AGEEFISHERBARRETT

CLIENT TAX ALERT | NOVEMBER 28, 2012

2012 Year-End Tax Planning

Year-end planning is a bigger challenge this year than in past years because, unless Congress acts, tax rates will go up next year, many more individuals will be snared by the alternative minimum tax (AMT), and various deductions and other tax breaks will be unavailable. To be more specific, as a result of expiring Bush-era tax cuts, individuals will face higher tax rates next year on their income, including capital gains and dividends, and estate tax rates will be higher as well. There are in excess of 100 tax changes that will take effect on 1/1/13. It is beyond the scope of this letter to cover all of them.

AMT and Expiring Tax Provisions - The AMT problem arises because, for 2012, AMT exemptions have dropped and fewer personal credits can be used to offset the AMT. Additionally, a number of tax provisions expired at the end of 2011 or will expire at the end of 2012. Rules that expired at the end of 2011 include, for example, the research credit for businesses, the election to take an itemized deduction for State and local general sales taxes instead of the itemized deduction permitted for State and local income taxes, and the above-the-line deduction for qualified tuition expenses. Rules that will expire at the end of this year include generous bonus depreciation allowances and expensing allowances for business, and expanded tax credits for higher education costs.

Uncertainty as to what Congress will do - These adverse tax consequences are by no means a certainty. Congress could extend the Bush-era tax cuts for some or all taxpayers, retroactively “patch” the AMT for 2012 to increase exemptions and availability of credits, revive some favorable tax rules that have expired, and extend those that are slated to expire at the end of this year. Which actions Congress will take remains to be seen. While these uncertainties make year-end tax planning more challenging than in prior years, they should not be an excuse for inaction. Indeed, the prospect of higher taxes next year makes it even more important to engage in year-end planning this year.

Once we discuss with you, we can narrow down the specific actions that you can take and tailor a detailed plan. In the meantime, please review the following list and contact your AgeeFisherBarrett, LLC tax advisor or Ana King at 404.250.4570 at your earliest convenience so that we can advise you on which tax-saving moves to make.

Year-End Tax Planning for Individuals

Flexible Spending Account (FSA) - Increase the amount you set aside for next year in your employer's health FSA if you set aside too little for this year. Keep in mind that beginning next year, the maximum contribution to a health FSA will be $2,500. And don't forget that you can no longer set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.

Health Savings Account (HSA) - If you become eligible to make HSA contributions late this year, you can make a full year's worth of deductible HSA contributions even if you were not eligible to make HSA contributions for the entire year. This opportunity applies even if you first became eligible in December. In brief, if you qualify for an HSA, contributions to the account are deductible (within IRS-prescribed limits), earnings on the account are tax-deferred, and distributions are tax free if made for qualifying medical expenses.

Selling loss stocks - Realize losses on stocks while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, and then buy back the same securities at least 31 days later. It would be advisable for us to meet to discuss year-end trades you should consider making.

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Selling gain assets - If you are thinking of selling assets that are likely to yield large gains, such as inherited, valuable stock, or a vacation home, try to make the sale before year-end, with due regard for market conditions. This year, long-term capital gains are taxed at a maximum rate of 15%, but the rate could be higher next year as noted above. And if your adjusted gross income exceeds certain limits ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 for all others), gains taken next year (along with other types of unearned income, such as dividends and interest) will be exposed to the extra 3.8% Medicare tax.

Selling your main home - If you are in the process of selling your main home, and expect your long-term gain from selling it to substantially exceed the $250,000 home-sale exclusion amount ($500,000 for joint filers), try to close before the end of the year (again, with due regard to market conditions). This can save capital gains taxes if rates go up and can save the 3.8% Medicare tax for those exposed to it.

Repurchasing gain stock - You may own appreciated-in-value stock and you want to lock in a 15% tax rate on the gain, but you think the stock still has plenty of room to grow. In this situation, consider selling the stock and then repurchasing it. You'll pay a maximum tax of 15% on long-term gain from the stock you sell. You also will wind up with a higher cost basis in the repurchased stock. If capital gain rates go up after 2012 and you sell the repurchased stock down the road at a profit, the total tax on the 2012 sale and the future sale could be lower than if you had not sold in 2012 and had just made a single sale in the future. This move definitely will reduce your tax bill after 2012 if you are subject to the extra 3.8% tax on unearned income. Also, consider this if you have a capital loss carryover to 2012.

Roth IRAs - Consider making contributions to Roth IRAs instead of traditional IRAs. Roth IRA payouts are tax-free and thus immune from the threat of higher tax rates, as long as they are made (1) after a five-year period, and (2) on or after attaining age 59-1/2, after death or disability, or for a first-time home purchase.

Converting to a Roth - If you believe a Roth IRA is better than a traditional IRA, consider converting traditional IRAs to Roth IRAs this year to avoid a possible hike in tax rates next year. Also, although a 2013 conversion won't be hit by the 3.8% tax on unearned income, it could trigger that tax on your non-IRA gains, interest, and dividends. Reason: the taxable conversion may bring your modified adjusted gross income (AGI) above the relevant dollar threshold (e.g., $250,000 for joint filers). But conversions should be approached with caution because they will increase your AGI for 2012. And if you made a traditional IRA to Roth IRA conversion in 2010, and you chose to pay half the tax on the conversion in 2011 and the other half in 2012, making another conversion this year could expose you to a much higher tax bracket.

Required Minimum Distributions - Take RMDs from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70-1/2. Failure to take a required withdrawal can result in a penalty equal to 50% of the amount of the RMD not withdrawn. If you turn age 70-1/2 this year, you can delay the first required distribution to 2013, but if you do, you will have to take a double distribution in 2013—the amount required for 2012 plus the amount required for 2013. Think twice before delaying 2012 distributions to 2013 - bunching income into 2013 might push you into a higher tax bracket or bring you above the modified AGI level that will trigger a 3.8% extra tax on unearned income such as dividends, interest, and capital gains. However, it could be beneficial to take both distributions in 2013 if you will be in a substantially lower bracket in 2013, for example, because you plan to retire late this year or early the next.

Medical expenses - This year, unreimbursed medical expenses are deductible to the extent they exceed 7.5% of your AGI, but in 2013, for individuals under age 65, these expenses will be deductible only to the extent they exceed 10% of AGI. If you have a shot at exceeding the 7.5% floor this year, accelerate into this year "discretionary" medical expenses you were planning on making next year.

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Prepay expenses - Consider using a credit card to prepay expenses that can generate deductions for this year.

Education expenses – Taxpayers with higher educational expenses may want to consider the scheduled expiration of the American Opportunity Tax Credit (AOTC) after 2012 in their plans. The AOTC reaches the sum of 100 percent of the first $2,000 of qualified expenses and 25 percent of the next $2,000 of qualified expenses, subject to income limits. If possible, pre-paying 2013 educational expenses before 2012 year-end could make the expenses eligible for the AOTC before it expires.

Eliminating the underpayment penalty - Increase your withholding if you are facing a penalty for underpayment of federal estimated tax. Doing so may reduce or eliminate the penalty. Another option is to take an eligible rollover distribution from a qualified retirement plan before the end of 2012 if you are facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2012. You can then timely roll over the gross amount of the distribution to a traditional IRA. However, you MUST timely roll over the gross amount of the distribution – the net cash received plus the amount of tax withheld. (Example: You receive a $30,000 gross distribution with $12,000 withheld in taxes. You will be required to roll over the entire $30,000 not just the net amount of $18,000 you received.) No part of the distribution will be includible in income for 2012, but the withheld tax will be applied pro rata over the full 2012 tax year to reduce previous underpayments of estimated tax.

Increase state withholding - If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or make estimated tax payments of state and local taxes) before year-end to get the deduction of those taxes into 2012 if doing so won't generate alternative minimum tax (AMT).

Annual gift tax exclusion - Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give $13,000 in 2012 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. Married couples may make combined tax-free gifts of $26,000 to each recipient. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax. Savings for next year could be even greater if rates go up and/or the income from the transfer would have been subject to the 3.8% tax in the hands of the donor. Also, use of the lifetime gift tax exclusion amount ($5.12 million for 2012) needs to be considered. Without Congressional action, the exclusion amount drops to $1 million in 2013 and the tax rate on taxable gifts increases from a maximum of 35% to 55%.

Year-End Tax Planning for Business Owners

Stock redemption - If your business is incorporated, consider taking money out of the business by way of a stock redemption if you are in the position to do so. The buy-back of the stock may yield long-term capital gain or a dividend, depending on a variety of factors. But either way, you'll be taxed at a maximum rate of only 15% if you act this year. If you wait until next year to make your move, your long-term gains or dividends may be taxed at a higher rate if reform plans are instituted or the Bush-era tax cuts expire. And if your adjusted gross income exceeds certain limits ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 for all others), gains taken next year (along with other types of unearned income, such as dividends and interest) will be exposed to the extra 3.8% Medicare tax.

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Work opportunity tax credit - If you are thinking of adding to payroll, consider hiring a qualifying veteran before year-end to qualify for a work opportunity tax credit (WOTC). Under current law, the WOTC for qualifying veterans won't be available for post-2012 hires. The WOTC for hiring veterans ranges from $2,400 to $9,600, depending on a variety of factors (such as the veteran's period of unemployment and whether he or she has a service-connected disability).

Bonus depreciation - Put new business equipment and machinery in service before year-end to qualify for the 50% bonus first-year depreciation allowance. Unless Congress acts, this bonus depreciation allowance generally won't be available for property placed in service after 2012. (Certain specialized assets may, however, be placed in service in 2013.)

Section 179 - Make expenses qualifying for the business property expensing option. The maximum amount you can expense for a tax year beginning in 2012 is $139,000 of the cost of qualifying property placed in service for that tax year. The $139,000 amount is reduced by the amount by which the cost of qualifying property placed in service during 2012 exceeds $560,000 (the investment ceiling). For tax years beginning in 2013, unless Congress makes a change, the expensing limit will be $25,000 and the investment ceiling will be $200,000. Thus, if you anticipate needing property in early 2013, you may want to push the purchase into 2012 to gain a higher expensing deduction. Property acquired and placed in service in the last days of 2012, rather than at the beginning of 2013, can result in a full expense deduction for 2012.

SUVs - If you are in the market for a business car, and your taste runs to large, heavy SUVs (those built on a truck chassis and rated at more than 6,000 pounds gross (loaded) vehicle weight), consider buying in 2012. Due to a combination of favorable depreciation and expensing rules, you may be able to write off most of the cost of the heavy SUV this year. Next year, the write-off rules may not be as generous.

Retirement Plan - Set up a self-employed retirement plan if you are self-employed and haven't done so yet.

Deducting pass-through losses - Increase your basis in a partnership or S corporation if doing so will enable you to deduct a loss from it for this year. A partner's share of partnership losses is deductible only to the extent of his partnership at-risk basis as of the end of the partnership year in which the loss occurs. An S corporation shareholder can deduct his pro rata share of an S corporation's losses only to the extent of the total of his at-risk basis in (a) his S corporation stock, and (b) debt owed to him by the S corporation.

These are just some of the steps that can be taken for year-end tax planning. Visit our website (http://www.afbllc.com/newsletter.html) for additional Tax Alerts and other current information. For further assistance, please contact your AgeeFisherBarrett,LLC tax advisor or Ana King at 404.250.4570 or tax.department@afbllc.com.

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