

# BLAIR INMAN & CO.

A PROFESSIONAL CORPORATION OF CERTIFIED PUBLIC ACCOUNTANTS

Dear Clients and Friends,

Taxes are going to be a major issue for the rest of 2012 and for much of 2013. On January 1, 2013, the country faces what Federal Reserve Chairman Ben Bernanke has called a “fiscal cliff,” resulting from the expiration of the Bush-era tax cuts and the automatic across-the-board cuts in government spending. Added to these events is the uncertainty over the alternative minimum tax and the tax breaks known collectively as the “tax extenders.”

There is no way to predict what Congress will do about these issues or when they will act. That uncertainty makes doing effective tax planning for yourself and your business very challenging. Yet doing nothing could leave you paying significantly more in taxes.

This year, the wise taxpayer may have to consider more than one tax strategy, running the numbers under two or more scenarios. By staying informed and being prepared to act as events unfold, you can minimize your 2012 and 2013 tax liability. This *Letter* is being sent to encourage you to make 2012 year-end planning a priority. We are committed to helping you analyze the tax-cutting options best suited to your particular circumstances. If you have questions or if you would like to arrange a year-end tax review, please contact our office.

## Tax-cutting time is ticking away

Tax planning may seem too difficult in the current political and economic environment. But reviewing your tax situation before the end of 2012 will position you to act quickly when the timing is right.

Some rules that applied when you prepared your 2011 federal income tax return have expired, others are expected to expire at the end of this year, and new provisions are slated to begin in 2013. Here are a few tax strategies to consider as year-end 2012 approaches.

### ■ Review options for accelerating income

The idea of paying federal and state income tax early may make you wince, but having a plan in place in case paying now results in saving later is still a good idea. One reason: Some methods of pulling income from 2013 into 2012 require time – time you may not have if you wait until the last minute.

For instance, say a viable tax planning strategy involves taking a payroll bonus from your business at year-end. You might choose to do this to take advantage of the current reduced rate of 4.2% for the employee portion of social security tax, which expires on December 31, 2012. Perhaps your goal is to lower the amount of your 2013 income that will be subject to either the 3.8% or 0.9% Medicare surtaxes taking effect next year. Or maybe you want additional earned income so you can increase your retirement plan contribution.

Retirement accounts also offer opportunities for accelerating income into 2012. If you turned 70½ this year and you expect to be subject to higher taxes in 2013, it may make sense to take your initial required minimum distribution by December 31 instead of waiting until next April.

Remember, too, you can withdraw funds without penalty from traditional IRAs beginning at age 59½. In some cases, penalty exceptions apply when you're under age 59½.

Converting your traditional IRA to a Roth also increases income in 2012. You can put this strategy in place now, because it comes with an added benefit: You can change your mind later, even after the beginning of the year.

Roth conversions provide future-year tax breaks, too. Unlike traditional IRAs, withdrawals from Roth accounts are not mandatory. When you do choose to take them, they are not subject to the new 3.8% Medicare surtax, nor are they included in figuring the taxable amount of your social security benefits.

Regular income tax planning is only one factor in the decision to increase current-year income. The alternative minimum tax (AMT) is another. The last annual AMT "patch" expired at the end of 2011, and you'll want to understand your exposure based on current rules.

## ■ Don't overlook less obvious income

At this point in 2012, you have a fairly complete picture of your income for the year from sources such as salary, retirement plan distributions, and dividends. The total of those, combined with other predictable income items, provides a good starting point for tax planning – one you'll want to augment by thinking about less obvious additions to income.

An example is taxable capital gains distributed by mutual funds. These differ from the gain you recognize when you sell mutual fund shares you own. Capital gain distributions from funds occur when a fund manager makes a profit selling investments the fund owns. Those gains are passed to shareholders, and you generally have no control over the timing. The distributed gains are taxable even if you reinvest them in additional shares, and in some cases can impact the AMT computation. Check with your mutual fund provider before assuming you've captured all your income for 2012.

Another potential item that's easy to overlook: a 2010 Roth conversion. If you opted to spread the tax over two years, you'll need to include the second half on your 2012 federal income tax return.

That will increase your income, which in turn can affect your marginal tax bracket, taxable social security benefits, and how much of your rental real estate activity losses are deductible. In addition, your estimated tax payments or withholding may need to be adjusted.

## ■ Utilize expiring tax breaks

Bonus depreciation, which lets you write off 50% of the cost of assets purchased in your business, expires at the end of December 2012. Review your asset acquisition schedule to determine if buying new equipment this year will garner a larger tax benefit versus waiting until 2013.

For help in analyzing available options for minimizing taxes in your particular situation, contact us soon for a year-end review.

## Are you eligible for 2012 tax credits?

Are you ignoring a credit that could lower your tax bill? According to the IRS, many individuals and businesses fail to take credits for which they qualify. Here's a checklist of some of these credits.

- **Adoption credit.** Nonrefundable credit for out-of-pocket adoption-related expenses. Maximum credit for 2012 is \$12,650 per child.
- **Child and dependent care credit.** Available when you pay for care for children under age 13 or other qualifying dependents so you can work. Summer day camp expenses may also count.
- **Disabled access credit.** Your small business can benefit when you remove accessibility barriers from an existing building or purchase equipment designed to allow easier access for disabled individuals.
- **Education credits.** Two credits are available for 2012 for expenses related to college and vocational education: American opportunity and lifetime learning.
- **Pension plan start-up credit.** A business credit for up to \$500 of the cost of starting up a qualified retirement plan such as a SEP, SIMPLE, or 401(k).
- **Retirement savings credit.** An AGI-limited credit of up to \$1,000 (\$2,000 for married filing jointly) when you make contributions to your IRA and certain other retirement plans.
- **Small employer health insurance credit.** Offsets up to 35% of premiums your business pays for employees' health insurance.
- **Work opportunity credit.** Your business can take a tax credit for wages paid to "targeted" groups such as unemployed veterans.

Requirements for claiming tax credits can vary from year to year. For current information and planning strategies for these credits and others that are available for 2012 returns, give us a call.

## Year-End Tax Moves: Don't overlook the tried-and-true

Despite past, present, and future changes to the rules, some tax planning advice remains tried-and-true. Here are a few time-tested strategies.

- **Maximizing retirement plan contributions.** You've heard this advice many times, because it's one of the best strategies for saving tax dollars, especially when wages are your primary source of income.

The maximum contribution to a 401(k) for 2012 is \$17,000. You can increase that by an additional \$5,500 if you're age 50 or older. For SIMPLE plans, the maximum 2012 contribution is \$11,500, and the additional age-50-catch-up amount is \$2,500.

Can't manage the entire amount? Try to contribute enough to take full advantage of any matching contributions offered by your employer.

- **Making charitable donations.** Payroll contribution programs and checks written and mailed to your chosen charity before year-end can get you a tax deduction, as can credit card charges made by December 31.

Donating appreciated stock is a charitable tax-saver that gives you an itemized deduction for the fair market value of the stock while letting you avoid the capital gains tax generated by a sale.

Remember, you have to itemize to claim charitable contributions, and you must have written documentation of your donation.

- **Timing itemized deductions.** Amounts you pay for interest, medical fees, taxes, and miscellaneous costs such as job hunting generally are deductible in the year you pay them. What to remember: Some expenses must exceed a percentage of your adjusted gross income (AGI) before you get any benefit. For example, out-of-pocket medical costs have to be greater than 7.5% of your AGI for 2012. The threshold increases to 10% in 2013.

Have less than you need to itemize? Consider accelerating or postponing expenses when possible to shift the deductions into the current or future year, depending on which year gives you the bigger tax benefit.

- **Making the most of dependency exemptions.** In addition to a tax deduction worth \$3,800 for 2012, claiming dependents on your federal income tax return can make other credits and benefits available to you. For instance, if your college-age child qualifies as a dependent, you may be able to benefit from education tax breaks, including the American opportunity credit or the lifetime learning credit.

Give us a call to discuss these and other tax-savers.

## **Looming tax changes could turn capital gain strategies upside down this year**

Generally speaking, tax experts usually advise their clients to postpone capital gains and other taxable income for as long as possible. That could change this year.

With the anticipated tax changes coming in 2013, you may want to turn conventional capital gain wisdom upside down and actually accelerate income into this year. Here's why. Beginning in 2013, individuals with adjusted gross income of \$200,000 or more (\$250,000 for couples filing jointly) will pay a new 3.8% Medicare surtax on certain unearned income. This includes interest, dividends, capital gains, and passive rental income.

In addition, the maximum rate on long-term capital gains is scheduled to rise from 15% to 20% next year. Also scheduled for 2013: Qualified dividend income will no longer be taxed at 15%, but will be subject to ordinary income tax rates instead.

And it's not just your portfolio that is at stake. Next year, gain from the sale of a residence exceeding the home exclusion of \$250,000 for an individual (\$500,000 for couples filing jointly) will also be subject to the 3.8% surtax if the taxpayer meets the income threshold mentioned above.

So what can you do? First, consider selling your appreciated securities before the end of this year to lock in the lower tax rates. On the flip side, you may want to wait until next year to sell any securities that have lost value. Such losses could provide a more valuable offset of future capital gains if sold in 2013.

Deferring charitable gifts of appreciated securities until next year, when the deduction might be worth more, could also be a tax smart move.

Taxpayers receiving retirement plan distributions should note that while such distributions are not subject to the 3.8% surtax, they could raise your adjusted gross income over the \$200,000 threshold, making all other unearned income fair game for the tax. One possible solution would be to convert your IRA to a Roth IRA and pay all the tax due at 2012 rates.

The looming tax changes might also be an opportunity to reallocate your portfolio. Because municipal bond interest is exempt from the surtax, one strategy might be to sell appreciated stock, pay the capital gains tax at 2012 rates, and invest more heavily in municipal bonds.

Before you make any significant changes, keep in mind that these scheduled changes to the tax law could be reversed by Congress. Before 2012 winds down, contact our office for an analysis of your situation.

## **Tax Update: Reporting requirements**

Although the U.S. Supreme Court recently upheld the constitutionality of the 2010 health care legislation, several new Form 1099 reporting provisions in the law had already been repealed.

Under the health care law, the 1099 reporting rules were extended to corporations. A different 2010 law imposed comparable 1099 reporting requirements on landlords for payments for services related to rental properties. A 2011 law repealed both of these new reporting requirements for corporations and landlords. With a few exceptions, such as payments made to an incorporated law firm, payments to corporations are once again exempt from the 1099 reporting requirements.

But taxpayers still must contend with other Form 1099 reporting requirements.

Generally, certain payments must be reported on variations of Form 1099. For instance, if your business pays \$600 or more during a calendar year to an independent contractor for services performed, you must issue a Form 1099-MISC to the provider reporting the amount, as well as providing a copy to the IRS. This form also covers commissions, fees, and other compensation totaling \$600 or more paid to a single recipient. Other forms in the 1099 series are used to report various other kinds of payments.

If you fail to issue a required Form 1099, the IRS may assess penalties which can be substantial.

Finally, the health care law requires employers to report the cost of health care benefits on W-2s issued to employees, beginning in 2012. But the IRS has temporarily postponed this requirement for employers filing fewer than 250 W-2s. Contact our office to review your reporting requirements for 2012.

*NOTE: This newsletter is issued to provide you with information about minimizing your taxes. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.*