offs for newly acquired equipment and other business property.

Bye-bye write-offs

The so-called "bonus" depreciation write-off was originally created in 2002 as a temporary economic incentive allowing landscape and lawn care contractors and other businesses to immediately deduct or write-off a large portion of cost-qualifying assets. A whopping 100 percent bonus depreciation allowance was in effect through the end of 2011, decreased to 50 percent for 2012, and is scheduled to expire after Dec. 31, 2012.

The Section 179 enhanced expensing allowances that allowed turf care professionals and businesses to immediately deduct as an expense up to $500,000 for investing in qualified equipment and other business property in 2011, was reduced to $125,000 for the 2012 tax year and will revert to $25,000 thereafter.

Unlike the "bonus" depreciation that applies only to "new" property, a turf care business may immediately deduct as much as $125,000 in equipment costs. Of course, the Section 179 expensing write-off is reduced, dollar-for-dollar, by any property acquisitions in excess of the $500,000 investment ceiling, limiting the write-off to smaller businesses.

The payroll tax cuts

Every lawn care and landscape business with employees is effected by The Federal Insurance Contributions Act (FICA) and the two taxes it imposes on employers, employees and self-employed workers: one for Old Age, Survivors and Disability Insurance (OASDI; commonly known as the Social Security tax), and the other for Hospital Insurance (commonly known as the Medicare tax).

To help stimulate the economy by increasing workers' take-home pay, the 2010 Tax Relief Act reduced by 2 percentage points the employee OASDI tax rate under the FICA (from 6.2 percent to 4.2 percent) and the OASDI tax rate under the SECA tax for the self-employed (from 12.4 percent to 10.4 percent) on the first $106,800 of wages.

Although the payroll tax cut benefits most taxpayers, it "may not be as targeted or cost-effective a stimulus as other tax policies or direct-spending programs" since it is based on the amount of wages received. Because the actual value of the tax cut depends on wages – thus providing a smaller benefit to lower earners – the fact that without Congressional action, the OASDI rates will revert to normal levels generating an estimated $225.7 billion for the government over the next 10 years may not be that big of a deal.

Worker hiring incentive

One worker-related incentive that has enjoyed an on-again, off-again life remains alive, at least temporarily. The Work Opportunity Tax Credit (WOTC), a direct reduction of the employer's tax bill as opposed to a deduction, is available to employers who hire members of certain targeted groups.

Generally, an employer could claim as much as 40 percent of qualifying first-year wages – up to $6,000 per employee. This credit expired at the end of 2011. An amended version of the credit remains available in 2012, but only for employers that hire qualified veterans.

Small business stock

Many newly formed and growing incorporated lawn care and landscape businesses have used a unique type of stock to attract badly-needed capital. Special tax treatment of so-called "Small Business Stock" allows the holder to exclude 50 percent of the gain realized when cashing out after five years. The amount excluded is 50 percent of the gain for qualified stock issued before 2009, or after 2011, 75 percent of the gain for qualified stock issued after Feb. 17, 2009, and before Sept. 28, 2010, and 100 percent for qualified stock issued after Sept. 27, 2010, and before Jan. 1, 2012.

S corporation built-in gains

The tax on built-in gains is a corporate level tax on S corporations that dispose of assets that appreciated in value during years when the turfgrass business was a regular (or “C”) corporation. The built-in gains tax applies to all lawn care and landscape operations that elected S corporation status after 1986, had a net recognized built-in gain,

Generally, net recognized built-in gain attributable to C corporation years is taxable to an S corporation during the first 10-year period as an S corporation. The 10-year period was reduced to seven years by the American Recovery and Reinvestment Tax Act of 2009, for taxable years beginning in 2009 and 2010. The Small Business Jobs Act of 2010, reduced the 10-year period to five years for taxable years beginning in 2011.

Dreaded and ongoing: the AMT

The dreaded alternative minimum tax, or AMT, was enacted to ensure that higher-income taxpayers who would otherwise pay little or no taxes would be required to pay a “minimum” amount. In calculating the AMT, taxpayers add back various tax preference items to their taxable income to calculate their AMT tax base, claim a basic exemption amount, and then apply either a 26 percent or 28 percent rate. The extent to which this figure exceeds a taxpayer’s regular tax liability is their AMT.

Unfortuantely, certain parts of the AMT were not indexed for inflation. To deal with this issue, the AMT exemption amount has been increased several times on a temporary basis (part of the “AMT patch”). The 2011 AMT patch allowed married individuals filing jointly and unmarried individuals exemptions of $74,450 and $48,450, respectively.

According to the Congressional Budget Office, unless Congress acts, 30-million-plus taxpayers, or roughly one-fifth of all taxpayers, will be hit by the AMT in 2012. For 2012, without another patch, the AMT exemption amounts are $45,000 for married individuals, and $33,750 for unmarried individuals.

Taxmaggedon is coming

The year 2012 will, in all likelihood, continue to be a year of considerable tax uncertainty, making tax planning difficult. This year, with the Bush-era tax cuts expiring, many tax planning issues are focused on whether those cuts that were scheduled to expire will re-emerge. With the economy on a slow mend and the Federal Reserve holding interest rates low, both lawmakers and the administration appear less likely to agree to an extension of tax cuts.

In the meantime, every turf care professional should be aware of the following:

- The distinction between ordinary and qualified dividends will expire at the end of 2012 and all dividends, including those paid by the lawn care or landscape business, will be subject to ordinary tax rates (with the top ordinary rate being 39.6 percent);
- For 2013, a new 3.8 percent tax on investment income will become effective for most joint filers with income above $250,000 ($200,000 for single filers);
- The current estate and gift tax exemptions of $5 million will expire at

the end of 2012 and drop to $1 million for 2013;
- Every turfgrass business owner can sell appreciated stock by the end of 2012 to utilize the lower capital gains rates. An investment sale, such as land or a business transaction, may warrant thinking about closing the sale prior to 2013 in order to take advantage of the lower capital gain rates. For those fortunate enough to file high-income returns, foregoing the 3.8 percent investment income tax set for 2013 is possible. There is also no restriction on repurchasing the same stock, as there is when sold for a loss;
- Those receiving sale proceeds in the form of payments spread over several years, such as with a so-called “installment agreement”, may want to consider electing not to defer the gain over the installment period, but instead take the gain entirely in 2012, a permitted strategy in most situations, but one that requires professional assistance; and
- As for those almost-inevitable capital losses, one strategy might be to hold off on taking capital losses until after 2012, as they could be more valuable to offset capital gains at the higher capital gain rates.

Some lawn care and landscape contractors and turf care business owners or managers have already decided that the uncertainty is too much to take any specific action yet this year. Many have decided to at least wait until after the November elections to think about what 2013 may bring. Everyone, however, should be armed with all of the facts and options currently available in order to intelligently weigh their decisions. After all, to do that effectively requires at least some advance consideration.

It is important for every turf care professional to take advantage of all disappearing tax breaks while they’re still available. To help ensure future prosperity for your business, it is important to consult with a tax specialist to discuss opportunities for the 2012 tax-filing season and beyond.

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