2013 TAX PLANNING

10/15/12

It's Year-End Tax Planning Time

As the end of the year approaches, we know you are busy with holidays, family, and travel, but it is also a good time to do some last minute tax planning. As a courtesy, we want to provide you with a few eleventh-hour tax tips you may find useful. Although tax planning is rarely fun, these strategies could help you keep more of your hard earned money.

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INTRODUCTION

Year-end tax planning is especially challenging this year because of ongoing uncertainty related to whether Congress will extend the Bush-era tax cuts into 2013. The current tax regime is slated to expire on December 31st, and if not extended, many Americans will face significant increases in their taxes next year, an issue dubbed "the fiscal cliff" by economists. Although it is possible that Congress will address the fiscal cliff before the end of the year, it is worth spending extra time on tax planning now to reduce your potentially higher tax burden next year.

While our primary expertise lies in wealth management, we have worked with our CPA friends to compile these tips for you. Before acting on any of the advice in this communication, we suggest you consult with your personal tax professional. If you don't have an accounting professional that you enjoy working with, please let us know and we will introduce you to one of our trusted associates.

ACTIONS THAT COULD BE TAKEN

☐ **Get Organized**

Now is an excellent time of year to get your financial house in order. Gather cash receipts to help you calculate possible deductions and miscellaneous payments. Do you have a hobby or activity that generates income? If so, any losses might also be eligible for deduction. Have you made home improvements? Charitable contributions? Get all of your documentation together early to make your life a little easier in April.

☐ **Contribute the Maximum to Your Retirement Plan**

You have until April 17, 2013 to make IRA contributions for 2012, but the sooner you get your money into the account, the sooner it has the potential to start growing tax-deferred. Making deductible contributions also reduces your taxable income for the year. You can contribute a maximum of $5,000 to an IRA for 2012, plus an extra $1,000 if you are 50 or older. This limit can be split between a traditional IRA and a Roth IRA if you desire, but the combined limit is still $6,000.[1]

☐ **Check Your IRA Distributions**

You are required to make minimum distributions from your traditional IRA by April 1st following the year in which you reach age 70 ½. Failing to take out enough triggers a 50% excise tax on the amount you should have withdrawn based on your age, life expectancy, and the amount in the account at the beginning of the year.[2]

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☐ **Fatten Your 401(k)**
Tax-deferred investing is a smart choice because it allows your money to grow tax-free until you withdraw it. Maximize your 401(k) contributions, up to $17,000 or $22,500 if you will be age 50 or older in 2012.[3]

☐ **Postpone Loss-Harvesting until 2013**
In order to avoid paying capital gains taxes, many investors sell off investments such as stocks that have experienced losses in order to help offset any taxable gains have realized during the year. Since capital gains taxes are scheduled to increase next year, it makes sense to hold off in order to maximize your potential tax write-off in 2013. Be sure to check with your financial advisor before making major investment decisions.[4]

Federal income tax rates may increase in 2013. Federal income tax rates for 2012 are 10%, 15%, 28%, 33%, or 35%. They are scheduled to increase to 15%, 25%, 28%, 31%, 36%, or 39.6% in 2013.
Source: IRS.gov

☐ **Accelerate Your Income**
Income is taxed in the year it is received. Depending on your circumstances, you may be paying higher income taxes next year; in order to lower your future tax burden, take as much income in 2012 as possible. It's tough for employees to collect wages and salaries early, but it may be possible to receive a bonus early. If you are self-employed or do freelance or consulting work, you have more flexibility. Ensuring you get all your billing in before the end of the year will lower the income you have to claim in 2013, when your income tax may be higher. [5]

☐ **Cash in Your Winners**
Along with higher ordinary income tax rates, there's a possibility that tax rates on capital gains will increase in 2013. Through the end of 2012, the top federal capital gains tax rate on assets held for more than one year is 15% for most taxpayers.[6] If taxes go up in 2013, 2012 will be an excellent time to lock in the profits on your long-term investments. Although tax planning is extremely important this year, it should form only part of your overall financial strategy. Please discuss your tax situation with your financial advisor before making important investment decisions.

☐ **Reposition Investment Assets**
Take advantage of 2012's low capital gains and dividend tax rates and shift assets between taxable and tax-deferred accounts. By moving dividend-paying stocks into a qualified retirement account (such as an IRA or 401(k)/403(b)) and replacing the taxable investment with tax-free municipal bonds, you can retain the same portfolio while limiting your tax burden. For example, if you currently hold a stock paying a 3.5% dividend in your taxable account and a municipal bond paying 3%, the after-tax yield is about the same. However, next year a taxpayer in the top income tax bracket would see the after-tax yield of the stock drop to 1.98% (since the dividend will be taxed at 39.6%) versus the 3% tax-free muni bond yield.

☐ **Pay Attention to Your FSA**

This time of year is when you probably need to specify how much salary you'll contribute to your flexible spending account. Starting Jan. 1, 2013, FSAs will have annual limits of $2,500 per year.[7] Going forward, the limit will rise annually based on the rate of inflation. Not only is it appropriate to review your changing needs now, but tax-free withdrawals can then be taken from these accounts for medical, dental, and child-care costs in 2012. Remember, FSAs are "use-it-or-lose-it," and you will forfeit any balance left in these accounts at the end of the year, so take advantage now by filling prescriptions early, making medical or dental appointments, or scheduling elective surgeries.

☐ **Accelerate Your Mortgage Payments**

Unlike rent, which is paid in advance, mortgage payments are made at the end of your occupancy period. That means your January 1 mortgage statement represents interest for December, making it eligible for a tax break this year. By accelerating that payment even by just a day, you get an additional deduction for the interest paid. Don't get greedy though. You can't make your February, or any other upcoming, mortgage payment early to boost your year-end deduction amounts. Tax law generally prohibits write-offs for prepaid interest (although there is an exception for loan points in some cases). Note: Accelerating your mortgage payments may not pay off if you expect to be subject to the Alternative Minimum Tax (AMT). If you are unsure, discuss the matter with your tax professional.[8]

☐ **Go Green**

Buyers of plug-in hybrids and electric cars benefit from a tax credit of $2,500 to $7,500, depending on the size of the battery in the car. The credit maxes out at $7,500 for cars with a 16 kWh battery pack, like the Chevy Volt. The credits were provided as part of the American Recovery and Reinvestment Act, otherwise known as the "stimulus bill," and apply to plug-in hybrids purchased after 2010.[9] In addition, energy-efficient home improvements to your principal residence such as installing a heat pump, qualify for credit of 30% of the cost, and can be claimed on your 2012 taxes.[10]

To avoid headaches and penalties, mark your calendar with the following key dates.

January 15, 2013

4th Quarter 2012 Estimated Tax Payment Due
If you are self-employed or have other fourth-quarter income that requires you to pay quarterly estimated taxes, get them postmarked by January 15, 2013.

April 15, 2013

2012 Individual Tax Returns Due

Individual Tax Return Extension Form Due
If needed, file your request for an extension by April 15 to push your deadline back to October 15, 2013.

1st Quarter 2013 Estimated Tax Payment Due

Last Day to make a 2012 IRA Contribution
If you haven't already funded your retirement account for 2012, do so by April 15, 2013. That's the deadline for a contribution to a traditional IRA, deductible or not, and a Roth IRA. However, if you have a Keogh or SEP and you get a filing extension to October 15, 2013, you can wait until then to put 2012 money into those accounts.

June 17, 2013

2nd Quarter 2013 Estimated Tax Payment Due

September 16, 2013

3rd Quarter 2013 Estimated Tax Payment Due

October 15, 2013

Extended Individual Tax Returns Due

Last Chance to Recharacterize 2012 Roth IRA Conversion
If you converted a traditional IRA to a Roth during 2012 and paid tax on the conversion with your 2012 return, October 15, 2013 is the deadline for recharacterizing (undoing) the conversion.

Source: turbotax.intuit.com & planningtips.com

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☐ **Be Charitable**

A gift to a qualified charitable organization may entitle you to a charitable contribution deduction against your income tax if you itemize deductions. If the gifts are deductible, the actual cost of the donation is reduced by your tax savings. For example, if you are in the 33% tax bracket, the effective cost of a $100 donation is only $67. As your income tax bracket increases, the real cost of your charitable gift decreases, making contributions more attractive for those in higher brackets. For a person in the highest tax bracket, 35%, the actual cost is only $65. Not only can the wealthy afford to give more, but they receive a larger reward for giving. Typically, charitable donations are capped at 50% of your AGI.[11]

☐ **Give a Gift**

This time of year, many people choose to donate items to charity instead of making a monetary contribution. Not only does this save you money and prevent perfectly good items from getting wasted, but charitable donations can be deducted from your taxes as long as you get written documentation of the donation.

Most gifts are not subject to the gift tax. For instance, you can give up to the annual exclusion amount ($13,000 in 2012) to any number of people every year, without facing any gift taxes. Recipients never owe income tax on the gifts. In addition to the annual gift amount, until the end of 2012, you can give a total of up to $5.12 million before you start owing the gift tax. This gift exclusion amount is due to drop to $1 million in 2013, so now is a good time to address inheritance and estate issues with your family.[12]

Overview of major tax provisions due to expire December 31st:

- Two marriage penalty elimination breaks will expire such that: The standard deduction for married couples will be lower – no longer double that of single filers; and the ceiling of the 15% tax bracket will also be lower.
- The tax rate on qualified dividends earned by middle- and upper-income earners will increase from 15% to the taxpayer's ordinary income tax rate, as high as 39.6% for the highest tax bracket.
- The Personal Exemption Phase-Out (PEP) and Pease itemized deduction phase-out will be restored, removing the value of some exemptions and deductions (like charitable contributions) from high-income earners.
- The Lifetime Estate Tax Exemption will drop back to the 2001 level of $1 million (from the current $5.12M for 2012); any amount over the exemption will be taxed at 55%.
- The Lifetime Gift Tax Exemption and Lifetime Generation Skipping Tax (GST) will revert from $5.12M to a $1M exclusion.

☐ **Fund an Education**

The American Opportunity tax credit is valued at $2,500 for 2012, up from $1,800 in 2008. Because a tax credit reduces your tax bill dollar-for-dollar, this basically means the government will give you up to $2,500 per year for each qualifying college student in your family. And unlike the old Hope credit, which only covered the first two years of college, the American Opportunity credit can be claimed for all four years of post-high-school education. You can get the maximum credit if you spend at least $4,000 in qualifying expenses, which now includes the cost of books, tuition, and fees. The full credit is available to individuals whose modified AGI is $80,000 or less, or $160,000 or less for married couples filing a joint return. The credit is phased out for taxpayers with incomes above these levels. The tax credit was extended for the 2012 tax year, however, this could be its last year, so be sure to claim the American Opportunity Credit while you can.[13]

☐ **Plan for the New Medicare Tax**

High-income earners will have a new tax consideration in 2013; beginning in January, a new 3.8% Medicare tax will be imposed on profits from the sale of investment property.

Higher-income earners always have a few more tax considerations, and that's true in 2012. In 2013, a new 3.8 percent Medicare tax is slated for collection on profits from investment sales. This includes capital gains, dividends, interest payments and net rental income. The tax will apply to wealthy individuals earning a gross income of $200,000 or more and joint filers with a combined gross income of $250,000. If you're in the affected income bracket, speak with your investment advisor and accounting professional to discuss how the new tax will affect your tax burden next year.[14]

☐ **Buy Something Nice**

State or local sales taxes you have paid on the purchase or lease of a vehicle, the purchase of a boat or aircraft, or the purchase or renovation of a home may all be eligible for deduction against your federal income taxes. Additionally, people who claim the sales tax deduction don't have to report any state income tax refund as taxable income in the following year. So if your sales tax deduction is about the same as your income tax deduction, you'll probably come out ahead by taking the sales tax deduction.[15]

CONCLUSION AND STEPS TO TAKE

We hope you will find some of these strategies useful as you go through your tax planning process. One of the ways we help our clients is by working hard to provide tax-smart investment strategies to minimize the impact Uncle Sam can have. In addition, we consider it our responsibility to educate you about things that could affect your financial future. As always, feel free to contact us with any questions, and to discuss points of interest with your tax professional as there may be crucial details involved in making your plan effective.

Sincerely,

V. Michael Greben, Vice President of Investments

Would someone you know benefit from receiving this communication? If so, call our office at 1-888-356-5221 to provide us with their contact information and we will be happy to send them a copy.

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Footnotes, disclosures and sources:

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Consult your financial professional before making any investment decision.

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[1] http://www.irs.gov/retirement/article/0,,id=202510,00.html
[2] http://www.irs.gov/retirement/article/0,,id=96989,00.html
[3] http://www.irs.gov/uac/IRS-Announces-Pension-Plan-Limitations-for-2012
[4] http://news.morningstar.com/articlenet/article.aspx?id=439379
[5] http://www.bankrate.com/finance/taxes/12-tax-tips-2012-1.aspx
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