CORDASCO
& COMPANY P.C.
Certified Public Accountants

2012

YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

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2012 YEAR-END INCOME TAX PLANNING FOR "INDIVIDUALS"

It's that time of year to focus on year-end planning strategies. Year-end planning for 2012 is a bigger challenge than in previous years because we are facing the most significant tax uncertainty in recent memory, largely caused by: **1)** the scheduled expiration of the so-called *Bush-Era* tax cuts ***after 2012***, **2)** the new "Medicare Surtaxes" ***starting in 2013***, **3)** a host of popular tax breaks that ***expired after 2011***, **4)** another long list of tax breaks scheduled to expire or be scaled back ***after 2012***, **5)** the current *unified exclusion amount* of $5,120,000 for estate and gift tax purposes scheduled to drop to $1,000,000 ***after 2012***, and **6)** the uncertainty as to whether, or for how long, any of these expired or expiring tax breaks will be extended.

It is possible that Congress may address many of these uncertainties before the end of 2012. Some are predicting that Congress may address these expired or expiring tax breaks in an "extender's bill" in its lame-duck session after the Presidential election. However, others believe that Congress will not address these tax issues until early 2013. Due to this uncertainty, we believe the best approach for year-end planning in this volatile tax environment is to become familiar with the tax changes that are ***currently scheduled*** to occur ***after 2012***, and to be ***prepared to act quickly near the end of 2012*** based upon the tax climate at that time. In addition, whether or not Congress takes action by the end of 2012, there are "***traditional" year-end planning strategies*** that can save taxes for many individuals.

We are sending this letter to: **1)** identify potential year-end tax strategies that exist in light of the major tax changes scheduled to take effect in 2013; **2)** identify alternative considerations if Congress changes the law late in 2012; and, **3)** remind you of traditional year-end planning opportunities that could likely save 2012 taxes no matter what course Congress takes with future legislation.

> **Planning Alert!** Our firm is monitoring potential 2012 tax legislation, so please call us if you want a status report. Also, tax planning strategies that we discuss in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions; state and local income taxes; real estate taxes; and interest on home equity loans (unless the loan proceeds were used to improve, build, or buy your residence). Also, AMT can be triggered by taking large capital gains or exercising incentive stock options. Therefore, we encourage you to ***call our firm before implementing any tax planning technique*** discussed in this letter. You cannot properly evaluate a particular planning strategy without calculating your overall tax with and without that strategy.

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PREPARING FOR POTENTIAL TAX RATE INCREASES

Starting In 2013 – Tax Rates Scheduled For Significant Increase.

Unless Congress changes current law, individuals are facing an increase in their federal income tax rates beginning next year. **In 2013,** the top regular individual income tax rate on income, other than long-term capital gains, is scheduled to jump from 35% to 39.6%. The maximum tax rate on long-term capital gains is scheduled to increase from 15% to 20%. And, the top tax rate on dividends is scheduled to increase from 15% to 39.6%. Furthermore, starting in 2013, the *Health Care Act* imposes ***an additional Medicare Surtax of .9%*** on the wages and self-employment income of higher-income individuals as well as a ***new*** **3.8% Medicare Surtax** on their *net investment income*. Thus, the Federal tax rates for individuals taxed in the ***highest income tax brackets*** in ***2013*** who are also subject to these new Medicare surtaxes could be as high as: ***40.5%*** for wages and self-employment income; **23.8%** for long-term capital gains; and ***43.4%*** for dividend and interest income.

The uncertainty concerning the extension of the Bush tax cuts makes tax planning during 2012 extremely challenging. Our firm is available to help you accelerate ordinary income, capital gains, and dividends into 2012 and to defer deductions into 2013, if doing so would result in significant tax savings. However, it is uncertain at this point whether Congress will allow the scheduled rate increases to take effect in 2013 or continue 2012 tax rates at least for the short term. Therefore, we recommend that individuals who will be significantly hurt by the scheduled 2013 rate increases ***begin planning now*** to accelerate income into 2012 and possibly defer deductions into 2013.

However, it seems prudent to postpone the actual acceleration of the income until later in 2012 when we will, hopefully, have a better handle on Congress' plans. In addition, please remember that the only way to determine the benefit from accelerating income into 2012 or deferring deductions until 2013 is by performing detailed calculations with and without such acceleration or deferral. With and without calculations will take into account the regular taxes, the AMT, and state taxes. We are available to assist you in determining if accelerating income into 2012 will benefit you.

Although the overall tax rates for 2013 are currently in a state of flux, the temporary ***2% Social Security tax holiday*** scheduled to expire after 2012, and the new ***Medicare Surtaxes*** enacted under the *"Patient Protection Act of 2010"* (2010 Health Care Act), discussed below, may warrant action ***before 2013*** that could save you taxes in 2012 and later years.

The "Temporary" 2% Social Security Tax Holiday Scheduled To Expire After 2012.

Last February, Congress extended ***through December 2012*** the temporary reduction in the Social Security tax rate from 6.2% to 4.2% ***for employees,*** and from 12.4% to 10.4% for ***self-employed individuals.*** Therefore, **if you are an employee, for 2012,** the normal 6.2% "employee" portion of your Social Security tax rate has been reduced to 4.2%. Thus, your take-home pay for 2012 has been generally increased by 2% of each dollar of compensation that you earn. Since Social Security taxes apply only to the first $110,100 of compensation in 2012, your ***maximum savings for 2012*** is generally ***$2,202*** (i.e., $110,100 x 2%). If you are married and you and your spouse each earn at least as much as the wage base in 2012, your maximum combined savings will be $4,404. Likewise, ***if you are self-employed***, your Social Security taxes are reduced by 2% of your self-employment income for 2012 (up to $110,100).

> **Tax Tip.** You and/or your spouse should consider accelerating into 2012 compensation (e.g., by accelerating a bonus, commission, etc.) or self-employed income (e.g., encouraging a customer or client to pay early) in order to save the 2% Social Security tax to the extent the additional income does not cause either of you to exceed the $110,100 cap, and does not cause you to pay more income taxes. Moreover, the compensation or self-employed income that ***you accelerate into 2012*** will not be subject to the new .9% Medicare Surtax (discussed in the next segment) ***which becomes effective in 2013.***

New .9% Medicare Surtax On *Earned Income* Of Higher-Income Individuals Begins In 2013.

Payroll taxes imposed on your W-2 earnings include both a Social Security tax and a separate Medicare tax. Under current law, the overall Medicare tax rate is 2.9% (1.45% imposed on the employee and an additional 1.45% imposed on the employer). If you are self-employed, you must pay the entire 2.9% Medicare tax on your income from self employment. **Generally, effective for wages and self-employed earnings received after 2012** that exceed certain thresholds, the *2010 Health Care Act* imposes **an additional .9% Medicare Surtax.** This surtax applies to the amount by which the sum of your *W-2 wages* and your *self-employed earnings* exceeds $250,000 if you are married filing a joint return (exceeds $200,000 if you are single, or $125,000 if married filing separately).

> **Note!** For married individuals filing a joint return, the .9% Medicare Surtax will apply to the extent *the sum of* both spouses' W-2 earnings and the self-employed earnings exceed the $250,000 threshold. Also, you will not be entitled to take an "income" tax deduction for any portion of the .9% surtax, whether or not you are self-employed.

New 3.8% Medicare Surtax On Net Investment Income Of Higher-Income Taxpayers Begins In 2013.

Starting in 2013, a new 3.8% Medicare Surtax is imposed on the *net investment income* (e.g., interest, dividends, annuities, royalties, rents, certain "passive" income, and long-term and short-term capital gains – less applicable expenses) of ***certain higher-income individuals*.** The tax will apply to individuals with modified adjusted gross income (MAGI) exceeding the following ***"threshold amounts"*** – $250,000 for married filing jointly; $200,000 if single; and $125,000 if married filing separately. More specifically, the 3.8% Medicare Surtax will be imposed upon ***the lesser of*** the individual's **1)** modified adjusted gross income (MAGI) in excess of the "threshold amount," or **2)** net investment income. Moreover, ***trusts and estates*** that have *net investment income* and *adjusted gross income* (AGI) in excess of a certain ***"threshold amount"*** must pay the 3.8% Medicare Surtax, unless the income is timely distributed to beneficiaries. Fortunately, the following types of income are ***not subject*** to the 3.8% Medicare Surtax: tax-exempt bond interest; gain on the sale of a principal residence *otherwise excluded* under the ***home-sale exclusion*** rules (i.e., up to $250,000 on a single return, up to $500,000 on a joint return); and distributions from qualified plans (e.g., IRAs, §403(b) annuities, etc.).

> **Planning Alert!** Although the 3.8% Medicare Surtax is not effective until 2013, there are certain steps you might ***consider before 2013*** to reduce the amount of income subject to the tax in 2013:

- **Consider Shifting Toward Investments That Generate Tax-Exempt Income.** Investments that generate tax-exempt income will become more attractive in 2013. For example, tax exempt municipal bond interest will potentially provide higher-income individuals with a double tax benefit: **1)** the interest will not be included in the taxpayer's MAGI thus reducing the chance that the taxpayer will exceed the income thresholds for the 3.8% Medicare Surtax, and **2)** the tax-exempt interest itself is exempt from the Medicare Surtax.

> **Planning Alert!** Always consider the economics of the investment first!

- **Consider Shifting Toward "Tax-Deferred" Investments.** The 3.8% Medicare Surtax does not apply to earnings generated by a ***tax-deferred annuity*** (TDA) contract ***until the income is distributed.*** Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the Medicare Surtax income thresholds.

- **Recognizing Capital Gains in 2012 And Deferring Capital Losses Beyond 2012.** With the scheduled increase in the maximum long-term capital gains rates from 15% to 20% **in 2013,** and the imposition of the new 3.8% Medicare Surtax on capital gains starting **in 2013,** timing your sales of stocks, bonds, or other securities for 2012 is even more important than in previous years. If you are a higher-income taxpayer, ***after considering the economics of selling your investment,*** you may save taxes by selling investments producing long-term capital gains **that have peaked in value** in 2012, instead of waiting until 2013 or later. Likewise, overall tax savings may occur if you postpone selling investments producing a

capital loss until 2013 or later, so that those losses can shelter capital gains that otherwise would be subject to the higher 20% capital gains rate and the 3.8% Medicare Surtax.

Tax Tip. Under the so-called "wash sale" rules, you are not allowed to recognize a loss on the sale of securities if, within 30 days before or after the sale, you acquire substantially identical securities. However, the "wash sale" rules ***do not*** apply if you sell securities ***at a gain.*** Thus, you can accelerate capital gains by selling your appreciated securities ***before 2013,*** even if you purchase *substantially identical securities* at any time before or after the sale. Furthermore, by purchasing the replacement securities at their current appreciated values, you will obtain a higher tax basis in the newly-purchased securities. This higher basis in the replacement securities will reduce the gain that you might otherwise recognize after 2012.

Caution! If the replacement securities go down in value after your purchase, you could face the "capital loss" limitations when you sell the investment.

Planning Alert! Generally, for tax purposes, marketable securities are deemed sold on the ***trade date*** (i.e., the date the owner executes the contract to sell), as opposed to the ***settlement date*** (i.e., the date certificates are transferred and payment is received, which may be several days after the *trade date*). If you want help developing a strategy for harvesting capital gains and losses to your maximum tax advantage, please call us. We should develop this strategy well before year end so you can act swiftly in response to possible late-breaking tax changes.

- **Consider Roth IRA Conversions.** Tax-free distributions from a Roth IRA are exempt from the 3.8% Medicare Surtax, and do not increase your MAGI (and, thus will not increase your exposure to the Medicare Surtax). Therefore, these new tax-favored features should be factored into any analysis of whether you should convert your existing IRA to a Roth. However, if the conversion occurs ***after 2012***, the income triggered by the conversion increases your MAGI and, therefore, increases your potential exposure to the 3.8% Medicare Surtax on your other *net investment income* (e.g., capital gains, dividends, interest, passive income, rents). Thus, by converting to a Roth ***prior to 2013,*** you might avoid the higher income tax rates in 2013 and the 3.8% Medicare Surtax on your other *net investment income* that might otherwise apply for 2013.

Planning Alert! If you want the Roth conversion to be ***effective for 2012,*** you must transfer the amount from the regular IRA to the Roth IRA ***no later than December 31, 2012*** (you do not have until the due date of your 2012 tax return). Also, if you made a Roth conversion in 2010 and you chose to include 50% of the conversion income in 2011 and 50% in 2012, a Roth conversion in 2012 could expose you to a higher 2012 tax bracket than expected.

EXPIRED, EXPIRING, AND SCALED BACK TAX BREAKS

Selected Individual Tax Breaks That Expired After 2011.

There is an ever-expanding list of temporary tax breaks that expire every few years. However, even though Congress often waits until the last minute, it has *historically* extended most of the more popular provisions. Unfortunately, Congress has yet to extend a host of tax breaks that ***expired at the end of 2011,*** including: School Teachers' Deduction (Up to $250) for Certain School Supplies; Deduction for State and Local Sales Tax; Deduction (Up to $4,000) for Qualified Higher Education Expenses; Qualifying Tax-Free Transfers from IRAs to Charities for Those at Least 70½; Higher Alternative Minimum Tax (AMT) Exemption Amounts; Increased Charitable Deduction Limits for Qualifying Conservation Easements; Lifetime $500 Credit for Qualified Energy-Efficient Home Improvements; and Deduction for Qualified Home Mortgage Insurance Premiums.

> **Planning Alert!** If recent history is a guide, Congress will likely extend these provisions eventually, but there is no guarantee. Our firm will monitor the status of these expired provisions closely. Please call us if you want an up-to-date report.

Tax Breaks Currently Scheduled To Expire (Or Be Scaled Back) After 2012.

As discussed previously, the so-called *Bush-era tax rate cuts* are scheduled to expire after 2012. In addition, there are many other tax breaks that were enacted or expanded during the Bush administration that are likewise scheduled to ***expire*** or be ***scaled back***, including:

- **Targeted Individual Tax Breaks Scheduled To Be Scaled Back Or Expire *After 2012*.** The following are selected popular individual tax breaks scheduled to expire (or be scaled back) ***after 2012:*** Student Loan Interest Deduction; Adoption Credit; Child Tax Credit; Earned Income Tax Credit; Child and Dependent Care Credit, and Income Exclusion for Principal Residence Mortgage Cancellations.

- **Marriage Penalty Relief Expires *After 2012.*** Several tax provisions were enacted back in 2001 to reduce the so-called "marriage penalty" (i.e., provisions causing married individuals filing jointly to pay more tax than if they were unmarried filing single returns). These relief provisions (e.g., an enhanced standard deduction and larger 15% brackets for married taxpayers filing jointly) ***expire after 2012.***

  > **Planning Alert!** Without this relief, the marriage penalty is most significant when each spouse has about the same amount of taxable income. If you and your spouse generate or earn comparable amounts of income, the expiration of these "marriage penalty relief provisions" after 2012 could increase your "effective" tax rates on your joint return.

- **Phase Out Of Personal Exemptions And Itemized Deductions Return *After 2012.*** For the past two decades, higher-income individuals have been subject to phase-out provisions that reduced their *personal exemptions* and *itemized deductions* as their income exceeded certain amounts. These phase-outs were temporarily eliminated for ***2010, 2011, and 2012***. Starting ***in 2013,*** these personal exemption and itemized deductions phase-out rules are scheduled ***to be reinstated,*** potentially causing the highest "effective" income tax rate on the *ordinary income* of many *higher-income* individuals to be above the 39.6% published rate.

TRADITIONAL YEAR-END TAX PLANNING TECHNIQUES IN LIGHT OF TAX UNCERTAINTIES

Traditional year-end tax planning typically includes strategies that lower your current taxable income and postpone the payment of taxes to later years. The classic techniques to accomplish these goals are to ***defer the current recognition of taxable income*** to later years, and to ***accelerate deductible expenses*** into the current tax year. Although these strategies are still advisable for many taxpayers in 2012, they are more problematic (particularly for higher-income individuals) in light of the scheduled tax rate increases after 2012, the tax breaks that expired after 2011, and the host of targeted tax breaks scheduled to expire (or be scaled back) after 2012. After these scheduled tax changes are fully evaluated regarding your particular situation, the following strategies could save you 2012 taxes:

Year-End Planning For Investments.

As mentioned earlier in this letter, the maximum long-term capital gain rate is scheduled to increase from 15% to 20% ***after 2012,*** and to 23.8% if the new 3.8% Medicare Surtax applies. In addition, ***through 2012*****,** long-term capital gains that would otherwise be included in the 15% (or below) ordinary income tax bracket, are taxed at zero percent. ***After 2012,*** this zero percent bracket is scheduled to increase to 10% (8% for assets held more than 5 years).

> **Planning Alert!** After ***fully evaluating the economic factors*****,** the following are traditional year-end tax planning ideas that could save you 2012 taxes for sales of capital assets:

- **Planning With *Temporary* Zero Percent Capital Gains Tax Rate.** For 2012, all ordinary income (e.g., W-2, interest income) up to $70,700 for joint returns ($35,350 if single) is taxed at the 15% rate, or below. Thus, married taxpayers filing jointly can benefit from the zero percent capital gains rate if (and to the extent) they have 2012 ordinary taxable income under $70,700 ($35,350 if filing single).

> **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2012, may temporarily have income low enough to take advantage of the zero percent capital gains rate for 2012. If you are experiencing any of these situations, please call our firm and we will help you determine if it is possible for you to take advantage of this low capital gains rate.

> **Planning Alert!** Don’t forget, long-term capital gains that currently qualify for the zero percent rate will be taxed at 10% (8% for assets held more than 5 years) starting in 2013, unless Congress extends the zero percent rate beyond 2012.

- **Timing Your Capital Gains and Losses.** If you have already recognized capital gains in 2012, and you want to shelter those gains from the current 15% maximum capital gains rate, you should consider selling securities that have declined in value **prior to January 1, 2013.** These losses will be deductible on your 2012 return to the extent of your recognized capital gains, plus $3,000.

  Tax Tip. These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tuition Tax Credit, $1,000 child credit, $12,650 adoption credit, etc.

  Planning Alert! If within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock).

  Tax Tip. If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, as previously mentioned in this letter, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, to take advantage of the current 15% maximum capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

  Caution! As we previously warned in the discussion of the new 3.8% Medicare Surtax, it may be better tax-wise for you to wait to sell your *capital loss* investments until ***after 2012.*** That way, the capital losses could be used to offset capital gains that might otherwise be taxed under the higher 20% capital gains rate, and the new 3.8% Medicare Surtax. Please call our firm if you want us to review your particular situation and help you develop the most tax-favorable strategy for timing your capital gains and losses.

- **Stock "Traders" Should Consider The "Mark-to-Market" Election.** If you are a "trader" (instead of an "investor") in stocks, the "mark-to-market" election could possibly save you taxes. Generally, you may qualify as a "trader" if you have frequent purchases and sales of stock, you hold the stock for short-term gain (rather than long-term appreciation and dividends), and you have a high volume of stock transactions throughout the year. As a trader, you can elect (for tax purposes) to mark your stock down or up to market at year end. This election will convert what would generally be short-term capital gains and losses, into "ordinary" gains and losses.

  Tax Tip. This election could save taxes if at some point you incur significant losses. If you qualify as a "trader," making a timely "mark-to-market" election allows you to deduct those losses as "ordinary losses," instead of being limited by the $3,000 ceiling on net capital losses.

Planning Alert! Unless you made the "mark-to-market" election for a prior year, the mark-to-market election, unfortunately, must be made by the due date (without regard to extensions) of your **prior year's tax return.** Even though it is now too late to make the election for 2012, you may wish to make the election by April 15, 2013, for 2013 and future years. ***Please call us*** if you think this election might save you taxes and we will be glad to fill you in on the details.

- **Exercising Incentive Stock Options (ISOs) Could Trigger AMT.** Exercising an incentive stock option (ISO) in 2012 can generate a 2012 alternative minimum tax (AMT) if the difference between the stock's value and the exercise price is substantial.

Tax Tip. If you exercised an ISO ***in 2012*** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2012 AMT tax liability if you sell the stock ***on or before December 31, 2012.*** Please check with us if you have exercised incentive stock options during 2012 and the price of the stock has fallen since the date of exercise.

Postponing Taxable Income.

Even if all or some of the currently-scheduled tax rate increases do go into effect after 2012, it is still generally a good idea to defer income into 2013 if you believe that your marginal tax rate for 2013 will be equal to or less than your 2012 marginal tax rate.

Tax Tip. This classic tax planning strategy may be particularly valuable for 2012 if it also keeps your 2012 income below the phase-out thresholds for the many tax breaks that are currently scheduled to expire or be scaled back after 2012 (e.g.,adoption credit, student loan interest deduction, American Opportunity Tax Credit, child tax credit). If, after considering your anticipated 2013 tax rates, you believe that deferring taxable income into 2013 will save you taxes, consider the following strategies:

- **Self-Employed Business Income.** If you are self-employed using the cash method of accounting, consider delaying year-end billings to defer income until 2013.

Planning Alert! If you have already received the check in 2012, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

- **Installment Sales.** If you plan to sell certain appreciated property in 2012, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify, the gain will be taxed to you as you collect the principal payments on the note.

Planning Alert! Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe that your chances of getting paid are at risk.

Caution! On a seller-financed sale, most property that qualifies for the installment method also generates a long-term capital gain (e.g., closely-held stock, partnership interests except for certain recapture items, investment realty, improved realty used in a business or held for investment). Therefore, you should consider the scheduled increase in the long-term capital gains rates of up to 23.8% after 2012, before agreeing to accept an installment note with payments due beyond the 2012 tax year.

Tax Tip. If you are currently receiving payments on an installment sale obligation (e.g. promissory note) and you decide that you want to accelerate the remaining gain on the note into 2012 to avoid future tax increases, there are certain actions that you may be able to take to accelerate the remaining gain. If you have this situation, we will be glad to advise you on the options that might be available to accelerate recognition of the deferred gain into 2012.

- **IRA Owners Reaching Age 70½ During 2012.** If you reached age 70½ at any time during 2012, you must begin distributions from a traditional IRA account ***no later than April 1st of 2013.*** A 50% penalty applies to the excess of the "required minimum distribution" over the amount actually distributed. If you wait until 2013 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2013, which will cause you to take two payments in 2013.

Planning Alert! This "bunching" of the first two annual payments into one tax year (2013) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2012. Also, taking your first required distribution ***in 2012*** may save even more taxes than in previous years, if the scheduled tax increases after 2012 actually occur. Furthermore, if you are a higher-income taxpayer, taking two payments in 2013 could cause you to exceed the income thresholds for imposing the new 3.8% Medicare Surtax on your ***net investment income*** (e.g., interest, dividends, and capital gains).

Tax Tip. If you turned 70½ in 2012 and you also retired this year, taking your first two payments in 2013 may save you taxes if your income is significantly less in 2013 causing you to be in a lower tax bracket in 2013. If you reached age 70½ in 2012, and you own an IRA or other qualified retirement account, please call us and we will help you navigate these rules to your best tax advantage.

- **IRA And Qualified Retirement Plan Rollovers By Surviving Spouses.** If a spouse ***over age 70½*** died during 2012 with a surviving spouse named as beneficiary of the decedent's IRA or qualified plan account, there are certain steps that should be taken ***before 2013*** – if the surviving spouse wants to defer taking "required minimum distributions" (RMDS) as long as possible. More specifically, if the *surviving spouse* is ***over 59½,*** he or she should consider rolling the decedent's qualified plan or IRA amount into the surviving spouse's name ***on or before December 31, 2012.*** This will potentially reduce the RMDs to the surviving spouse in two ways: **1)** provided the surviving spouse has not reached age 70½, no RMDs will be required in 2013, and **2)** if the surviving spouse is at least 70½, the RMDs in 2013 (and later years) will generally be smaller than if the surviving spouse did not roll over the account.

  Caution! If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty.

  Planning Alert! These rules are complicated, so please call us if your spouse passed away in 2012 and you are named as the beneficiary of your spouse's retirement plan or IRA. We will help you determine the steps you should take to maximize tax savings.

Taking Advantage Of Deductions.

After considering the currently-scheduled tax rate increases for 2013, if you believe that your marginal tax rate for 2012 will be equal to or greater than your anticipated 2013 marginal tax rate, you may save taxes by accelerating deductions into 2012. Likewise, accelerating 2013 deductions into 2012 may be particularly valuable for 2012 if it also keeps your 2012 income below the phase-out thresholds for the many tax breaks that are currently scheduled to *expire* or be *scaled back* after 2012 (e.g. adoption credit, student loan interest deduction, American Opportunity Tax Credit, child tax credit). If, after considering your anticipated 2013 tax rates, you believe that accelerating deductions into 2012 will save you taxes, consider the following strategies:

- **Accelerating "Above-The-Line" Deductions into 2012.** As a cash method taxpayer, you can generally accelerate a 2013 deduction into 2012 by "paying" for the deduction item in 2012. Accelerating an **"above-the-line"** deduction (e.g., IRA contribution, Health Savings Account (HSA) contribution, health insurance premiums for self-employed individuals, qualified student loan interest, qualified moving expenses, deductible alimony) into 2012 may allow you to reduce your "adjusted gross income" (AGI) or "modified adjusted gross income" (MAGI) below the thresholds needed to qualify for many other tax benefits (e.g., child credit, education credits, adoption credit, ability to contribute to a deductible IRA, etc.). However, **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your AGI or MAGI and, therefore, will not affect your 2012 deductions and credits that are reduced as your income increases. *Itemized deductions* generally include charitable contributions, state and local income and property taxes, medical expenses, unreimbursed employee business expenses, and home mortgage interest.

  Tax Tip. "Payment" typically occurs in 2012 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged in 2012 on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express). **Be careful,** if you post-date the check to 2013 or if your check is rejected, no payment has been made in 2012.

  Planning Alert! The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment will not be deductible in 2012.

- **Accelerating "Itemized" Deductions Into 2012.** If your *itemized deductions* fail to exceed your *standard deduction* in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years.

  Tax Tip. The easiest deductions to shift from 2013 to 2012 are *charitable contributions*, *state and local taxes*, and your January, 2013 home *mortgage interest payment*. For 2012, the standard deduction is $11,900 on a joint return and $5,950 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,150 if you're married ($1,450 if single).

  Watch Out For AMT! Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes, un-reimbursed employee business expenses, and interest on home equity loans (unless the loan proceeds were used to improve, build, or buy your residence). Before you accelerate 2013 itemized deductions into 2012, to be safe, we should first do a "with and without" computation so we can determine the AMT impact of this strategy.

Planning Alert! If Congress fails to extend certain provisions that reduced the so-called *marriage penalty* that expires after 2012, the standard deduction for married taxpayers filing jointly is currently scheduled to drop from **$11,900** for **2012,** to an estimated **$10,150** for **2013.**

- **Higher-Income Individuals May Get Additional Benefit From Accelerating Itemized Deductions Into 2012.** As mentioned previously, until 2010, *itemized deductions* (other than medical expenses, investment interest, casualty and theft losses, and gambling losses) were generally reduced by a percentage of an individual's AGI above a threshold amount. For **2010, 2011, and 2012,** all individuals are exempt from this phase-out. However, beginning in 2013, *itemized deductions* (other than medical expenses, investment interest, casualty and theft losses, and gambling losses) are scheduled to be reduced by 3% of an individual's AGI above the 2013 threshold amount. Thus, if you anticipate that your income will exceed the beginning phase-out threshold in 2013 (projected to be **$178,150**), accelerating 2013 itemized deductions into 2012 can avoid the phase-out.

- **Starting In 2013 – Medical Deduction Threshold Increases From 7.5% To 10% of AGI.** Currently, you are generally allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums) to the extent that the expenses exceed ***7.5%*** of adjusted gross income (10% for alternative minimum tax purposes). ***Starting in 2013,*** the *Health Care Act of 2010* generally increases this threshold from 7.5% of adjusted gross income (AGI) ***to 10% of AGI.***

Exception For Seniors. If either you or your spouse is at least age 65 before the close of the tax year, the 7.5% of AGI threshold will continue to apply **through 2016** (whether you file a joint return or separate returns).

Planning Alert! Since the alternative minimum tax (AMT) treatment of the itemized deduction for medical expenses is not changed under the health care legislation, medical expenses will continue to be deductible for AMT purposes only to the extent they exceed 10 percent of AGI, even if the taxpayer (or the taxpayer's spouse) is age 65 or older.

Tax Tip. If you will be subject to the 10% threshold in 2013, you should consider accelerating (i.e., bunching) your anticipated discretionary medical expenses into 2012 if your total medical expenses will exceed the 7.5% threshold, but not the 10% threshold.

Planning Alert! The following *may* qualify for the medical expense deduction, but are sometimes overlooked: braces, laser eye surgery, transportation essential for medical care, lodging (but not meals) while away from home primarily for medical care, *certain* changes to your house to accommodate a physical handicap, *certain* tuition payments to a special school for a child with severe mental or physical disabilities recommended by a physician, costs of programs and prescription drugs to help people stop smoking, and *qualified* long-term care services. Also, the standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is ***23 cents*** per mile ***for 2012.***

- **Take Advantage Of Health Savings Accounts (HSAs).** Qualifying contributions to health savings accounts (HSAs) are fully deductible whether or not you itemize deductions, and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). **For 2012,** if you have "family" coverage, your HDHP must have a minimum annual deductible of $2,400 ($1,200 for self only coverage). For 2012, your maximum contribution to an HSA is $3,100 ($4,100 if 55 or older) for self-only coverage, and $6,250 ($7,250 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less.

  Tax Tip. Your contribution to your HSA reduces your AGI which, in turn, could free up other deductions and credits that phase out as your income exceeds certain thresholds.

  Planning Alert! As long as you are covered by a qualifying high deductible health plan by **December 1, 2012,** you will be able to contribute up to the maximum 2012 contribution limitation (e.g., $6,250 for family coverage in 2012), subject to potential recapture rules.

  Caution! You may only reimburse *"prescribed"* medicines or drugs (other than insulin) from the HSA without tax or penalty. IRS says, however, that if you obtain a prescription for an over-the-counter drug, it may be reimbursed tax-free and without penalty.

- **Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans.** If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). For most *calendar-year* plans, you must clean out your 2012 account by March 15, 2013, or forfeit any funds that aren't used for qualifying expenses.

  Planning Alert! The March 15, 2013 deadline applies only to flex plans **that have been amended** to give participants 2½ months after year-end to use up current year contributions to the plan. If your calendar-year flex plan has not been amended, you must use up your account by **December 31, 2012, or forfeit the balance.** Also,

reimbursements for drugs and medicines (other than insulin) will be tax free only if you have a prescription for the drug or medication.

- **Starting In 2013 – Annual Contributions to Health FSAs Capped At $2,500.** Through 2012, there is no limit (except as imposed by the plan itself) on the amount which an employee can elect to contribute to a health FSA through salary reductions. ***Starting in 2013,*** cafeteria plans will be required to cap the annual salary reduction contribution to a health FSA ***at $2,500*** (which is adjusted for inflation after 2013).

  Planning Alert! The IRS has recently announced that if you work for two unrelated employers, each maintaining a health FSA, you may contribute up to $2,500 to each plan. Also, the IRS says if you have a grace period (up to 2 months and 15 days) after the 2012 plan year to use your 2012 health FSA account, the unused portion that is carried over from 2012 into the 2013 grace period ***will not count toward*** your $2,500 limit for 2013.

- **Home Office Deduction.** Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. To qualify, your home office must be used ***"regularly and exclusively"*** as your ***"principal place of business."*** For example, your home office will be deemed your ***principal place of business*** if you use the office to perform ***management or administrative duties*** for your business ***and*** there is ***no other fixed location*** where you perform substantial management or administrative duties for your business. If you are an "employee" (as opposed to being self employed), in addition to meeting these requirements, you must also establish that your home office is ***"for the convenience of your employer"*** (this generally means you're not provided an office at work).

  Tax Tip. The IRS says that if you have a qualifying home office, you can deduct any daily travel from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible travel expense.

  Note! The ***"business standard mileage"*** rate for 2012 is ***55.5 cents*** per mile. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement should be excluded from your income if reimbursed under an ***"accountable reimbursement plan."*** We can help you establish a qualifying *accountable reimbursement plan* with your employer.

  Planning Alert! Generally, you must reduce your *unreimbursed* employee business expenses (including home and office expenses) by 2% of your adjusted gross income, and the unreimbursed expenses are not deductible at all for alternative minimum tax (AMT) purposes. However, you can avoid the 2% reduction rule and the AMT exposure if you properly document your employee business expenses and get reimbursed by your employer under an "accountable reimbursement plan." If you are an employee, you should always formally seek reimbursement from your employer

for legitimate employee business expenses, or obtain a confirmation that your employer will not reimburse the expenses. Otherwise, your unreimbursed employee business deduction may be disallowed altogether.

- **Charitable Contributions.** As you plan for your year-end charitable giving, consider the following planning techniques:

  - **"Pay" Your Charitable Contribution in 2012.** A charitable contribution deduction is allowed for 2012 if the check is *mailed* ***on or before December 31, 2012,*** or the contribution is made by a credit card charge in 2012. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay off the note or pledge.

  - ***Temporary*** **Rule For Tax-Free IRA Payments To Charities** ***Expired After 2011!*** For the past several years, we have had a popular (but *temporary*) rule that allowed a taxpayer at least age 70½, to make a *qualifying* transfer of up to $100,000 from his or her IRA directly to a qualified charity, and exclude the distribution from income. The IRA transfer to the charity also counted toward the owner's "required minimum distributions" (RMDs) for the year.

    Planning Alert! Although this provision ***expired after 2011*** and is not currently available for 2012, it is possible that Congress may retroactively extend this provision for 2012. If so, and you plan to use this provision if retroactively extended, be prepared to make the transfer from your IRA to the charity on short notice. Also, if you are eligible for this provision and you have not taken your 2012 RMD from the IRA, consider waiting until later in 2012 to take the distribution. That way, if Congress retroactively extends this provision at least through 2012, you will have the option to transfer up to $100,000 directly to a charity and reduce (or eliminate) your RMD for 2012.

    Caution! There is generally a 50% penalty for failure to make the RMD by the end of 2012.

  - **Contributions of Appreciated Property.** If you are considering a significant 2012 contribution to a public charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation.

    Caution! Your current year deduction for appreciated capital gain property is generally limited to 30% of your AGI, with a 5-year carryover of the excess.

Tax Tip. If you want to continue to hold an investment position in the stock that you contribute to the charity, consider purchasing stock that is the same or similar to the appreciated stock you contributed. That way, you will have a higher "tax" basis in the replacement stock, without having to recognize the gain on the contributed stock.

Planning Alert! If you want to use "loss" stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, although you will get a charitable deduction equal to the value of the contributed stock, you will ***lose the capital loss*** deduction.

Tax Tip. If you plan to contribute appreciated realty or stock for 2012, make sure that you begin the paperwork for the transfer early enough so that all documentation is completed by **December 31, 2012.**

- **Contributions Made In Cash.** In order to deduct a "cash" cash contribution to a charity, you must have a receipt, letter, or other written communication from the charity (showing the name of the charity, the date and the amount of the contribution).

  Planning Alert! If your contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Contributions Made By Check, Debit Card, or Charge Card.** If you make a contribution by check, you are required to have either a receipt described above for ***"Contributions Made In Cash,"*** a copy of the cancelled check, or some other bank record (e.g., a bank statement). If your contribution is by debit card or by charge card, you are required to have either a receipt as described above for ***"Contributions Made In Cash,"*** or a bank record (e.g., a bank statement, credit card statement, etc.).

  Planning Alert! If your contribution is $250 or more, you ***must also satisfy*** the ***"Mandatory Documentation Requirements For Contributions Of $250 Or More,"*** discussed below.

- **Mandatory Documentation Requirements For Contributions of $250 Or More.** If you contribute ***$250 or more*** to a charity, you are allowed a deduction ***only if*** you receive a ***"qualifying written receipt"*** from the charity by the time you file your return (a cancelled check is not enough), if the return is timely filed. The ***qualifying written***

receipt must contain the following information: **1)** the amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** a statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** a description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). ***In addition,*** for all noncash contributions, the receipt must contain the date of the charitable contribution and a description of the property contributed. Furthermore, to take a charitable contribution deduction ***for noncash property valued in excess of $5,000,*** you must have both a ***qualifying written receipt*** (as described above), and an ***appraisal*** by a ***qualified appraiser*****.** Moreover, if you are claiming a deduction of ***more than $500*** for a ***vehicle, a boat, or an airplane*** you contributed to charity, the law requires that you obtain a ***Form 1098-C*** as well as a ***qualifying written receipt*** (if the deduction is $250 or more) from the charity in order to deduct your contribution.

- **Contributions of Clothing And Household Items.** Even if you meet the previously-discussed documentation requirements, you are not allowed a deduction for charitable contributions of ***clothing or household items*** unless the items are in ***"good used condition or better."***

  Tax Tip. You should consider contributing your clothing and household items to charities that have a policy of accepting only items that are in good condition.

- **IRS Charitable Mileage Rate.** The standard IRS charitable deduction mileage rate for use of your vehicle for qualified charitable purposes is ***14 cents*** per mile ***for 2012.***

- **IRS Is Rigidly Enforcing The Charitable Contribution Documentation Requirements.** Over the last 12 to 18 months, the IRS has successfully taken several taxpayers to court denying a charitable deduction for those who failed to timely obtain documentation that satisfies the strict requirements discussed above. Consequently, please make sure you have the required documentation for all your 2012 Charitable Contributions.

- **Maximizing Home Mortgage Interest Deduction.** If you are looking to maximize your 2012 deductions, you can increase your home mortgage interest deduction by paying your January, 2013 payment **on or before December 31, 2012.** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December.

  Planning Alert! Make sure that you send in your January, 2013 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender will be sure to reflect that last payment on your 2012 Form 1098, and we can avoid a matching problem on your 2012 return. Here are some other planning strategies for the interest deduction you should consider:

- **Look For Deductible "Points."** Points paid in connection with the purchase or improvement of your ***principal residence*** are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include "loan-processing fees," "loan premium charges," or "loan origination fees" so long as they don't represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys' fees, credit checks, property taxes, or mortgage insurance premiums).

  Tax Tip. If 2012 marks at least the second time that you refinanced your home, and you are not refinancing with the same lender, you may deduct in 2012 any unamortized points from the previous refinancing.

- **Remember To Deduct Seller-Paid Points.** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

- **Pay Off Personal Loans First.** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

- **Time Payment of State And Local Taxes To Your Benefit.** If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2012) and any property taxes for 2012 **prior to January 1, 2013** if your tax rate for 2012 is higher than or the same as your projected 2013 tax rate. This will provide a deduction for 2012 (a year early) and possibly against income taxed at a higher rate.

  Planning Alert! State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, "overpayment" of your 2012 state and local income taxes is generally not advisable particularly if a refund in 2013 from a 2012 overpayment will be taxed at a higher rate than the rate that applied to the 2012 deduction. **Please consult us before you overpay state or local income taxes!**

- ***Temporary* Rule For Deducting Sales Tax Expired *After 2011!*** For the past several years, we have had a *temporary* rule that allowed taxpayers to "elect" to deduct "either" state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among individuals who live in states with little or no state income taxes, or states where the state income tax rate is generally lower than the sales tax.

  Planning Alert! This provision **expired after 2011,** and is not available for 2012 unless Congress decides to extend it.

PLANNING WITH EDUCATION COSTS

To encourage higher education, Congress has provided a host of deductions and credits that have become a key component of year-end planning for many taxpayers.

> **Caution!** In recent years, several of these education tax breaks have been "temporarily" enhanced, making them more valuable. Unfortunately, several of these more recent enhancements are currently ***scheduled to be eliminated or scaled back after 2012.*** This puts more pressure on taxpayers to ensure they qualify for the expanded education tax breaks still available in 2012, in the event the enhancements are not extended.

> **Planning Alert!** If your income is down for 2012, this may be a particularly good time to take advantage of these tax breaks since these benefits are reduced or eliminated at higher income levels. As you develop your 2012 year-end planning strategies, the following should help you plan for these interrelated (and sometimes overlapping) education tax incentives:

- **"American Opportunity Education Tax Credit."** Before 2009, individuals were allowed a HOPE tuition tax credit (HOPE Credit) for qualifying tuition costs generally for the first two years of college (e.g., freshman and sophomore years). **For 2009 through 2012,** Congress changed the name of the HOPE credit to the ***"American Opportunity Tax Credit,"*** and enhanced and expanded it by: **1)** increasing the maximum credit from $1,800 to $2,500 (100% of the 1st $2,000 of qualifying education expenses plus 25% of the next $2,000 of qualifying expenses); **2)** increasing the total number of years that a student may qualify from *two* years to *four* years (i.e., generally, freshman through senior years); **3)** increasing the income phase-out levels (for 2012 the credit is phased out as your modified adjusted gross income (MAGI) increases **from $160,000 to $180,000 for those filing joint returns** and from **$80,000 to $90,000 for single filers**); **4)** making 40% of the credit refundable *(unless the person claiming the credit* is subject to the so-called *kiddie tax rules*); and **5)** adding *course materials* to the expenses (in addition to tuition and fees) that qualify for the credit.

  > **Planning Alert!** Unless Congress decides to extend the current provisions, each of the enhancements listed above will automatically expire **after 2012.** For example, if no extension occurs, ***for 2013,*** the MAGI phase-out thresholds are projected to be from $107,000 to $127,000 for joint filers (down from $160,000 to $180,000 in 2012), and from $53,000 to $63,000 for single filers (down from $80,000 to $90,000 for 2012).

Tax Tip. To get the full $2,500 credit for 2012, you must pay qualifying expenses of at least $4,000 for the student ***by December 31, 2012.*** For example, if you paid tuition and books of $2,500 for the fall, 2012 semester for a college freshman, you would need to pay tuition of at least $1,500 for the spring, 2012 semester by **December 31, 2012,** to get the full credit of $2,500 for 2012. Paying qualifying expenses by ***December 31, 2012*** is particularly important if you qualify for the credit in 2012, but you would not qualify in 2013 if the credit reverts to its Pre-2009 provisions. For example, where you have already taken the credit for at least two years for the same child.

- **The Lifetime Learning Credit.** The *Lifetime Learning tax credit* equals 20% of the first $10,000 of qualified higher education tuition and fees. The credit phases out ratably as your modified adjusted gross income increases from **$104,000 to $124,000** on a joint return (**$52,000 to $62,000** on a single return). The Lifetime Learning credit is for an unlimited number of years and can be used for graduate or professional degrees (as well as undergraduate education). However, the Lifetime Learning credit **limitation of $2,000 is per tax return, not per student.**

Planning Alert! If your income **is more than $124,000 ($62,000 on a single return),** you do not qualify for the Lifetime Learning credit. However, the IRS says the student (e.g., your child) may claim the credit on his or her return, provided you elect not to claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). Since the Lifetime Learning credit is a *non-refundable* credit, your child must have sufficient income tax liability to utilize the credit on his or her return.

- **Temporary Tuition Deduction Expired *After 2011!*** For the past several years, we have had a *temporary* rule that allowed taxpayers who were below certain income thresholds, to deduct up to $4,000 of *qualified* higher education tuition and fees.

Planning Alert! This provision ***expired after 2011*****,** and is not available for 2012 unless Congress decides to extend it.

- **Student Loan Interest.** For **2012,** you may deduct (whether or not you itemized deductions) up to $2,500 of interest on qualified student loans. Your deduction phases out as your adjusted gross income increases from **$125,000 to $155,000 on a joint return (from $60,000 to $75,000 on a single return).** The IRS says that if a family member pays your interest, the payment will be treated as a gift to you, and you will then be treated as paying the interest yourself.

Planning Alert! Without Congressional action, ***after 2012,*** this deduction will become more restricted, and the deduction is projected to phase out as your modified adjusted gross income increases from $75,000 to $90,000 if you are married filing jointly ($50,000 to $65,000 if you are single).

- **Using IRA Funds for Education Expenses.** If you have an IRA, you can withdraw funds for qualified higher education expenses without having to pay the normal 10% early distribution penalty. The distribution is, however, still taxable.

Tax Tip. The taxes on the distribution for higher education expenses, may be offset by an American Opportunity Tax credit or a Lifetime Learning credit resulting from the payment of the qualifying education expenses.

Caution! This exception from the early distribution penalty for qualifying education expenses ***only*** applies to *distributions from IRAs*. Therefore, if you receive a distribution from your *employer's retirement plan* and you do not meet any other exception to the 10% penalty; you will generally pay the 10% penalty tax even if you pay qualifying education expenses.

Tax Tip. You could avoid the 10% penalty by first rolling the distribution from your employer's retirement plan **into an IRA**, and then distributing funds from the IRA to pay for the education expenses.

Planning Alert! You must withdraw the IRA funds *in the same tax year* that you pay the qualified education expenses to avoid the 10% early distribution penalty. Therefore, if you have paid qualifying education expenses in 2012 and want a penalty-free reimbursement from your IRA for those expenses, you must make the distribution ***no later than December 31, 2012.***

PLANNING WITH RETIREMENT PLANS

- **IRA Contributions.** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $10,000 ($12,000 if you're both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,000 ($6,000 if at least age 50) may be contributed to your or your spouse's separate IRA for 2012. If you are an active participant in your employer's retirement plan during 2012, your IRA deduction is phased out ratably as your adjusted gross income increases from **$92,000 to $112,000** on a joint return (**$58,000 to $68,000** on a single return). However, if your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your ability to contribute the full amount to an IRA phases out as the adjusted gross income on your joint return goes from **$173,000 to $183,000.**

    Planning Alert! Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2012, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$173,000 to $183,000** on a joint return, and from **$110,000 to $125,000** if you are single.

- **Workers At Least Age 70½.** If you are age 70½ or older, you **cannot** make a contribution to a traditional IRA.

    Tax Tip. If you are working, are age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½.

- **Consider Contributing To Your Company's 401(k) Plan.** If you are covered by your company's 401(k) plan, you should consider putting as much of your compensation into the plan as allowable. The maximum employee contribution you may make for 2012 is $17,000 ($22,500 if you're at least age 50 by the end of 2012). This is particularly appealing if your employer offers to match your contributions.

- **Be Careful Before Taking Money From Your Qualified Retirement Accounts Or IRAs!** If you are experiencing financial distress which is tempting you to tap into your retirement plan funds, **be extremely careful!** There are specific ways to withdraw funds without paying a 10% penalty (although you generally must include the withdrawal in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** you have reached age 59½, **2)** you have been medically determined to be disabled, **3)** you are using the funds for qualified education expenses, **4)** you are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** you take substantially equal payments over your life expectancy.

  Planning Alert! These rules are exceedingly technical and if not properly followed, can result in a 10% penalty on the distribution.

CORDASCO
& COMPANY P.C.
Certified Public Accountants

CONSIDER MAXIMIZING FAMILY GIFTS

For individuals dying in **2012,** there is generally a **35%** estate tax to the extent the value of the estate, plus any taxable gifts made during the decedent's life, exceeds **$5,120,000** (the estate and gift ***"unified exclusion amount"***). This current *unified exclusion amount* is scheduled to **drop to $1 million** for ***gifts made after 2012*** and for estates of individuals ***dying after 2012.*** Also, the top estate and gift tax rate is scheduled to **increase to 55% after 2012.** If you believe that your estate is large enough to be exposed to the estate tax, and you want to minimize that exposure, consider the following year-end gift-giving strategies:

- **Utilize Annual Gift Tax Exclusion.** You can reduce your estate without using any of your *unified exclusion amounts* by making annual gifts up to $13,000 per donee (projected to be $14,000 for 2013). Your spouse can do the same, bringing your combined 2012 gift to $26,000 per donee, without reducing either your or your spouse's *unified exclusion amount.*

  Planning Alert! If you make your 2012 gift by check, the IRS says that the donee must actually ***"deposit"*** the check ***by December 31, 2012*** in order to utilize the $13,000 annual gift tax exclusion for 2012. Therefore, if gifts are made near the end of the year, instruct the donee to deposit ***no later than December 31, 2012***, or consider using a cashier's check which should constitute a gift when the check is delivered.

- **Consider Giving Appreciated Property.** If you are a high income individual, and you give appreciated property (e.g., appreciated stock) to a low-income family member, this may allow the family member to take advantage of the zero-percent capital gains rate (discussed previously in this letter) if the property is sold before 2013. Also, if the low-income donee sells the stock after 2012, giving the stock to the low income family member and allowing that person to sell the stock may avoid the new 3.8% Medicare Surtax (discussed previously).

  Caution! This strategy contains potential tax traps. For example, the donee's gain on the sale of the property will generally be taxed at the donee's parent's higher tax rate if the donee is subject to the "kiddie tax."

- **Larger Estates Should Consider Using The Temporary $5,120,000 Unified Exclusion Amount For Lifetime Gifts.** As mentioned above, the current gift and estate tax *unified exclusion amount* of $5,120,000, which may be used to reduce either gift taxes for lifetime gifts or estate taxes at death, is scheduled to drop to $1 million ***after 2012.*** This dramatic drop in the *unified exclusion amount* has caused many high-wealth individuals to consider large family gifts before 2013. If you are in this situation, please call our firm and we will review with you the many tax and non-tax factors you should evaluate before implementing a significant year-end gift strategy, including: **1)** the size of your estate, **2)** whether you expect the assets that you plan to give will appreciate, **3)** whether you will continue to feel financially secure after making the gift, **4)** notwithstanding the potential tax savings, whether you are comfortable transferring ownership of significant property to other family members, and **5)** what to do if Congress changes the estate and/or gift tax rules late in 2012.

  Planning Alert! Maximizing the benefits of a large 2012 gift may require appraisals, the establishment of trusts, etc. Therefore, we need to begin planning for the gift as soon as possible. That way, we will be in a position to "implement" (or postpone) the gift – depending on late-breaking 2012 tax changes.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Before wrapping up your *traditional* year-end planning review, here are several more strategies you might consider:

- **Consider Increasing Withholding If Facing A Tax Underpayment Penalty.** If you have failed to pay sufficient estimated taxes during 2012 potentially causing an underpayment penalty, ***increasing your withholdings before the end of 2012*** may solve the problem. Any income tax withholding (including withholdings at the end of 2012 from a year-end bonus or IRA distribution) is generally deemed paid 1/4 on April 17, 2012, June 15, 2012, September 17, 2012 and January 15, 2013. Therefore, amounts ***withheld on or before December 31, 2012*** may reduce or eliminate your penalty for underpaying estimated taxes.

  > **Planning Alert!** If you use this technique by withholding taxes from an IRA distribution near year end, to avoid paying taxes (and possibly a 10% penalty) on the distribution, you must roll the distribution (unreduced by the withheld taxes) into a new IRA within 60 days of the distribution. Also, you are allowed to take a distribution from an IRA and roll it over into a new IRA, ***only one time per year*** (beginning with the date you received the distribution). So, if you used this withholding technique with your IRA last year, you must generally meet the one-year waiting period for it to work this year for the same IRA account. Please call us if you have any questions.

- **Don't Overlook The 30% Credit For Qualified *Residential* Solar Equipment, Geothermal Heat Pumps, Etc.** If you install a qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property in or on your residential property located in the U.S., you may qualify for a credit equal to 30% of the equipment's cost (including onsite labor costs). The residence does ***not*** have to be your **"principal residence,"** so installations in your second residence or vacation home may qualify.

  > **Tax Tip.** The IRS says on its website that this credit is available to the extent that the purchase price of a new home can be reasonably allocated to the qualifying energy-efficient equipment. Therefore, if you purchased a new home in 2012, be sure to ask the builder to provide you a cost breakdown of any solar electric panels, solar water heaters, etc.

  > **Planning Alert!** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify. Also, to take the credit for 2012, the property must *actually be installed* **no later than December 31, 2012. Please note** that this credit is not currently scheduled to expire until **after 2016.**

- **Maximize Tax-Favored Medical Benefits For Children Under Age 27.** An employer-provided health plan may provide tax-free reimbursements to an employee's child **who is under age 27** *at the end of the tax year*. This exclusion applies even if the employee cannot claim the child as a dependent for tax purposes.

  Tax Tip. If your employer's health insurance plan is currently covering your child who will turn age 27 in 2013, accelerating discretionary medical expenses for that child from **2013 to 2012** will allow your employer's 2012 reimbursements to be tax-free. In addition, **if you are self-employed and you otherwise qualify,** you may take an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums that you pay for your child who is **under age 27** at the **end of the year,** even if the child is not your "dependent" for tax purposes.

- **Planning With the "Kiddie Tax."** A child who *is not filing a joint return with a spouse* will have his or her unearned income (e.g., interest, dividends, and capital gains) in excess of the *threshold amount* ($1,900 for 2012), taxed at the *parents' tax rate* if: **1)**The child **has not attained age 18** by the *close of the tax year*; **OR 2)** The child **is age 18** by the *close of the tax year* AND the child's **earned income does not exceed one-half the child's support; OR 3)** The child is **age 19 through 23** by the *close of the tax year* AND the child is a full-time student AND the child's earned income does not exceed one-half the child's support.

  Planning Alert! College students who are subject to this so-called *kiddie tax* will not be able *to* sell their appreciated capital gain property (for example to cover tuition), and pay tax at their lower tax rates to the extent their interest, dividends and capital gains exceed $1,900.

  Tax Tip. Since a child's *earned income* is not taxed at the parents' tax rates, parents may save taxes by employing a child in the parent's business and paying the child *reasonable* compensation. The child's earnings won't be subject to tax at the parent's rates under the kiddie tax rules and the earnings should be deductible by the business. Also, if the child is over age 17 and the earnings exceed one-half of his or her support, the child would also avoid the kiddie tax exposure for any unearned income.

CONCLUSION

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. Please call us before implementing any planning ideas discussed in this letter, or if you need additional information.

Note: The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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