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Plan now for Dec. 31 expiration of tax cuts

Many small business owners feel as though they are starring in the latest Jason Bourne movie thriller, where the business owner is targeted by the relentless government, deploying assets from any street corner with the intent of snuffing out their intended target.

If Congress does not renew the Bush tax cuts that will expire on Dec. 31, the tax man will attempt a new financial choke hold in 2013 in the following ways:

- Individual top rates will increase to 39.6 percent from 33 percent.
- A new tax of 3.8 percent will be levied on individuals, filing married filing jointly, with unearned income that have adjusted gross income of $250,000 or more. The threshold for individuals filing single or head of household is $200,000.
- Business owners, living in a high taxing state like Maryland, could pay a combined federal and state marginal income rate in excess of 50 percent on unearned income, such as interest and dividends.
- They may be affected by the increased capital gains rates and the expiration of the special tax rate on corporate dividends.
- The sunset of the current estate and gift tax exemptions will mean that exemptions change to $1 million for individuals and $2 million for married couples from $5.12 million for individuals and $10.24 million for married couples.
- The top estate and gift tax rate will increase from 35 to 55 percent.

So how does the small business owner escape or remove the target from his/her back? Just like Jason Bourne, he/she needs to assess the risk and execute a plan, as most owners will have to contend with higher income tax rates starting on Jan. 1.

To combat the threat of increased individual income taxes rates in 2013, business owners should be looking for capital gains that might be realized in 2012 with the lower capital gain tax rates.

The initial step is to determine the basis in the various investments in order to ascertain if the owner does, in fact, have a capital gain. Secondly, they should consider removing proceeds and/or a portion of the principal of the account and placing the money into a tax-protected account or investment.

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Tax-protected accounts include traditional IRAs, Roth IRAs and certain types of insurance contracts, including life and annuities. By moving funds from taxable accounts into tax-protected accounts, the owner will be successful in reducing the 3.8 percent tax on unearned income in future years. It can be the proverbial gift that keeps on giving. The cost of such a move is the reduction in the business owner's working capital.

With regard to unearned income from a business that passes through to the owner's tax return, the owner should consider accelerating revenues to the current year and delaying expenses until 2013. This is a difficult step because no one likes to accelerate taxes in an uncertain world. The small business owner, however, can minimize the tax burden over the next couple of years if he/she is confident of a healthy bottom line.

The most significant risk, albeit affecting a smaller percentage of small business owners, is the changes in exemptions and tax rates of estates and gifts. Confront this risk by determining if the small business owner has a taxable estate, and identifying prior taxable gifts. If the estate is taxable or might be in the future, the owner should consider the cost/benefits of gifting a part of his/her estate in order to reduce the estate taxes in the future.

A wealth manager, CPA and/or attorney can help with the calculation. They can also help the owner determine which gift and trust planning strategies are appropriate.

Small business owners can wait until and see what Congress and President Barack Obama work out in the coming months. However, that tactic may be equivalent to Jason Bourne trying to elude his pursuers by walking down the middle of the street. There is a short window to execute a plan by year end.

Be like Jason — assess the risk and execute the plan. Take the first steps by reviewing taxable accounts, possibly accelerating revenues into 2012 and delaying expenses until 2013, and reviewing the estate. Consult with a wealth management team to discuss which planning techniques are appropriate.

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