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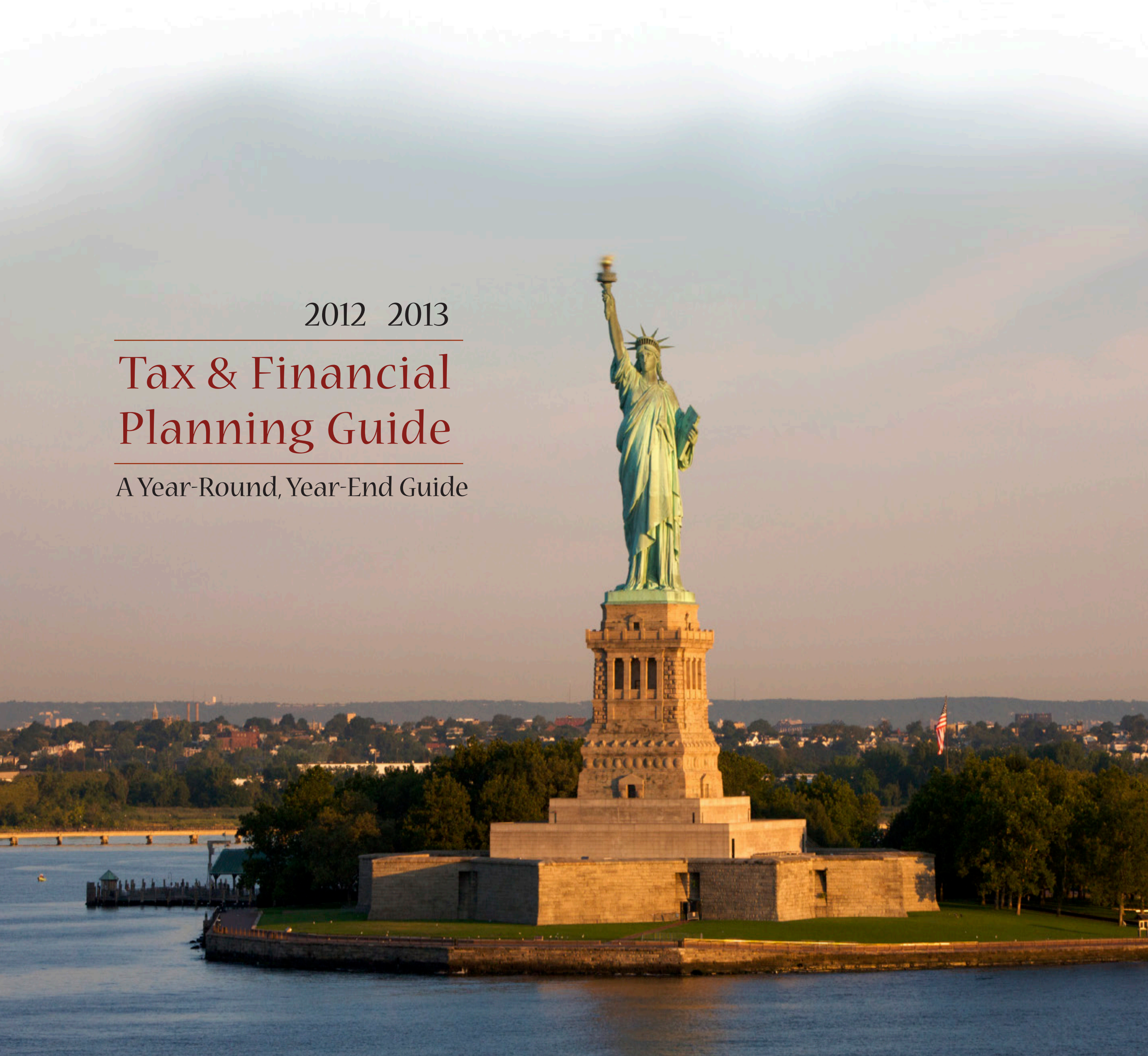

2012 2013

# Tax & Financial Planning Guide

A Year-Round, Year-End Guide

# Contents



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# Common Goal - Separate Paths

Keeping abreast of the continual changes to the tax code and what they mean to you are daunting challenges. Knowing how and when to take advantage of the opportunities these changes impart is easier with the guidance and advice of knowledgeable professionals.

This guide is intended to offer encouragement and show you where to look for tax savings and financial opportunities. The goal is the same: enhance your income, preserve your assets, and protect your wealth. The path to get there, however, will depend on your particular situation: one size does not fit all. Let's work together so you can make the most informed decisions regarding your goals and objectives.

*United States of America National Bird – Bald Eagle*

**The bald eagle was chosen as the national bird in 1782 and incorporated into the design of the Great Seal. It appears on coins, official documents, the Presidential flag, and in many State Seals. Benjamin Franklin famously disagreed with its selection, writing, "I wish the bald eagle had not been chosen as the representative of our country; he is a bird of bad moral character, he does not get his living honestly…the turkey is in comparison a much more respectable bird." To others, the bald eagle represented strength, courage, and freedom.**

**Bald eagles are indigenous to North America. They can grow to 3 feet in height, can weigh up to 14 lbs., and have an average wingspan of 6½ feet. They live near water and are solitary, but monogamous, birds. Females are larger than the males. Each year they lay 2 or 3 eggs, which incubate for about 35 days. Bald eagles can live up to 28 years in the wild.**

# Quick Reference

## "Above-the-line" Deductions (even if you don't itemize)

- portion of self-employment tax
- health insurance for self-employeds (and 2% or greater owners of S Corps)
- performers' expenses
- certain job-based moving costs
- surrendered jury pay
- up to $2,500 of student loan interest
- contributions by self-employeds to Keogh, SEP and SIMPLE plans, Medical Savings Accounts (MSAs) and Health Savings Accounts (HSAs)
- eligible IRA contributions
- alimony paid
- eligible HSA contributions
- up to $4,000 for eligible college expenses (based on AGI)*
- teachers' supplies up to $250*

*lapsed, likely to be reinstated before year-end

## Fully Deductible (not subject to the 2%-of-AGI limit)

- estate tax on income heirs inherit, including estate taxes on IRAs, Keoghs, 401(k)s and savings bonds
- impairment-related job expenses of the handicapped
- amortizable bond premiums
- gambling losses to the extent of winnings

## Included in Income

- wages, salaries, fees, tips, commissions
- gain on sale of some real estate, securities, and other property
- alimony received and separate-maintenance payments
- annuities (to the extent the return exceeds investment) and pensions
- gambling winnings (gambling losses to extent of winnings are deductible)
- business profits, net rental income
- interest received, dividends, royalties
- prizes and awards, some fringe benefits
- income from an interest in an estate or trust
- up to 85% of Social Security benefits - see pg. 20
- net hobby income, barter income
- strike benefits, unemployment compensation
- sick pay

## Not Included in Income (Generally)

- gifts and inheritances
- interest from certain state and municipal bonds (or received by mutual funds that hold them)
- gain up to $500,000 on sale of primary residence (under certain conditions)
- employer-paid health coverage for immediate family
- accident- and health-insurance proceeds
- scholarships and fellowships to a degree candidate if used for certain purposes
- returns of capital
- federal income tax refunds
- interest on eligible Education Savings Bonds
- employer reimbursements for business expenses (that you don't deduct)
- some or all of Social Security benefits - see pg. 20
- workers' compensation for sickness or injury
- child support, veteran benefits, welfare
- life-insurance proceeds (estate tax may apply)
- child's investment income up to $950

## Looking Ahead

- Many tax breaks expired at the end of 2011 but could be reinstated retroactively by Congress before the end of 2012. Affected items are noted throughout the guide.
- Those with high incomes take note: surtaxes on investment income and earned income are scheduled to take effect in 2013. A 3.8% surtax will be applied to the lesser of net investment income or the excess of MAGI over: Single and Head of Household $200,000; Married/filing sep'y $125,000; and MFJ $250,000. A .09% surtax will be applied to earned income (wages and self-employment income) above: Single and Head of Household $200,000; Married/filing sep'y $125,000; and MFJ $250,000. It may not be advisable to defer compensation to 2013, wait until 2013 to convert an IRA to a Roth or sell highly appreciated assets, or take any other action that could raise your AGI in 2013. Talk with your advisor now to plan properly.

## At A Glance—2012

| | |
|---|---|
| Personal exemption | $3,800 |
| Standard Deduction | $5,950 (Single)<br>$11,900 (MFJ) |
| Phaseout of personal exemptions | None |
| Phaseout of itemized deductions | None |
| Standard mileage rate | |
| • business use | 55.5¢ |
| • medical & moving | 23¢ |
| • charitable | 14¢ |
| Taxable wage base | |
| • Social Security tax | $110,100 |
| • Medicare | no limit |

| | |
|---|---|
| Social Security earnings limit | |
| • Age 62 to 66 | $14,640 |
| • Turn age 66 in 2012 | $38,880 |
| • Age 66 and older | no limit |
| 2012 contribution limits | |
| • 401(k)s | $17,000 |
| additional catch-up amount | $5,500 |
| • IRAs | $5,000 |
| additional catch-up amount | $1,000 |
| • SIMPLEs | $11,500 |
| additional catch-up amount | $2,500 |
| Automatic exemption from federal estate tax | $5,120,000 |

Important! There could be a large drop in the exemption amount for 2013. See Estate Planning chapter.

# Terms and Acronyms

**Deduction** – reduces the amount of your income on which your tax liability is determined.

**"Above-the-line" Deduction** – directly reduces your gross income. Eligible deductions (listed on opposite page) are taken on the first page of your tax return *above the bold solid line*. You can take above-the-line deductions and still take the standard deduction or itemize your deductions.

**Credit** – lowers your tax liability by the amount of the credit.

**Refundable Tax Credit** – a credit paid to you even if the credit amount is more than the tax you owe, i.e., your tax liability. The Earned Income Credit (EIC) is one example.

**Adjusted Gross Income (AGI)** – the difference between your gross income and your adjustments to income (eligible above-the-line deductions). It's a benchmark to determine if you can take certain deductions—e.g., IRA contributions, medical expenses (7.5%-of-AGI) and miscellaneous expenses (2%-of-AGI). Itemized deductions are deductions from AGI; they are not used to calculate AGI.

**Modified Adjusted Gross Income (MAGI)** – determined by adding back certain deducted or excluded items, such as IRA contributions, student loan interest, foreign income, and savings bond interest, to your AGI.

**Required Minimum Distribution (RMD)** – the amount the IRS requires the owner of a traditional IRA (not a Roth IRA) to withdraw each year upon reaching age 70½. SEPs, SIMPLEs, and other employer sponsored retirement plans are also subject to RMDs.

### RMD Schedule For IRAs

| AGE | YEARS* | AGE | YEARS* | AGE | YEARS* |
|---|---|---|---|---|---|
| 70 | 27.4 | 80 | 18.7 | 90 | 11.4 |
| 71 | 26.5 | 81 | 17.9 | 91 | 10.8 |
| 72 | 25.6 | 82 | 17.1 | 92 | 10.2 |
| 73 | 24.7 | 83 | 16.3 | 93 | 9.6 |
| 74 | 23.8 | 84 | 15.5 | 94 | 9.1 |
| 75 | 22.9 | 85 | 14.8 | 95 | 8.6 |
| 76 | 22.0 | 86 | 14.1 | 96 | 8.1 |
| 77 | 21.2 | 87 | 13.4 | 97 | 7.6 |
| 78 | 20.3 | 88 | 12.7 | 98 | 7.1 |
| 79 | 19.5 | 89 | 12.0 | 99 | 6.7 |

**Distribution span in years*

To get a year's RMD, divide the sum of the prior year's Dec. 31 balances in your plan(s) by the withdrawal period for your age.

### Social Security Retirement Age Schedule

| YEAR OF BIRTH | FULL RETIREMENT AGE |
|---|---|
| 1937 or earlier | 65 |
| 1938 | 65 and 2 months |
| 1939 | 65 and 4 months |
| 1940 | 65 and 6 months |
| 1941 | 65 and 8 months |
| 1942 | 65 and 10 months |
| 1943-1954 | 66 |
| 1955 | 66 and 2 months |
| 1956 | 66 and 4 months |
| 1957 | 66 and 6 months |
| 1958 | 66 and 8 months |
| 1959 | 66 and 10 months |
| 1960 and later | 67 |

# You and Your Family

## What's New for 2012

- The 2012 tax rates remain unchanged although the tax brackets have increased slightly (see back inside cover).
- The Standard Deduction rises to $5,950 for singles and marrieds/filing separately, $11,900 for marrieds/filing jointly (MFJ), and $8,700 for heads of household (HH).
- The personal exemption is $3,800. You can take an exemption only for the regular tax; add it back when you calculate the AMT.
- The AMT exemption amounts drop to $33,750 for singles, $45,000 for MFJ and $22,500 for marrieds/filing separately. These amounts may be increased by Congress before year-end.
- The employee part of Social Security payroll tax on the first $110,100 of earnings remains at 4.2% for 2012.
- Estimated tax: in 2012 you must timely prepay 100% of your 2011 taxes or 110% of them if your 2011 AGI was more than $150,000 to avoid underpayment penalties.
- The child tax credit remains $1,000 and is allowed against the AMT.
- The adoption tax credit is no longer refundable. The expense limit drops to $12,650 (also the exclusion for company-paid adoption aid). Adoptions of special needs children merit the full credit even if the expenses were less. The credit and the exclusion amounts start to phase out at AGI of $189,710 and disappear at AGI of $229,710. Claims for this credit must be substantiated.
- The higher earned income tax credit (EITC) for taxpayers with three or more qualifying children was extended through 2012. The maximum credit in 2012 is $3,169 for a filer with one qualifying child, $5,236 for two children, and $5,891 for three or more; $475 for a filer with no qualifying children.
- The exclusion for qualifying taxpayers working abroad rises to $95,100. The IRS is tightening its scrutiny for false claims. The general limit on allowable housing expenses is $28,530; high-cost foreign areas may have higher limits.
- Donations of conservation easements must meet new substantiation rules documenting the decline in the value of the property.
- Lapsed for 2012 but will likely be reinstated before year-end: tax deductions for state and local sales taxes instead of income taxes; $250 of teachers' supplies; above-the-line deductions for college tuition; tax-free IRA distributions to charity; and tax benefits aimed at certain local disasters.

### Education

- The phaseout range of the income exclusion with respect to tax-free EE bonds used for higher education is MAGI $72,850–$87,850 (single and HH), $109,250–$139,250 (MFJ).

### Medical

- More long-term-care premiums are deductible again: $350 for age 40 and younger; $660 for those age 41–50; $1,310 for age 51–60; $3,500 for age 61–70; and those age 71 and older can claim up to $4,370 per person. The limit on tax-free payouts rises to $310 per day.
- The limits on Medical Savings Accounts (MSAs) have increased slightly. A high-deductible health plan for self-only coverage must have a deductible of at least $2,100 and not more than $3,150, and out-of-pocket expenses for covered benefits cannot exceed $4,200. For family coverage the respective limits are: $4,200, $6,300, and $7,650.
- An annual contribution cap of $2,500 on medical Flexible Spending Accounts (FSAs) is scheduled for 2013.

### Green Energy Credits

- The 30% credit continues for alternative energy systems (such as solar water heaters, geothermal heat pumps, and wind turbines), and it can be carried over to later years.
- Tax credits for energy efficient home improvements have ended.

The reduction of two percentage points (to 4.2%) in the employee part of Social Security payroll tax on the first $110,100 continues through 2012. Self-employeds get the same tax break. There are no additions to the Standard Deduction this year.

Unemployed? Keep track of your job-hunting expenses. If you're looking for a job in the same line of work you can deduct job-hunting costs to the extent all your miscellaneous itemized deductions exceed 2% of your AGI. If you're looking for your first job, you can't deduct the expenses, but if you're moving to get to your first job, and the job is at least 50 miles away from your previous home, some moving costs may be deductible "above the line." You can deduct certain costs of getting your self, family, and goods to the new area, and this includes parking fees, tolls, and 23¢ per mile.

Always consider the effect of your actions on your adjusted gross income (AGI), a benchmark for many deductions, such as IRA and retirement plan contributions and medical expenses. To secure dependency exemptions, especially for other than qualified children, make sure to pay more than half the support, or, if adopting, pay qualifying expenses by year-end to get the credit. Before year-end, pay tuition and education costs due early next year to get education deductions and credits earlier.

Work out the effect of alternating between taking the Standard Deduction one year and itemizing the next; Contribute appreciated stock to a favorite charity to get a deduction for the fair market value—no tax is due on the capital gain; Contribute to retirement plans which may lower your AGI. To lower income and estate taxes, shift your income or assets to other family members with lower brackets and wealth. Avoid gift tax by limiting gifts to $13,000 per person this year ($26,000 if your spouse agrees). Gifts of a direct payment to providers for medical and education expenses do not count toward the annual gift tax limit. Watch the many thresholds where tax liabilities begin—reducing AGI or income to just below them may save on tax. Review your records for deductible items—go over credit card statements, cancelled checks, and sales receipts. Keep careful records on the tax basis of all assets. Try to defer any year-end bonus (and/or other salary) to early next year if it's to your advantage. If you're in a high bracket, try to convert current income into deferred compensation, fringe benefits, or incentive stock options (ISOs). If you run your own cash basis business, delay income by sending this year's bills next year.

Checks mailed before year-end for deductible items qualify for this year's deduction no matter when the checks clear. There are specific rules on using credit cards for deductibles, so take note. Charges made with a retail store credit card can be deducted only in the year the bill is paid. Charges made with a bank credit card can be deducted in the year the charge was made even if the credit card bill is paid the following year.

## Alternative Minimum Tax (AMT)

The AMT exemption amounts for 2012 have dropped: $33,750 for singles and HH, $45,000 for MFJ and surviving spouses, and $22,500 for marrieds/filing separately. It's probable that these amounts will be increased before year-end. The adoption, child and saver's credits are usable against the AMT, and although the dependent-care and education tax credits are not, this is likely to change before year-end. Among the hardest hit by the AMT are couples with two or more children who own their homes, invest, and make between $75,000 and $500,000 annually.

The AMT is like a flat tax: it has only two rates and only a few deductions. Many ordinary tax write-offs are not allowed: personal exemptions, Standard Deduction, state and local income taxes, sales and real estate taxes, and some medical expenses. Taking large capital gains can trigger it. If your tax is higher under the AMT rules than under the regular tax, you must pay the AMT, which will cancel some common tax planning moves such as paying 2013 state estimated tax in 2012, or deducting home equity loan interest on proceeds not used to buy, build, or improve your home. If you exercise an ISO in 2012, the AMT hits the discount unless you sell the shares by year-end.

### AMT Risk Factors

- large unreimbursed employee business expenses
- exercising incentive stock option (ISOs) gains
- living in states with high state and/or real estate taxes
- large miscellaneous deductions
- large number of personal exemptions (big families)
- high medical expenses

## Children and Dependents

If you claim a person as a dependent, no one else, not even that person, can claim the exemption, but you get no exemption for anyone with 2012 income (excluding Social Security and tax-exempt income) over $3,800 except your spouse or a child under age 19 (24 if a student). There is a uniform definition of "qualifying child" for head-of-household filing status, the child care credit, and the earned income credit (EIC).

To claim a child as a dependent you may not need to pay over half of the child's support, so long as the child doesn't either. There are rules on age, living in the same house, and close relationship. The definition of a "qualifying child" includes the provision that the child must be younger than you in order to claim a dependency exemption. If you have a "qualifying relative," you may be able to take a dependency exemption but you can't claim head-of-household status, the child tax credit, the EIC, or the dependent care credit (unless the person is disabled). You may be able to claim an unrelated child as a dependent under certain conditions.

The assets of a "special needs" child who requires care may disqualify him or her for government aid, and your out-of-pocket costs could soar. Consider setting up a special needs trust charged with supplementing, rather than replacing, government aid. Even if your children are healthy, one or two may become disabled. If you establish a larger trust, such as a 2503(c) trust, include a "special needs" clause that kicks in if a child becomes disabled. (Laws on special needs trusts vary from state to state.)

A dependent child must file a return if any of the following apply: 1) unearned income is more than $950 2) earned income is more than $5,950 or 3) gross income is more than the larger of $950 or earned income (up to $5,650) plus $300. You can report and pay a child's tax on your return if you and the child meet certain requirements.

*Missouri and New York State Bird - Eastern Bluebird*

**These colorful song birds are found primarily east of the Rockies and range from Canada to Honduras. Their average life span is 6 to 10 years. The nesting period occurs in late March or early April but may occur earlier in southern states. There are usually two broods per season although three broods are possible. The incubation period for the light blue eggs is approximately two weeks and the babies will fledge three weeks later. Although the bluebird population has declined substantially over the years, bluebirds remain fairly common and a perennial favorite among birders.**

## Child-Related Credits

These reduce your regular tax dollar for dollar.

- Child Tax Credit. If you have one or more qualifying dependent children younger than age 17 as of year-end, and at least $3,000 of earned income in 2012, you may qualify for a credit of up to $1,000 per child. Phaseout of the credit starts at modified AGI: $75,000 (single and HH), $110,000 (MFJ) or $55,000 (married/filing separately).
- Earned Income Tax Credit (EITC). This refundable credit is for low to moderate income working taxpayers. The maximum credit for 2012 is $3,169 for a filer with one qualifying child, $5,236 for two, $5,891 for three or more, and $475 for a filer with none.
- Adoption Credit. This credit can be taken on up to $12,650 of expenses in 2012, a reduction from 2011, and the credit is no longer refundable. The full credit is available for adoptions of kids with special needs even if the adoption cost less than $12,650 (which is also the exclusion for company paid adoption aid). The phaseout range for the credit is AGI $189,710–$229,710.
- Child and Dependent Care Credit. You might claim a tax credit for costs of caring for a child up to age 13 or disabled dependent. The credit is 20% to 35% for qualifying expenses up to $3,000 (one child) or $6,000 (more than one). A phaseout begins at AGI of $15,000. Employer provided dependent-care assistance reduces the qualifying expenses dollar-for-dollar. For a married couple, the claimed expenses can't exceed the earnings of the lower-earning spouse. The caregiver can even be a relative, such as a grandparent, but not a dependent. If you have access to a Flexible Spending Account (FSA), you may save more on taxes by paying dependent-care expenses from it than by taking any of these credits. Using a FSA will reduce the tax credit.

### Children and Investments

A child is subject to the kiddie tax if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–24 and a full-time student whose earned income does not exceed one-half his/her support. The child's income can be reported on the parent's return if the child's gross income is only from interest, dividends, and capital gain distributions, and is more than $950 and less than $9,500. The first $950 of a child's investment income (interest, dividends, etc.) is tax-free, and the next $950 is taxed at the child's tax rate. If a child subject to the kiddie tax has investment income greater than $1,900, the excess is taxed at the parent's marginal rate and could reduce the parent's credits and deductions tied to his or her AGI. Consider shifting the child's investments to tax-exempts, life insurance, an index stock fund, or investments that defer taxes until the child turns age 19.

To transfer investment assets to younger kids may still be a good idea if they are in a low tax bracket. You can transfer $13,000 (or $26,000 with your spouse) to each child this year without gift tax implications. The child owns the assets, however, which could be a barrier to financial aid if the child goes to college. If you shift assets to your children, they are treated as having held the assets since you acquired them.

Children age 19 and older may pay no capital gains tax on long-term gains up to the difference between their other taxable income and $35,350 this year. Up to $35,350 of this other income is taxed at a maximum income tax rate of 15% (or 10% if under $8,700), so consider shifting income-producing S Corp stock or appreciating stocks to them.

If you're a business owner, consider paying a child or grandchild reasonable summer job wages for a few years (bona fide services must be performed). If the child is under age 18, Social Security or Medicare taxes may not be due. Deduct the salary and put the wages into a Roth IRA in the child's name. The child can't deduct the contributions, but his or her tax bracket is probably low. If you give the child the money for the contribution, it counts toward the $13,000 annual gift tax exclusion, but even a single payment can constitute a nice retirement nest egg.

The same may work as well with your parents. Hire them in the family business and the salary is deductible at the business's rate and taxed at their rate. They may qualify along with other employees for a 401(k) and/or a health plan, and if younger than age 70½ might contribute to a deductible IRA.

## Education Credits

Marrieds who wish to take either of these credits must file jointly and claim the student as a dependent. Students can claim these credits if their parents don't take personal exemptions for them, and even if the parents paid the college tuition. Students must have some income tax liability to offset.

| Tax Credit | Maximum Benefit | Qualified Expenses | 2012 Income Phaseouts | Notes |
|---|---|---|---|---|
| American Opportunity Tax Credit | $2,500 tax credit per student per year<br>100% of first $2,000<br>25% of second $2,000<br>(Credit is 40% refundable; not subject to AMT) | Tuition, fees, and course materials (conditions apply) | Single and HH $80,000–$90,000<br>MFJ $160,000–$180,000 | Usable for first 4 yrs. of college |
| Lifetime Learning Tax Credit | $2,000 tax credit<br>20% of first $10,000 | Tuition and fees | Single and HH $52,000–$62,000<br>MFJ $104,000–$124,000 | Usable for undergrad and graduate education and courses to gain/improve skills |

Eligible tuition expenses do not include any covered by grants, scholarships, and employer-assistance programs, and must be incurred on behalf of the taxpayer, spouse, or dependent. The student must be at least a half-time student for at least one academic period in the year. You can take either credit in a year you take tax-free distributions from a Coverdell Education Savings Account but not for the same expenses. Tuition paid in December for a course that begins next year counts toward this year's credit. The American Opportunity Tax Credit is set to expire after 2012 so you may want to pay 2013 tuition before year-end to take full advantage of the credit.

### Other Education-Related Tax Benefits

Additional options that may be available to you:

| Tax Benefit | Maximum Benefit | Qualified Expenses | 2012 Income Phaseouts | Notes |
|---|---|---|---|---|
| Tuition and Fees Deduction<br>(lapsed for 2012; may be reinstated before year-end) | $4,000 above-the-line deduction Reduced to $2,000 in income phaseout band | Tuition and fees | Single and HH $65,000–$80,000<br>MFJ $130,000–$160,000<br>(If the credit is reinstated, these limits may change) | • Undergrad + graduate<br>• Can't claim deduction & educ credit in same year<br>• Marrieds filing sep'ly cannot claim<br>• Taxpayer who can be claimed as dependent by another is not eligible for deduction |
| Student Loan Interest Deduction | $2,500 above-the-line deduction | Student loan interest | Single and HH $60,000–$75,000<br>MFJ $125,000–$155,000 | Person obligated to make loan payment must be at least half-time student in degree program |
| Employer Tuition Assistance | $5,250 exclusion from income per student | Tuition, fees, books, supplies, equipment | None | |
| Scholarships | Excluded from income | Tuition, fees, books, supplies, equipment | None | Student must be degree candidate |

Those who have student loans forgiven may not have to pay tax on the waived debt if they work in public service jobs, or teach in schools in low-income areas for 120 months and make regular loan payments during that time. This rule applies to loans first made by the government or by private lenders that are later consolidated into federal loans. Information on federal loan forgiveness programs can be found at www.federalstudentaid.ed.gov.

## Paying for Education

It's never too early to set aside funds for educational expenses. Here are some methods for doing so.

| Education Plan | Tax Benefit | Qualified Expenses | 2012 Income | Notes |
|---|---|---|---|---|
| Education Bonds | Tax-free interest on Series EE bonds issued after Dec. 31, 1989, and all Series I bonds. | Tuition and fees<br>Rollover into a 529 plan or Coverdell ESA | Single and HH $72,850–$87,850<br>MFJ $109,250–$139,250 | • Income limits apply when bonds are cashed not bought<br>• Bonds must be in parent's name; child must be beneficiary, not co-owner<br>• Purchaser must be age 24 or older |
| 529 College Savings Plans | Qualified distributions are excluded from income. Earnings portion of a non-qualified distribution is taxed at the beneficiary's rate and may be subject to a 10% tax penalty. | Tuition, fees, books, supplies and equipment, expenses for special needs services. Room and board if enrolled at least half-time. | None | • Undergrad + grad<br>• Beneficiary can be changed but monies must be used for college expenses |
| Coverdell ESA | $2,000 non-deductible contribution limit per year but earnings are tax-free | Books, supplies, equipment. Higher educ: room & board if enrolled at least half-time.<br>Payments to a Qualified Tuition Plan | Single and HH $95,000–$110,000<br>MFJ $190,000–$220,000 | • K–12 at private and parochial schools<br>• Undergrad & grad<br>• Available for use until child reaches age 30<br>• Can take distribution in same year as educ credit, but not to cover same expenses |

- Contributions to 529s are generally excluded from a donor's estate, making these a great way to reduce an estate and the potential for taxes on it. You can deduct from your estate in the first year the first five years' worth of gifts to a child's prepaid tuition account in a 529 plan. So, $65,000 can exit the estate (or up to $130,000 for a couple) in the first year for each child. Each state puts limits and conditions on its plans, but your advisor can help you find the best one for you.
- Parents and others (perhaps a relative) can establish Coverdell accounts for children under age 18. The non-deductible funds can grow and be used tax-free to pay tuition and other costs up to the time the child reaches age 30. There could be significant changes to Coverdell accounts in 2013 unless the current provisions are extended by Congress.

Other Ideas

- Put money in your child's account under the Uniform Gifts to Minors Act. Once a child gets access to the funds at age 18, he or she may spend them as desired.
- The cost of tuition for kids with learning problems may be deductible.
- Save funds in your own name. To get financial aid, parents only need to use 5.65% of their assets each year for college costs. If you have a child going to college next year, and you face assessment of your need for financial help (based on this year's tax return), consider these steps:
    - » minimize or defer all types of your earned income
    - » fully fund all retirement accounts to reduce your income (they don't figure in the aid formula)
    - » accelerate investment losses and postpone taking gains
    - » switch investments to hold down interest and dividend income
    - » use cash to pay debt or build up your home equity
- A 2503(c) trust – the trustee can use the trust funds to pay the child's college expenses. The trust counts as an asset of the child in financial aid formulas.

## Domestic Help

When employees' (such as maids, housekeepers, day-care workers, and babysitters) wages reach this year's $1,800 threshold for Social Security tax, the "Nanny Tax" is due on each person's wages. Babysitters and yard workers under age 18 and in school are exempt (including wages earned during the calendar year of the 18th birthday), but someone you hire to care for your child in your home may be included. You also owe federal unemployment tax (FUTA) if you pay more than a total of $1,000 to all your domestic workers for any quarter. Employers can increase their own withholding or estimated tax to cover the Social Security taxes on a domestic.

## Divorce

Before a child reaches the age of majority (18 years), the custodial parent must waive the right to exemptions before a non-custodial parent can claim them. Any conditions in the divorce agreement cancel the non-custodial parent's claim to the dependency exemption if the custodial parent hasn't signed Form 8332 to waive his or her right to it. After a child reaches majority or a custody arrangement ends, the parent who supplies more than 50% of support gets the child's exemption.

*Virginia and Missouri State Tree – Flowering Dogwood*

**The flowering dogwood tree is often mentioned as a favorite among the spring flowering trees. It is a common woodland tree found throughout the eastern U.S. These trees normally grow to heights of 15–25 feet although they can grow higher in wooded areas. The "flowers" of the dogwood are actually four large bracts (modified leaves) that encircle the tiny cluster of tiny yellowish true flowers.**

Liquid assets are good to take from a divorce, but with up to $500,000 in gain on a primary home sale tax exempt, a house can be more attractive, even though it generates maintenance and property tax bills and no income. An ex-spouse no longer residing in a house who helps to pay the mortgage cannot deduct the interest. Always have your tax advisor check out tax issues.

"Innocent spouses" are protected after a divorce against collection of tax for mistakes made on a joint return. Many spouses are eligible, and executors can assert claims for deceased spouses, or pursue claims filed before death. To qualify you must be at least legally separated from the other and not have lived together for the past 12 months. New IRS guidelines may enable more innocent spouses to qualify for relief.

Transferring assets in a divorce must normally occur within six years but more time may be allowed. The transfer triggers no gain or loss for the recipient until the asset is sold. Alimony is deductible by the payer and taxable to the payee. Child support is neither. Post-divorce payments on a marital home are alimony, says the IRS.

Because of the potentially complicated and financially significant implications of divorce, always consult with your tax, financial, and legal advisors for comprehensive advice.

## Medical Expenses

The medical mileage rate for 2012 is 23¢. In general, medical expenses are deductible to the extent they exceed 7.5% of AGI, and large medical insurance premiums put many over the threshold. Premiums deducted from Social Security benefits, or paid from certain benefit plans, count for purposes of exceeding the 7.5% limit. Other deductions: capital improvements to your home needed for medical reasons (get a statement from your doctor); medical expenses paid for relatives and directly to the provider if you also pay more than half of the person's living costs; cosmetic surgery that improves the body's functioning. The floor for deductible medical expenses will rise to 10% of AGI in 2013 for those under age 65.

Prescription drugs are fully deductible. Flexible Spending Accounts (FSAs), Health Saving Accounts (HSAs) and Health Reimbursement Arrangements (HRAs) cannot reimburse workers for unprescribed over-the-counter drugs. Only prescriptions and insulin are reimbursable. Medicare Part B and D payments are deductible as medical expense deductions. Costs of physician-prescribed weight loss plans and prescriptions to treat obesity, or prescribed in connection with another malady, are deductible under the 7.5%-of-AGI rule. The cost of diagnosing (e.g., pregnancy test kits, electronic body scans, or annual physicals), preventing, or treating a specific disease may be deductible. Refundable entry fees to continuing care facilities are not deductible, but a deduction is okay for the medical related portion of non-refundable monthly fees. Payments by states to providers of respite care are taxed; only payments for foster care can be tax-free.

Self-employeds can buy medical insurance in their own names (rather than that of the business) but cannot aggregate profits from more than one business when calculating the deduction. 100% of their premiums are deductible.

You may be able to deduct medical expenses you pay for a parent for whom you pay more than half the support, even if the parent lives separately and is not a dependent. Long-term-care insurance may be especially valuable in protecting the parent's house and other assets. You might buy the insurance for him or her and possibly deduct all or some of the cost.

### Flexible Spending Accounts

Does your employer offer a "flexible spending account" (FSA)? There are several types of FSAs but the medical expense FSA and the dependent care FSA are the most common types. Medical FSAs let employees pay some health care expenses with pre-tax dollars. The tax savings can be substantial. Deductibles, copays, and coinsurance are reimbursable expenses as well as doctor-prescribed drugs and insulin. Some over-the-counter items may also be eligible. Amounts in flex plans unused at year-end are forfeited, although some plans give a 2½ month period after the end of the calendar year to use up contributions. Employers can set a maximum contribution limit to their plans. Starting in 2013 a federally mandated contribution cap of $2,500 will be in place for medical FSAs.

Dependent care FSAs can be used to pay certain expenses for dependents who live with the employee. Often this means child care for children under age 13, but care for mentally or physically handicapped children of any age as well as elderly dependents is also eligible. Spouses can each have a dependent care FSA but the combined total of their accounts cannot exceed the $5,000 cap.

### Health Reimbursement Arrangements (HRAs)

If your employer offers HRAs, you can withdraw funds tax-free to pay medical expenses (only) for yourself, your spouse and dependents. Unused sick leave can go into the HRA when the employee retires, but tax is payable if the employee could have taken cash. If a beneficiary other than an employee's spouse or dependent receives an HRA's funds after an employee's death, all reimbursements under the plan become taxable.

### Health Savings Accounts (HSAs)

HSAs help workers, their spouses, and dependents who have health insurance policies with high deductibles (HDHP). Coverage under a disability, dental, vision, or long-term-care plan is okay. Some states require policies to pay certain expenses in full or part. There are new limits for 2012 and 2013 (see chart).

| HDHP | Self-Only Coverage 2012 | Self-Only Coverage 2013 | Family Coverage 2012 | Family Coverage 2013 |
|---|---|---|---|---|
| Minimum Deductible | $1,200 | $1,250 | $2,400 | $2,500 |
| Contribution Limit* | $3,100 | $3,250 | $6,250 | $6,450 |
| Maximum Out-of-Pocket | $6,050 | $6,250 | $12,100 | $12,500 |

**Those age 55 by year-end can add another $1,000.*

Neither income nor withdrawals used to pay medical costs are taxed, but other distributions are taxed—and penalized 20%, except after age 65 or for death or disability. If you set up an HSA by December 1, you can put in the maximum for the whole year.

Unlike FSAs, you can carry over HSA balances from year to year, or roll over an old Medical Savings Account into an HSA if you do so within 60 days. You can roll IRA funds into an HSA—once, up to the maximum annual contribution. A one-time transfer from an IRA to an HSA can make tax sense if after-tax contributions were made to the IRA. Making a medical payment from an HSA after an IRA rollover saves you tax and a 10% penalty on early distributions from the IRA. HSAs can be tapped to pay Medicare Part D premiums if the owner is age 65 or older, but withdrawals to pay them for a spouse are taxed as income and hit with a penalty if the account owner is under age 65. HSAs can be used to pay premiums for COBRA coverage for a spouse or dependent (or medical premiums for them if they're unemployed). Employers can give employees debit cards to access funds in their HSAs. Employers can open HSAs and contribute to them if they include all eligible workers. The contributions are then tax-free to the employees and free from payroll and income taxes.

## Charitable Gifts

The deduction for charitable contributions is usually limited to 50% of your AGI. That limit falls to 30% for gifts to private charities and gifts of appreciated stock. First deduct gifts that qualify for the 50% limit, then other gifts. In general, there's a five-year carryover for gifts you can't deduct this year. Not sure if a charity is eligible to receive deductible contributions? The IRS website (www.irs.gov) now has a database of eligible organizations that is updated monthly.

You can deduct the full market value of capital assets you donate to charities without paying taxes on their appreciation (limited to 30% of AGI). Don't donate loss property. Sell it first (so you can take the loss on your taxes) and donate the proceeds (so you can take the charitable deduction). IRA holders age 70½ and older can no longer directly transfer tax-free up to $100,000 to an eligible charity. This could be reinstated before year-end 2012.

All monetary donations, regardless of amount, must be substantiated through bank records or written communications from the charity. Gifts under $250 get no deduction without a canceled check, a bank record, or a receipt with the charity's name and the amount of the gift. The only exception is for a contribution of less than $250 to a charitable remainder trust. For gifts of $250 or more, the charity's receipt must contain additional information: 1) a statement that no goods or services were provided in return for the contribution or 2) a description and estimate of the value of any goods or services that were provided. Incomplete information from the charity can invalidate the tax deduction. For donations made via payroll deductions, a pay stub or W-2 with donated amounts, and a pledge card with the charity's name, may do. It may be a good idea to make all donations via checks. Clothing and household goods that are not in good used condition need an appraisal if you claim a deduction of more than $500. For items in good used condition or better, you need an appraisal if the item is valued at more than $5,000. Items of low value (e.g., socks) can't be deducted. Credit card rebates you donate to charity are deductible, but if the gift is $250 or more you need a receipt from the charity documenting the date and amount. You can deduct out-of-pocket costs you incur while doing work for a charity and 14¢ per mile you drive for charity.

The rules on donations to charities of autos, boats, and planes are strict. If the donor claims the value of an item exceeds $500, there must be a written acknowledgement. If the charity sells the gift without rehabbing or using it, the donor's deduction cannot exceed the selling price (with a few exceptions). A charity need not sell a vehicle in 2012 for the donor to take a deduction for the year; the vehicle only needs to be transferred this year.

There are several additional tools, such as charitable remainder trusts and charitable lead trusts, which may be useful for your charitable giving objectives. Consult with your estate planning and tax advisors to determine their applicability to your situation.

## Casualty Losses

The floor for casualty losses on personal assets in regions not declared disaster areas remains $100. The balance above $100 is deductible to the extent it exceeds 10% of AGI. The addition to the Standard Deduction for casualty losses is gone. Decline in the value of a home because of problems with drywall is eligible as a casualty loss, but not slow damage, as from rust or insects. Gain on insurance proceeds for personal property lost in a declared disaster is not taxed. You can take a 2012 declared-disaster loss on your 2012 or (amended) 2011 return; choose the year of lower AGI.

Insurance reimbursements for living expenses are taxable to the extent they exceed actual expenses, in the year the owner receives the funds or moves back into the house, whichever is later. Insurance payments also taxed: for a destroyed house and not spent to replace the house within two years (four years in disaster areas); and for items listed in separate schedules of the policy and not reinvested in the house or similar items.

## Compensation

Keep in mind that severance pay is fully taxable and subject to payroll taxes. An ex-employer's continued payment of health and accident benefits is not taxable. An ex-employee who pays his or her own COBRA health premiums can deduct them to the extent they exceed 7.5% of AGI. Outplacement services are a tax-free benefit if not paid in cash, but state unemployment benefits are taxable.

You can convert compensation to a tax-advantaged form, such as no-extra-cost-to-the-employer services (e.g., free standby flights for airline employees), working-condition fringe benefits, employee discounts, or *de minimis* fringe benefits. Some types of noncash compensation are taxable—e.g., employer-provided automobile for personal use or employer aid for education not directly job-related or job-required. Also, stock options: the difference between the stock's fair market value and the option price is "income" when the option is exercised, but a special rule delays the tax on incentive stock options (ISOs) until the stock is sold or exchanged. Even ordinary stock options let you speculate on the stock, while ISOs benefit from the low rate on capital gain. Certain conditions must be met to receive favorable tax treatment on ISOs. If you receive restricted stock or options from your employer or exercise ISOs, consider making a Section 83(b) election within 30 days. With respect to stock, the election lets you use long-term capital gains rates on the difference between the sales price and your basis when you sell the stock; with respect to ISOs, it lets you pay lower AMT. Firms must report to the IRS on ISOs exercised in 2012 and also on employee stock purchase plans.

The IRS never uses email or social media sites to communicate with taxpayers.
If you receive an email from the IRS, don't open it or any "attachment"
it may include.

# Investments

## What's New for 2012

- Mutual funds must report the cost basis of shares purchased after 2011.
- Looking ahead to 2013 – The capital gains rate is scheduled to increase to 20% (10% for those in the lowest income tax bracket). Congressional action before year-end could alter these rates. Surtaxes are scheduled to take effect for high-incomers. Refer to the "Looking Ahead" box on page 2 for details.

Gains on assets held short-term—12 months or less—are taxed at ordinary income tax rates. Assets held longer than a year, however, are taxed at reduced rates. The tax on long-term capital gains remains 0% through 2012 for taxpayers in the 10% and 15% income tax brackets. For those in the 25% income tax bracket or higher, the capital gains tax rate is 15%. Dividends are either ordinary dividends or qualified dividends. Ordinary dividends are taxed at the income tax rate for your tax bracket. Dividends are "qualified" dividends if you owned the shares for at least 60 days before and after the date the stock goes ex-dividend and are taxed at the long-term capital gains rates. Dividends received from a regulated investment company (RIC) or real estate investment trust (REIT) also qualify for the reduced capital gains rates. The capital gains rates are scheduled to increase in 2013 and all dividends to be taxed at ordinary income tax rates.

Do what you can to get your taxable income low enough to qualify for the 0% long-term capital gains rate if you plan to sell long held assets this year. (The 2012 threshold for a married couple is $70,700.) For example, maximize your contributions to retirement plans to lower your AGI. When you do sell gain assets to get the 0% rate, try to sell the shares with the largest gains.

Capital losses you incur this year offset your gains and up to $3,000 of other income. Net losses greater than $3,000 carry over to defray capital gains in later years. To limit the tax on your capital gains, plan and correctly "net" (i.e., offset) your long- and short-term gains and losses. First net your short-term losses and gains then apply any excess loss against your net long-term capital gain. If you have a net long-term capital loss, you can apply it (and losses carried forward from earlier years) against any net short-term capital gain. Try to plan your sales to take full advantage of these offsets, without letting tax considerations dominate your investment moves.

You can increase your deduction for margin interest (up to the amount of your net investment income) by taking short-term gains. Long-term gains aren't investment income unless you forego taking the capital gains rate on them (so also for qualified dividends). Low-bracket taxpayers and older investors who may lose the investment-interest carryover at death might elect to have capital gains taxed as ordinary income. Investment interest is deductible up to the total of investment income, and you can carry forward the excess undeducted interest to later years.

*New Jersey State Flower – Violet*

**The common blue violet is a well known simple flower native to eastern North America. Because of its small size, its complexities may be overlooked. The blue/violet flower has 5 petals and has developed a scent to attract pollinating insects. The two upper and two lateral sets of petals attract insects as well and the bottom petal provides a place for the insects to land. Insects are cleverly guided into the spur of the flower which holds the nectar by markings called honey guides. There are tiny hairs near the nectar which help keep the nectar undiluted by rain or dew.**

Investors take note: an individual whose return fails to flag a "reportable transaction" (tax shelter) will now pay a minimum $5,000 penalty.

Collectibles held longer than one year are taxed at 28%, and gains on real property, to the extent depreciation was claimed on it, are taxed as high as 25%. If you inherit property from a decedent, generally you'll be able to classify its sale as a long-term transaction. Like-kind exchanges of business or investment property also may delay tax on any gain until you dispose of the property you receive.

Profits up to $500,000 for couples, or up to $250,000 for singles, upon the sale of a principal residence are exempt from tax under certain conditions. (See Real Estate chapter.)

Many expenses connected with investments qualify as miscellaneous itemized deductions (subject to the 2%-of-AGI floor): office rent; legal fees; accounting and secretarial fees; certain travel expenses (not to conventions or meetings); investment-related newsletters, books, etc.; long-distance phone calls; postage; travel to your broker's office; custodial IRA fees paid out of separate funds; fees to financial planners or managers; and rental fees for safe-deposit boxes. Brokers' and mutual fund commissions aren't deductible but should be added to the basis to reduce capital gain upon sale.

The Kiddie Tax: A child is subject to the kiddie tax if the child is 1) under age 18, 2) age 18 whose earned income does not exceed one-half his/her support or 3) age 19–24 and a full-time student whose earned income does not exceed one-half his/her support. Unearned income over $1,900 is taxed at the parent's marginal rate. Many such kids will get no advantage from the 0% capital gains rate. Shifting capital-gain property, however, especially if slated for sale before 2013, to other family members in the lower brackets might save much tax. Grandparents who wish to help grandchildren pay for college, take note, especially if the grandchildren are age 19 and over and escape the kiddie tax. Tax savings could be significant if the child sells the stock at a 0% capital gains rate.

## Other Ideas

- Selling stocks to pay a tax bill is usually a bad idea. If they have appreciated, you are generating more tax bills.
- Bond interest is taxable at regular rates that can reach 35% and, when interest rates rise, bond and bond mutual fund values fall. Municipal bonds may be good investments for high-incomers, especially in high-tax states.
- Use the correct "basis" for stocks or assets you inherit.
- The penalties for tax-shelter investments the IRS deems lack economic substance are stiff—up to 40%.
- The "wash sale" rule disallows losses on stocks and bonds if you re-buy substantially identical securities (or funds) within 30 days of the sale.
- Owners of worthless securities (but not of worthless partnerships) have seven years to file retrospective claims for tax refunds.
- There are tax incentives to invest in low-income areas. The cap on allowable credits for ordinary low-income housing deals is high, and states can issue private-activity tax-exempt bonds.
- Keep your "buy and hold" stocks in your taxable account, and stocks you may hold for shorter periods (as well as high-yield fixed income securities and CDs) in your tax-deferred account.

## Mutual Funds

Capital gain distributions from mutual funds increase your net capital gain for the year. Long-term gains of mutual funds qualify for the capital gains tax rates. Non-qualified dividends of interest and short-term gains do not; they are taxed at ordinary income tax rates. If you see such gains coming, try to offset them by selling securities with values currently below your basis in them. You might even sell an extra $3,000 of loss securities, so as to deduct the losses and reduce your taxes. Then use the proceeds from the sales to update and reposition your portfolio. You can enter on Schedule D summary totals of stock transactions if you provide a broker's summary to the IRS that contains all the required details.

If you sell a mutual fund this year, remember to add to your original cost basis all subsequent reinvested interest, dividends, capital gains distributions and sales charges. This could greatly reduce your reported gain or increase your reported loss.

Long-term investors in mutual funds who plow back dividends and capital gains may fail to include these in the cost basis of shares, and thus overpay taxes when they sell them. However, this requires meticulous record keeping. An alternative is to take the dividends in cash, and thus keep your original cost basis, while reducing paperwork. Funds usually tell you your average basis for all your shares, including those bought by reinvesting dividends.

There are several ways to figure the cost basis of shares, and they all become complex when investors reinvest dividends and capital gains and sometimes sell shares. The average-cost method is most popular and most fund groups use it to provide cost figures to clients. Although the most flexible method to minimize taxes is to designate specific shares, it requires careful record keeping. Once you select a method, you must stick with it.

If you invested in international mutual funds, you probably paid foreign taxes for which you may be able to claim a dollar-for-dollar foreign tax credit. Your fund should be able to tell you how much foreign tax was paid on each share.

- A mutual fund is "tax efficient" if its returns show up as appreciation in the share price, not as taxable distributions. Such funds often use a buy-and-hold strategy, although buying and selling actively provides more chances to offset gains with losses. A fund with large unrealized losses may be a buy, because, when realized, the losses will offset gains. A fund can lose value and still pay out gains taxable to you.
- You can swap one fund for another to lock in a loss while keeping exposure to the same asset class. Don't wait until year-end to capture losses; you can sell at any time.
- Mutual fund shareholders whose only gains are from fund payouts can avoid Schedule D. Form 1099-Div will tell you which portion of gain qualifies for what treatment.
- If you want to keep your taxable state income down, buy short-term Treasuries rather than money-market funds.
- If you buy a mutual fund that is about to pay a dividend, including capital gains dividends, you'll pay tax on the payout without enjoying any increase in your wealth (share prices drop by amounts paid out). Wait to buy until after the record date for payment. If a fund's value has fallen, selling before the payout record date will provide a loss that can offset gains elsewhere, and you avoid taxes on the payouts.

## Passive Activities

Certain investments are defined as "passive" to prevent their use as tax shelters for other types of income. Passive activities are of two types: 1) the owner (often limited partnerships or S Corporations) does not "materially participate" and 2) any rental activity (irrespective of the level of participation) for which payment is mainly for the use of tangible property. (There are a few exceptions.) Passive activity investments do not include stocks and bonds. The Real Estate chapter describes a large exception to the passive-loss restrictions for those who actively participate in renting real estate.

Calendar year filers must report changes on how passive activities are grouped or any new groupings. The reporting rules are supposed to keep filers from playing games to deduct losses. The grouping rules are important because if two or more activities are grouped as one, the disposition of an activity will not trigger any suspended passive losses until all the others are disposed of.

Passive losses that can't be deducted this year can be carried forward and deducted when you dispose of the entire activity or have passive income to offset them. Interest owners receive on loans to passive activities is treated as portfolio income, and can't be used to offset passive losses—except that interest earned on loans owners make to partnerships or S Corps with passive activities (such as rental realty) is passive income to the owners. The owners need not have a 10% share in the S Corp or partnership to use this break.

To reduce your passive-activity interest expense, reduce your debt in a rental activity or convert the debt to home-equity debt, the interest on which may be deductible. (Use the proceeds from a home-equity loan to repay passive-activity loans.)

# Retirement

## What's New for 2012

- Tax-free direct payouts of up to $100,000 to eligible charities from IRAs by taxpayers age 70½ or older has lapsed for 2012 but will likely be reinstated by year-end.
- The definition of a highly compensated employee rises to $115,000. The definition of a key employee in a top-heavy plan increases to $165,000.
- Reminder: if you converted a traditional IRA into a Roth IRA in 2010 and deferred the taxes, the remaining 50% of that income must be reported on your 2012 tax return.

The burden is steadily shifting to provide for one's own retirement so retirement saving should be an essential part of your financial plan. There are numerous retirement saving vehicles, many of which are discussed in this chapter. The chart on page 19 provides a snapshot of the plans.

Contributions to retirement plans confer two large tax benefits: 1) they reduce your AGI and current income tax, and 2) they can grow faster than your other assets because they're sheltered from tax until withdrawn. Yet you may not lose current or early use of the money, since many plans let you borrow from them or withdraw funds early for certain reasons. Take advantage of your employer's plan especially if it features an employer match or you can make catch-up contributions.

*Georgia State Flower – Cherokee Rose*

**The Cherokee rose, rosa laevigata, is native to southern China. It was introduced into the southeastern United States near the end of the 18th century. Cherokee rose is a hardy evergreen climbing shrub. The flowers are pure white with a golden center, thorny and very fragrant. The blooms appear in the early spring, but, if conditions are right, a re-bloom can occur in the fall. In 1916, with the support of the Georgia Federation of Women's Clubs, the Cherokee rose was named the state flower. It is also known as the camellia rose.**

If you have stock from your company in your retirement plan, find out its "cost basis" now; this number will determine your later taxes and affect how you should take distributions. Employee contributions to pension plans can be rolled over into another plan, via a trustee-to-trustee transfer. Non-spouse as well as spouse beneficiaries can roll over a decedent's interest in a qualified plan under strict rules. See your advisor.

If you retire before the age of 55, you may incur a 10% penalty on early plan distributions. The penalty is avoided only if you are 55 in the year you retire. The separation date, not the distribution date, is the key factor. This exception does not pertain to early distributions (before age 59½) from IRAs.

Couples with MAGI up to $57,500, heads of household with MAGI up to $43,125 and singles with MAGI up to $28,750 can get the "saver's credit" on the first $2,000 contributed to retirement plans. The credit amount (10% to 50%) is tied to MAGI. Maximum credit: $2,000 for MFJ, $1,000 for singles and all others. Taxpayers who are younger than 18 years, full-time students, or claimed as a dependent on another's return cannot take the credit. The credit is trimmed if the taxpayer took a payout from a plan or IRA the same year or the two previous years.

## Individual Retirement Accounts (IRAs)

If neither you nor your spouse is covered by a qualified employer-sponsored plan, you can each contribute to an IRA and jointly exclude from current tax up to $10,000 (or

$12,000 if both are age 50 or older) of current income, even if one spouse does not work. (Spouses cannot contribute more than their combined earned incomes.) If either spouse participates in a qualified employer-sponsored plan, contribution deductibility is subject to MAGI limits (see chart below).

If ineligible for a deductible IRA contribution (or over the AGI limit for a Roth IRA), you can make non-deductible contributions up to your earned income or $5,000, whichever is less. Non-deductible IRAs are a good place for after-tax dollars if you trade in and out of stocks and mutual funds: you can buy and sell without paying taxes.

Be sure to amend your IRA forms if your beneficiary dies. If the IRA passes to the estate, unintended taxation and flexiblity issues may result. Heirs may be able to claim an itemized deduction, not reduced by 2% of AGI, for the part of an estate tax bill due to the IRA.

You can temporarily withdraw funds from an IRA for 60 days without penalty, but if you exceed that limit you pay tax and penalty on the funds as of the day of withdrawal. You can make only one such temporary withdrawal per plan per year.

### Is My IRA Contribution Deductible?

| Plan at Work | Filing Status | 2012 Modified AGI | IRA Deduction up to contribution limit |
|---|---|---|---|
| You're covered by retirement plan at work | Single and HH | $58,000 or less<br>$58,000–$68,000<br>$68,000 or more | Full<br>Partial<br>None |
| | MFJ | $92,000 or less<br>$92,000–$112,000<br>$112,000 or more | Full<br>Partial<br>None |
| You (and your spouse) are not covered by retirement plan at work | Single and HH | no limits | Full |
| | MFJ - neither covered at work | no limits | Full |
| You're not covered by retirement plan at work but your spouse is | MFJ - spouse covered at work | $173,000 or less<br>$173,000–$183,000<br>$183,000 or more | Full<br>Partial<br>None |
| | Married/Filing Separately | special rules apply | |

A 10% penalty plus regular income tax applies to premature withdrawals (before age 59½) from IRAs unless you are disabled, but you can avoid the penalty by withdrawing the funds in equal periodic payments (conditions apply). The penalty is also waived if the early withdrawal is used for: medical expenses in excess of 7.5%-of-AGI; health insurance premiums (conditions apply); certain education-related expenses; or up to $10,000 for the purchase of a first house. Unemployed persons who receive unemployment benefits for 12 consecutive weeks can tap their IRAs (in the year the benefits are paid or the following year) penalty free to pay for health insurance. All early distributions are subject to income tax.

Required minimum distributions (RMDs) are required once the owner of a traditional IRA reaches age 70½. The first RMD can be delayed until April 1 of the year after turning 70½. For each year thereafter, the deadline is December 31. The RMD amount is determined by 1) the previous-year year-end IRA balances, and 2) a life-expectancy schedule provided by the IRS (shown on page 3).

## Roth IRAs

Contributions to traditional IRAs are deductible and taxed on withdrawal. A Roth is the opposite: contributions come from after-tax money and are not taxed on withdrawal. Eligibility to contribute to Roths is subject to modified AGI limits as shown in the chart on page 19. The greatest benefits of Roth IRAs may be in transferring wealth to heirs. A Roth IRA is not subject to minimum withdrawals (or a ban on contributions) at age 70½ and may provide far more to a beneficiary than other plans. Assets in the account for five years can pass to heirs without current income tax. Non-spousal heirs who inherit a Roth IRA may have to take minimum distributions but can stretch them out over a lifetime, during which the IRA is enjoying tax-free growth. Other heirs can compound the Roth assets for decades with only minimum annual withdrawals. A Roth can grow into a large sum for a child. A 16-year-old with $5,000 in a Roth that earns 7% each year will have $137,000 at age 65 and $193,000 at age 70, and much more if the child makes annual contributions for a few years.

Although contributions to a Roth IRA are non-deductible, you can withdraw the contributions without tax or penalty. So keep track of your Roth contributions. After five years you can withdraw earnings early (before age

59½), with tax but without penalty, for your first purchase of a house ($10,000 limit), for education, or because of disability. After five years and age 59½, you can withdraw all of the Roth for any reason. The five year period starts with the tax year of the first conversion or contribution.

Conversions to Roth IRAs: Traditional IRAs can be converted to Roth IRAs and the latter back to traditional IRAs. If you convert an IRA to a Roth, watch out for a 10% penalty on withdrawals in the first five years, even if you take out funds you converted tax free. Usually the penalty is on taxable withdrawals, but the whole payout is subject to the penalty unless you've turned 59½, are disabled, or have elected to take a series of equal distributions from the Roth. A market slump can lower the tax bill on a Roth conversion. A conversion can make sense if your personal tax rate will be higher or the same in the future.

If you convert a traditional IRA to a Roth IRA and want to put the funds into different types of investments, consider using a different Roth for each type. If any of the investments declines in value later in the year you can uncovert that portion until as late as the filing date plus extensions without paying income tax on it. Having enough cash on hand to pay the tax is important; you don't want to cripple the IRA's ability to grow.

Switching to a Roth from a traditional IRA can make more of seniors' Social Security benefits taxable in that year, and the increase in income could cause loss of tax breaks such as the child tax credit. So try to schedule the conversion in a year your income dips or you have investment losses, or wait until you near age 70½ and may have to take distributions anyway. Upper-incomers may have to pay a surcharge on their Medicare Part B premiums, and Roth conversion income counts toward the AGI trigger point. Even lower-income seniors who convert might see more of their Social Security benefits taxed, but at least they won't have to take minimum distributions from the Roth, adding to their future AGIs, and any payouts will be tax free.

A conversion must meet certain conditions and it's usually not smart to use part of the distribution in a conversion to pay the taxes due. Consult your advisor to refine your strategy.

## 401(k) and Roth 401(k) Plans

401(k) plans are excellent tax-saving vehicles, especially if your employer matches your contributions because the matches are not income to you; however, no unrealized losses, even on after-tax contributions, are deductible. Know the rules of your 401(k). If an employee cashes out of a 401(k) and doesn't roll over within 60 days, federal, state and local taxes are due on the entire amount withdrawn, and possibly a 10% early-withdrawal penalty. If a departing employee has a balance below $5,000 in a company 401(k) or pension plan, the company can evict ("cash out") the employee from the plan which can prove costly. Consider borrowing from your 401(k) rather than cashing out.

The usual "distribution" or withdrawal choices from a company plan are a lump-sum or an annuity. Many who leave their jobs take a cash distribution from their 401(k)s rather than rolling the funds over into their IRA or a new employer's plan. This can be a serious mistake. If you roll over a lump-sum distribution to an IRA within 60 days, tax is deferred, but you cannot roll over only the nondeductible portions. There may be an exception to the 60-day rule in cases of hardship.

If you take a lump-sum distribution from your 401(k), consider having the company give you any company shares in it and put them in a taxable account. You'll then pay ordinary income tax on the tax basis of the stock when it was put into the 401(k). No tax will be due on the built-up appreciation; you'll pay that tax, at potentially favorable long-term gain rates, when you sell the stock. If you hold the stock, your heirs will receive a step-up in basis when you die.

The Roth 401(k) combines the features of traditional 401(k)s and Roth IRAs. There's no up-front deduction for the contributions. The limits are the same as for regular 401(k)s and include catch-ups, but withdrawals are tax-free after age 59½. If the earnings are large or tax rates at the withdrawal date are high, the tax benefit will be invaluable. There are no income limits for eligibility for Roth 401(k)s, which is great for high-paids. The contribution limits apply to all your 401(k)s, so you can't put $17,000 (or $22,500 with catch-up) into both a regular and a Roth 401(k), but you can divide your contribution between the two types in any year. Which type is better? When you contribute to a regular 401(k), you get a current deduction and delay paying taxes on those assets until retirement. For young people, if their retirement tax rate is higher than now, the Roth 401(k) may be better for them. If the reverse is true, the deductible 401(k) may be better. In sum, the main variables for deciding between regular and Roth 401(k)s are your tax brackets today and those estimated at the time you'll withdraw.

The value of unpaid leave can possibly be transferred to an employee's 401(k) or profit sharing plan annually. This can help employees with vacation that can't be carried over. If the plan allows, the value of unused leave can be contributed when the employee leaves the company.

Non-spousal heirs can take payouts over their lifetimes if they properly roll the 401(k) into their own IRAs. There are strict rules so see your advisor. They still face a deadline, however: to beat the five-year rule, and get lifetime payouts, the heir must transfer the 401(k) to an IRA within a year after the 401(k) owner dies.

A 401(k) can be converted directly to a Roth IRA or a Roth 401(k). In a conversion to a Roth 401(k) the after-tax contributions may be free of tax. A conversion the other way, from a Roth 401(k) to a Roth IRA, might eliminate the minimum distribution requirement because the Roth IRA has none. Conversion of an employee's 401(k) to a Roth 401(k) is okay if contributions were in the plan for two years or the employee was a member for five or more years, and a worker must be at least age 59½ to convert contributions made by salary reduction. After-tax contributions and rollover amounts can be converted regardless of the owner's age. An in-plan conversion from a regular to a Roth 401(k) can't be reversed later.

## Keogh Plans

Keogh plans shelter self-employment income from tax and must cover any full time employee. The contribution limit to defined contribution plans (Keogh, profit-sharing, etc.) rises to $50,000 ($55,500 for those age 50 or older) and can be based on up to $250,000 in salary. The maximum annual payout for defined benefit plans increases to $200,000. Plans set up this year might qualify for a credit for some start-up costs. Keoghs must be set up by December 31 to get a 2012 deduction. "Defined-benefit"- type plans that provide a fixed amount per year have dwindled because of their complexity.

| Plan | | Contribution Limits 2012 | 2013 | Pros | Cons | Use |
|---|---|---|---|---|---|---|
| IRA | individual | $5,000 | Indexed to inflation | Tax-deferred savings | Withdrawals not tax-free; participation in employer plan affects contribution deductibility | For individuals |
| | age 50+ add'l | $1,000 | Indexed to inflation | | | |
| Roth IRA | individual | $5,000 | Indexed to inflation | Earnings and withdrawals tax-free; flexible distribution | No up-front deduction; contribution eligibility phases out at MAGI Single and HH $110,000–$125,000 MFJ $173,000–$183,000 | For individuals |
| | age 50+ add'l | $1,000 | $1,000 | | | |
| SIMPLE IRA | individual | $11,500 | Indexed to inflation in $500 increments | High contribution limit; employer must match | Withdrawals not tax-free | For small businesses-less than 100 employees |
| | age 50+ add'l | $2,500 | | | | |
| SEP | | Employer can defer lesser of $50,000 or 25% of compensation | | High contribution limits | Withdrawals not tax-free | For self-employeds and their employees |
| 401(k) | individual | $17,000 | Indexed to inflation in $500 increments | Tax-deferred contributions and growth; employer match not taxed to owner | Employee withdrawals only allowed under limited conditions | Employer sponsored |
| | age 50+ add'l | $5,500 | | | | |
| Roth 401(k) | individual | $17,000 | Indexed to inflation in $500 increments | Earnings and withdrawals tax-free; employer can match | No up-front tax deferral | Employer sponsored |
| | age 50+ add'l | $5,500 | | | | |

## Simplified Employee Pension Plans (SEPs) and SIMPLEs

The deferral limits on SEPs and SIMPLEs are higher than on traditional IRAs. SEPs let employers make deductible contributions to the IRAs of employees and avoid much paperwork. All eligible employees must be covered but there's no waiting period for vesting. Businesses with no more than 100 employees can have a SIMPLE plan, to which an employee can contribute this year up to $11,500 of pre-tax wages (plus another $2,500 if age 50 or older). Employer matches must be made by the due date of the return plus extensions. Contributions to a SIMPLE have an earlier deadline than for an IRA: one month after year-end. SEPs are easily converted to Roths, but there are restrictions on conversions of SIMPLEs. There are few options for a SIMPLE plan short on cash. It can't shut down until the end of the year and an employer can't renege on a promise to contribute or match, but can defer until the extended due date of the business tax return.

## Social Security Benefits

Social security benefits are not generally taxed if they are the only income source for the year. If you have earned income or large investment income, up to 85% of benefits may be taxable depending on the amount of income and your filing status. Tax-exempt income also figures into the calculation of the taxability of benefits.

The 2012 earnings test (not applicable for individuals at full retirement age) for Social Security benefits is: a charge of $1 for every $2 that earnings exceed $14,640 if below full retirement age; a charge of $1 for every $3 that earnings exceed $38,880 if full retirement age is reached in 2012 (for earnings made in the months prior to the month you reach full retirement age). Full retirement age depends on the year you were born as shown on the chart on page 3. The test applies to each person, not to couples. Beneficiaries who work get no relief from FICA tax, even if they work only part time and the pay is not enough to raise their benefits. Social Security beneficiaries may withdraw an application for retirement benefits but only once per lifetime and only within 12 months of their first Social Security payment. Any benefits received prior to the withdrawal would need to be repaid.

## Other Retirement Considerations

Federal taxation is uniform across the country but state taxation is a different story. If you're deciding where to live in retirement, consider the tax implications of a move. Take into account the state income tax rate, state taxation of retirement benefits and Social Security, state and local property taxes, state estate taxes, and state sales tax. These can vary widely from state to state and could have a measurable impact on retirees' finances.

*Florida, Texas, Arkansas, Tennessee, and Mississippi State Bird – Mockingbird*

**Mockingbirds can be found year round throughout the United States. They are known for mimicking the sounds of other birds. In the 19th century, people kept mockingbirds as cage birds because of their continual singing. They will sing throughout the day and at times into the night, especially during a full moon. A male mockingbird can have as many as 200 songs throughout its life. Both the males and females are aggressive and will defend their territories from other birds, cats, and dogs.**

# Real Estate

## What's New for 2012

- The deduction for certain mortgage insurance premiums paid in connection with a qualified residence has expired for 2012.

Recapture of the $7,500 first-time homebuyer's credit continues for those who bought a house between April 9 and Dec. 31, 2008, and took the credit; $500 must be added to this year's taxes. The IRS is aggressively pursuing the recaptures. The $8,000 tax credit for first-time homebuyers who purchased a principal residence in 2009 and 2010 is not subject to recapture if the buyers remain in the house for three years after the purchase date.

Filers can still, through the end of 2012, exclude up to $2 million of debt forgiveness on their primary home for debt that was used to purchase, construct, or improve. The tax basis of the home drops by the amount excluded from gross income. Discharges for insolvency, bankruptcy, or farm or business indebtedness may also qualify.

Gain of up to $500,000 on the sale of a principal residence by a couple remains exempt from tax. For individuals, $250,000. Unmarried co-owners of a house each can exclude $250,000 if they meet the other requirements. Surviving spouses have two years following a spouse's death to sell a primary home and claim the $500,000 exclusion. A taxpayer who owned and used the property as a principal residence for a cumulative two years during the five years preceding the sale can claim this exclusion once in any two-year period, for any number of periods. To qualify for a full exclusion, either spouse can meet the ownership requirement but both must meet the use requirement. A person who acquires a principal residence in a like-kind exchange must own the property for at least five years in order to qualify for the home-sale exclusion.

If your gains are below the exemption amounts, you won't have to keep records and account for the gains at tax time; if above those amounts, a 15% capital gains tax may apply (through 2012). Homeowners with potential gains larger than the excludable amounts should keep excellent records of all houses they owned so as to reduce their gains by the amount of all eligible improvements.

Sales due to job changes, bad health, or unforeseen circumstances may get partial relief even if the two-year use and residency tests aren't met. You can apply these rules retroactively to sales in which you didn't claim eligible relief.

## Home Loans

Mortgage points paid on the purchase of a main residence are fully deductible whether paid in cash or financed over the life of the loan, so long as the cash down payment at least equals the cost of the points. You can deduct points on a refinanced loan evenly over the term of the loan. Refinancing the loan for a second time triggers the deduction of the remaining balance of points from the last refinancing. If you sell a residence while amortizing the points, any points not yet deducted are written off in full. If you use some of the refinancing proceeds to fix up your principal home, a portion of the points is deductible up front. State and local transfer taxes on a house purchase are not deductible but can be added to the tax basis and reduce the realized gain when you sell the house.

Pulling out cash in a home refinancing can create AMT problems, because if the mortgage balance increases when you're refinancing a primary residence or a second home, interest on the excess portion is added back to income under the AMT. (Exception: when the extra proceeds are used to improve a first or second home.)

Interest on the first $1,000,000 of home acquisition debt (to buy, build, or substantially improve a main or second residence) is deductible. (For mortgages dated before Oct. 13, 1987, all interest is deductible.) Interest on a Home Equity loan up to $100,000 secured by a residence is deductible, with deductibility of amounts above that dependent on the use of the proceeds. If you borrow more than $1,000,000 to buy your primary home, the next $100,000 is deductible as home equity debt. Only home acquisition debt is deductible under the AMT; high home equity debt might trigger that tax.

## Keep in Mind

- You can tap an IRA (penalty-free but not tax-free) for up to $10,000 to buy a first home. You can tap a 401(k) only by borrowing from it.

- The time limits associated with tax-free exchanges of real estate are strictly enforced.
- If you tapped IRAs for a failed first-home purchase, you have 120 days to roll the money back to an IRA without tax or penalty—twice the time allowed for a standard IRA distribution. It's treated as a rollover, and only one is allowed for each IRA per year.
- The property tax on your home depends on the valuation. Big swings in real estate prices may put valuations out of sync with actual values.
- If your estate is worth more than the $5,120,000 estate tax exemption, you might shrink its value by encumbering your home with a "reverse mortgage," trading equity for current cash flow that is not taxable and doesn't affect Social Security benefits. If the lender is your child, you get regular payments of cash (or a lump sum) while the child gets the tax benefit of depreciation on the real estate. Depreciated real estate will not fully qualify for the lowest tax on gains, however.
- The tax code allows equity-sharing in which an investor (such as a parent) makes a down payment on a house while the resident (e.g., the child) pays the mortgage, taxes, and maintenance. The investor could get depreciation deductions, plus part ownership of a residence that may appreciate. The resident might get deductions for part of the mortgage interest and property taxes and eventual 100% ownership.

## Moving Expenses

Certain costs of moving household goods are an "above-the-line" deduction from gross income: you get this benefit even if you don't itemize. The only deductible moving costs are those for a professional mover, rented moving van, moving a mobile home, and travel and lodging en route, and these only if the new job is 50 miles farther than the old job from the old house. (If the mover had no full-time pre-move job, the new job must be at least 50 miles from the old house.) There are requirements for periods of work after the move. The nondeductible expenses of moving can be large, so bargain with your employer for reimbursement of as many of these as possible. Reimbursements to cover moving expenses that are not "qualified" are reportable as income, so try to get the taxes reimbursed as well. The standard mileage rate for moving is 23¢. If you move to a new state, you will likely owe income tax in both states. Consult with your tax advisor for proper allocation of your income.

## Rental Investments

A rental activity in which the payment is for use of tangible property is "passive." Losses from this type of activity can offset only gains from such activities, including profits from sales of the properties. Losses unusable this year can be carried forward to years when you have passive-activity income. The only other way to use suspended losses is to dispose of the entire activity. The depreciation period for nonresidential real property is 39 years for most property placed in service after May 12, 1993. That for residential rental property is 27½ years.

Exception: If you "actively" participate in renting real estate (i.e., you are at least a 10%-owner and are deeply involved in its operation), you can deduct up to $25,000 from your nonpassive income in rental real estate losses.


*New York State Flag*

**The flag in use today is a modern version of a Revolutionary War flag. The state coat of arms, which was adopted in 1778, sits on a blue background. The goddess Liberty stands to the left. At her feet is a discarded crown, representing freedom from England at the end of the revolutionary war. On the right is the goddess, Justice, wearing a blindfold and carrying the scales of justice. The state motto "Excelsior," meaning "ever upward," appears on a white ribbon expressing the idea of reaching upward to higher goals.**

The deduction is reduced by $1 for every $2 AGI exceeds $100,000 (joint returns). Losses from fire, storm, theft, or such calamities don't count toward the $25,000 limit, nor is gain from the insurance proceeds passive income. Separate filers can't take this loss deduction unless the couple lived apart for the entire tax year; otherwise, the landlord must spend over half his or her time materially participating in realty and put in more than 750 hours per year to deduct losses.

If your vacation home qualifies as a rental property, you can deduct up to $25,000 of rental expenses in excess of rental income. If you're close to the limit, consider reducing your time at the home, to take a full deduction. If you expect to qualify for the full deduction next year, postpone repair and maintenance expenses.

Realty pros can deduct rental losses from nonpassive income if they fill these requirements and spend 100 hours (500 in some situations) in rental activities. (Only one spouse in a couple needs to qualify.) Spouses who jointly operate rental real estate can elect joint venture status without subjecting themselves to SECA tax on the rental income. They can elect not to file a partnership return to report their shares of rental income. Owners of LLCs don't qualify. Closely-held companies may qualify if more than half their annual receipts is from real estate. Real estate pros can elect to treat multiple properties as a single entity.

Repairs to a rental property can be deducted for the year when made, but improvements must be depreciated over many years. The rules distinguishing one from the other can be complicated. To keep these types of work separate, do them at different times and get them billed separately, if possible by different contractors. If you convert to rental use a house that has lost value since you bought it, only the drop in value after the conversion will be deductible when you sell.

## Vacation Homes

The tax details of owning a vacation home can be complex so guidance from your tax advisor can help you take advantage of the benefits available to you. Basically, if you rent your vacation home for less than 15 days a year, the rental income is tax-free and you can deduct interest and property tax payments (and casualty losses) on the house, but not rental expenses, for the entire year. If you rent your vacation home out for 15 days or more during the year, and personal use does not exceed the larger of 14 days or 10% of the rental days, you must include the rent in income. Days spent maintaining and repairing the home don't count as personal use, even if your kids are with you. There is no deduction for depreciation, utilities, or repairs unless interest and taxes allocated to rental are less than rental income. If you occupy the house for more time, this is use of a personal residence and not part of a passive activity. Use by you, your family or relatives (even if they pay fair rent—except when the house is their main home) is "personal."

There's a restriction on converting a vacation home to a primary residence and later sold: a portion of any profit will be subject to tax, based on the time (after 2008) when the house was a second home or a rental to the total time you owned it. The tightening doesn't apply if you make a primary home a vacation home.

## Home Offices

Expenses of a home office are potentially deductible if you have no other fixed location where you perform administrative or managerial activities. A home office must be your principal place of business for your most important business functions, a place where you regularly meet with customers, or located in a separate structure on your property. It must also be used regularly and exclusively for business. Self-employeds gain more from a home office deduction than employees limited by the 2%-of-AGI floor. If you are an employee, it must be necessary for the employer's business.

You cannot deduct more than the net income from the business. You must first deduct from the income the business portion of your mortgage interest and real estate taxes and business expenses not related to the home office. Only then do you deduct home-office expenses and depreciation on the business portion of your house. You can carry any excess over to next year. In a sale of your home, gain on the office part may be taxable and depreciation may have to be recaptured.

# Estate Planning

## What's New For 2012

- The Estate Tax exemption rises to $5,120,000 in 2012 and the maximum rate remains 35%. Heirs can use the date-of-death valuation ("step-up basis") for assets inherited. If a spouse dies, any unused exemption can go to the other spouse for use at death.
- The lifetime gift tax exemption also rises to $5,120,000. Up to $139,000 in gifts to an alien spouse are excludable in 2012. There's no change in the annual gift tax exclusion: it remains $13,000.
- The Generation Skipping Tax (GST) for 2012 has an exemption amount of $5,120,000 while the rate remains 35%.
- The five-year deferral, for installment payments of estate tax when a closely-held business makes up over 35% of an estate, continues. For estates of decedents dying in 2012, the 2% interest rate applies on up to $486,500 in deferrals.
- The special use valuation of qualifying real property in 2012 rises to $1,040,000. The "two percent portion" for calculating interest is $1,390,000.

The tax laws for gifts and estates could change dramatically in 2013 making estate planning challenging to say the least. The estate and gift tax exemption amounts are scheduled to drop to $1,000,000 with rates as high as 55%. Whether this drop occurs depends on Congress: it could choose to extend the current exemption amounts and rates, pass a compromise bill, or do nothing. The current exemption of $5,120,000 affects far fewer people than the possible $1,000,000 exemption amount next year. Planning strategies should be in place well in advance so you can be prepared for all eventualities. Consult with your advisor now.

In 2012, couples are entitled to two exemptions ($5,120,000 each), and any of a deceased spouse's exemption that is unused passes to the other (for those who die through 2012). Exemption portability means in effect the exemption amount for a couple is now $10,240,000 and certain traditional strategies become unnecessary. Also, under the "marital deduction," one spouse can pass (outright or in trust) an unlimited amount to the other without tax. The assets are taxed when the surviving spouse passes them on to heirs. If one spouse passes everything to the other, they get only one exemption. To secure two exemptions, they can set up two asset pools: one pool, valued at the exemption amount, passes to children or others; the remaining assets are passed under the marital deduction to the surviving spouse, who can later use another exemption amount. Portability may make this roundabout method unnecessary. Yet in other cases trusts such as an "AB" or "by-pass trust" may still be desired. Note that the assets in a surviving spouse's estate will get a step-up in basis when he or she dies, whereas the value of assets in a by-pass trust are fixed when the trust starts. The executor who handles the first deceased's estate must explicitly transfer the unused exemption to the survivor within a certain period. Portability does not apply to the generation-skipping tax.

To reduce the size of your estate, transfer assets early through planned gifts and other devices. Passing your home on to your kids takes advantage of the housing slump. A personal residence trust may still be worth considering. You can live in the house during the trust period—usually 10 to 20 years—but the estate tax value of the home is fixed as of the trust's starting date. Even if you outlive the trust, the home's value is out of your estate. Estates can get a six month filing extension but only once. There is no extension, however, for any taxes due.

It's easy to misjudge your estate's size. It includes home equity, retirement accounts, foreign assets, and proceeds from life insurance. Many of your assets could pass outside your will through IRAs, qualified plans, and insurance proceeds, so a precise designation of beneficiaries may be your most crucial planning issue.

As baby boomers transfer assets to children, the latter must decide how to receive them. One method is an "inheritor's trust" to receive even small inheritances. Trust income, however, is taxed as high as 35% for income above $11,650. Get help from your advisor.

If you are in line to inherit part or all of an estate, consider these other ways to save more of the assets:

- If the inheritance will put your own estate over the exemption amount, you can renounce your share through a disclaimer and pass it on directly to later generations.

- You can value an estate's assets either as of the date of death or six months later. (The estate tax return is due nine months after the death.) Check the value on both dates and try to use what date produces the least estate tax.
- The basis of property you inherit is stepped up to its market value on the date of death. If you later sell the property at a loss, you can deduct the loss on your return.
- If the estate's executor is a beneficiary, he/she should collect executor's fees and deduct them from the estate. The executor's income tax rate may be far lower than the tax rate on the estate.

An executor must file an income tax return for the decedent on April 15 following the year of death even if no federal estate tax is due. Executors are liable for any unpaid estate tax and income tax, and often wait to distribute until the IRS agrees on its tax status. A joint return will cover part of a year for the deceased but a whole year for a surviving spouse, who can make tax-saving moves in the meantime. Examples: • Realize losses or gains to offset those of the deceased. • Deduct the decedent's medical expenses, if an appropriate election is made on the return. • One of an executor's main roles is to determine the market value of all the estate's assets on the date of the death, so that the heirs when they later sell the assets can calculate the stepped-up basis.

## Other Planning Considerations

- When a document conveying power of attorney is silent about making gifts, huge problems can result if the person holding the power tries to make gifts. The power to make gifts must be explicitly authorized by the document.
- Be careful about holding joint bank, brokerage or mutual fund accounts. Upon your death the joint owner will inherit the account no matter what your will says.
- A non-citizen spouse is not eligible for the marital deduction, but if the estate is less than the exemption amount, that doesn't matter. Professional counsel could help find possible solutions.
- Roth IRAs and 529 plans can be useful in estate planning, and 401(k) Roths may be even better. Don't neglect 529 college savings plans. Withdrawals are tax-free if used for authorized purposes. Contributions may not be subject to gift tax, are usually excluded from the donor's estate, and may be deductible on the state return. You might be able to shelter as much as $65,000 (or $130,000 with your spouse) from gift tax.
- If you inherit an IRA, ask the estate executor for any Form 8606s that were attached which track non-deductible contributions. The IRS exacts a penalty for failure to file them.

## Gifts and Gift Tax

The lifetime exemption amount for the gift tax is now $5,120,000. The aging of baby boomers and their parents makes gift-giving important for tax saving. Each person can give $13,000 free of gift tax this year to each of an unlimited number of people, or a couple can give away $26,000 if both spouses agree. This exclusion is in addition to the unified credit. Up to $139,000 of gifts to an alien spouse are excludable. Gifts from foreign persons have to be

*Colorado and Utah State Tree – Blue Spruce*

**The blue spruce tree is native to the Rocky Mountain area but is widely cultivated. Its distinctive deep silver blue needles derive their color from a powdery waxy bloom on their surfaces. These slow to medium growing trees mature at a height of 50–75 feet. Early American Indians tapped the frankincense, a gum-like resin, from the trees when they were cut. Colorado named the Blue Spruce its state tree in 1939; Utah in 1933.**

reported if they exceed $14,723 for the year. Gifts made by check must be deposited by the donee before year-end to qualify as a 2012 gift. A certified check will count toward this year's limit regardless of when deposited. Gifts of securities must be endorsed and delivered by year-end. Gifts paid to schools for tuition or to health-care providers for medical expenses or for medical insurance on behalf of a donee are not subject to the $13,000/$26,000 limit. Prepayments of tuition paid directly to a school get an unlimited exclusion, and reduce the donor's estate because they are not taxable gifts.

Recipients of gifts who are in lower brackets will pay lower income tax on the earnings of some assets, and any gain in donated property stays out of your estate. The best gifts are those with the highest chance of appreciation. If the assets are still in your estate when you die, their tax basis is stepped up but they could be subject to estate tax far higher than the capital gains rate. There can be good reasons to make gifts even above the tax-free limits; for example, if they would reduce your heirs' estate tax. If you exceed the $13,000/$26,000 limit, you must report the excess to the IRS (on Form 709) including transfers of real estate for little or no payment—usually to family—if they exceed the limit. You pay no gift tax, however, if you haven't used up your lifetime exemption, and many never will. Neglecting to attach past gift tax returns (709s) to an estate tax return is an audit trigger, which the IRS is vigorously pursuing. Taxable gifts are added back to the estate, and use of the lifetime gift tax exemption reduces the estate tax exemption by that amount.

## Beneficiary Designations

Your provisions in a will do not generally supersede or trump the beneficiary designations you make in trust agreements, insurance policies, bonds, bank accounts, and retirement and profit-sharing plans, which can represent most of an estate. These usually trump a will, so keep them up to date. Better, make sure your will and such designations agree. Don't name your child as beneficiary if your spouse will need the money. These are crucial issues.

## Trusts

You might consider putting assets in trust, with a trustee (possibly you) to administer and manage the trust's assets. Trusts have many features and variations: e.g., they can be established before or after you die. If you set up a trust now and make it irrevocable, the assets you donate to it are out of your estate. Assets transferred into a trust after you die may be subject to probate. Some trusts used in estate planning include:

- By-pass trusts ensure that both spouses use their exemptions if the estate is worth more than $5,120,000. This kind of trust became less useful when exemptions became portable.
- QTIPS (Qualified Terminable Interest Property) allow the income from the assets to go to the surviving spouse until his/her death, then the assets can pass to the children. A QTIP must give the surviving spouse a non-transferable income interest for life in all its assets, which will be included in the survivor's estate but could be distributed to others as the original donor directs. A QTIP is a way to provide income to a new spouse while making sure your assets eventually go to your kids from an earlier marriage.
- Living trusts let assets in the trust avoid probate and go directly to the heirs. Living trusts bypass probate but don't affect estate tax liability.
- "Wealth-replacement trusts" consist of a charitable remainder trust and an irrevocable trust holding a life insurance policy. The charitable trust can sell low-dividend stock you donate to it without paying tax on the appreciation as you would if you sold it. The trust can reinvest the proceeds and generate a larger income stream for the beneficiary. When you die, the assets in the trust go to charity while the insurance proceeds go to your heirs free of tax.

Instead of setting up a life-insurance trust, you could have one of your children buy a policy on your life, or you could transfer an existing policy to one of them—so long as you don't die in the next three years. As a gift, the transfer will use up some of your $5,120,000 lifetime gift tax exemption and reduce how much you can leave at death tax-free. You can give your child enough money each year to pay the premiums (which may not exceed the tax-free gift limit).

# Business

## What's New For 2012

- Note: these have expired for 2012 but most of them will likely be reinstated before year-end: a return of the $500,000 expensing limit; 100% bonus depreciation; 15 year recovery period for certain assets; the R&D credit; the work opportunity tax credit for non-veteran groups.
- The Section 179 expensing limit for 2012 has dropped to $139,000, available until $560,000 in qualifying new and used assets are placed in service. (See note above.) Computer software is eligible through 2012. Section 179 no longer includes qualified real property.
- Businesses of any size can claim 50% bonus depreciation on qualified new assets put in service in 2012. Generally, Section 179 is taken first and then bonus depreciation.
- The tax rate for the employee part of Social Security payroll tax remains 4.2%. Self-employeds benefit as well: their SECA tax rate falls to 13.3% on the first $110,100 of earnings.
- Employers who file 250 or more W-2s must report the value of the employee's health coverage on the W-2. Amounts do not affect employee taxes. In 2013, smaller firms may also need to report these figures.
- The IRS is requiring corporations with assets that exceed $50 million to flag uncertain tax positions on their returns. Foreign and state tax authorities also will be greatly interested.
- The per-diems for high-cost areas have risen to $242 per day; elsewhere, $163. Meals and incidentals only remained unchanged: high-cost areas, $65 per day; elsewhere, $52. Self-employeds on travel can use these rates for meals and incidentals only and must substantiate their lodging expenses separately.
- Businesses and qualified "tax-exempt" organizations that hire unemployed veterans can claim a credit. Qualified veterans hired from November 22, 2011, through 2012 are eligible. The credit amount is dependent on how long the veteran has been unemployed, hours worked, first-year wages, and whether he/she is disabled.
- Rules on deducting materials and supplies costing $100 or less have been eased. Larger items may qualify in some cases.
- There are new rules for determining whether costs are deductible repairs or improvements that can be capitalized.
- Taxpayers may deduct up to $5,000 in qualified business start-up expenses in 2012, but the deduction is reduced by the amount of total start-up costs that exceeds $50,000.
- Energy credits for improvements on commercial buildings may be available. The amount of the credit is based on the reduction in energy use and the square footage of the space.
- The 30% credit for businesses installing qualified solar energy property is good through 2016.
- A credit for providing health-care coverage to employees continues to be available for some small businesses. (See page 29.)


*California State Flag*

**This historic Bear Flag was raised at Sonoma on June 14, 1846, by a small band of settlers in revolt against Mexican rule. They issued a proclamation declaring California to be a Republic independent of Mexico. This uprising became known as the Bear Flag Revolt name after the hastily designed flag used in the revolt. The grizzly bear on the flag was a symbol of great strength while the star made reference to the Lone Star of Texas. The flag was adopted as the official state flag in 1911.**

# Corporate Structures and Taxes

Businesses can operate under a variety of structures. Choosing the right structure at the onset is important because changing the business structure later could have tax consequences. Although C Corporations pay only 15% on taxable income of less than $50,000, individual tax rates can be more favorable in many cases. Consequently, operating as a sole proprietorship, partnership, or S Corporation can make sense. Consult with your advisor about which structure is the best for your needs.

## C Corporation Tax Rates

| | |
|---|---|
| $0-50,000 | 15% |
| $50,001-75,000 | 25% |
| $75,001-100,000 | 34% |
| $100,001-335,000 | 39% |
| $335,001-10 million | 34% |
| $10 million + | 35% |

The first $50,000 of taxable income is taxed at 15%, the next $25,000 at 25%, etc. An extra 3% surtax applies to income between $15 million and $18 1/3 million. A Personal Service Corp. pays 35% tax on all income.

| | Definition | Taxes | Liability |
|---|---|---|---|
| Sole Proprietorship | Someone who owns an unincorporated business by himself/herself | Profits/losses included on owner's individual tax return | Owner generally not protected |
| Partnership | Relationship between two or more persons who join to operate business or trade | Profits/losses pass through to each partner's individual tax return | General partners: unlimited<br>Limited partners: to the extent of the investment |
| Limited Liability Company (LLC) | Structure allowed by state statute; not a classification for federal tax purposes | LLC must file corporation, partnership or sole proprietorship federal tax return | Limited |
| S Corporation | Corporation that passes income, losses, deductions and credits through to shareholders | Because of pass through to shareholders' tax returns, double taxation on corporate income avoided | Limited for shareholders |
| C Corporation | Entity that conducts business, realizes net income or loss, pays taxes and distributes dividends | Taxed on earnings; shareholders taxed on dividends received | Limited for shareholders |

# Business Credits and Deductions

Taking advantage of the numerous credits and deductions available to businesses can translate into substantial tax savings. Each year new credits are enacted while others may disappear. Your advisor can help pinpoint which credits apply to your business. The "What's New for 2012" section at the beginning of this chapter outlines some of the new or revised credits for 2012. Take note: credits that expired at the end of last year, such as the R&D credit, may be retroactively reinstated before year-end.

To be deductions, business expenses must be "ordinary" (common) and "necessary" (helpful and appropriate) in your type of business. You can increase your deductions by paying attention to what you do near year-end. For example, buy supplies before year-end and accelerate repairs into this year; reduce or defer year-end income; delay shipping until next year; make sales on consignment or approval. For cash method businesses, defer billing for services until the next month or quarter and advance into 2012 payments you expect to make in 2013 for expenses such as maintenance, office supplies, and advertising.

Keep in mind that the deduction for business meals and entertainment is 50% of eligible expenses, with receipts required for expenditures above $75. Documentation should be detailed for each expense, including the place, people in attendance, and the business focus of the discussion. You need an itemized bill for lodging; a credit card receipt is not enough.

During the holidays, you may want to hold a company party. Limits on deductions for meals and entertainment don't apply if the party isn't limited to the highly-compensated. Another idea: instead of buying your client a meal (only 50% deductible), give a gift certificate (100% deductible) to his or her favorite restaurant.

## Vehicles

The standard mileage rate for business driving in 2012 is 55.5¢ per mile, and can be used for hired vehicles such as taxis. It's also usable for leased cars and for valuing an employee's use of a company car, but not for more than two cars used alternately for business or more than four vehicles used simultaneously (such as a fleet). If you use the mileage rate, parking and tolls are expenses but not fuel, insurance, repairs, and other out-of-pocket costs. The allowance can't be used if you claimed depreciation or expensing on the vehicle. Employees have income of 55.5¢ per mile for personal use of non-luxury company cars. The 2012 maximum fair market value (FMV) for employer-provided vehicles using the cents-per-mile valuation rule: $15,900 passenger auto; $16,700 truck or van.

When you depreciate a business vehicle, you must indicate what percentage of the annual use was for business. Claiming 100% business usage can be an audit flag. Make sure your records for business use of a car are thorough or the deduction could be disallowed.

Depreciation Schedule Luxury Vehicles Placed in Service 2012

| | CARS | LIGHT TRUCKS/VANS |
|---|---|---|
| First Year | $3,160* | $3,360* |
| Second Year | $5,100 | $5,300 |
| Third Year | $3,050 | $3,150 |
| Fourth Year + | $1,875 | $1,875 |

*plus another $8,000 for vehicles that qualify for the "bonus depreciation"

## Employer-Provided Benefits

Health Care – Small employers that pay at least half of the premiums for employee health-care coverage may be eligible for a tax credit. An employer qualifies for some credit if it has no more than 25 "full-time equivalent" (FTE) employees, and pays them annual wages averaging no more than $50,000. The full 35% credit is good only for employers with 10 or fewer FTEs paid annual average wages of less than $25,000. Tax-exempts that qualify get a credit of 25%. Household employers get the credit for coverage to a nanny. The credit is scheduled to be available for up to six years: 2010 through 2013 and any two years thereafter. The credit reduces the company's deduction for medical premiums. The Small Business Health Care Tax Credit page at www.IRS.gov can help you determine if you qualify for the credit.

Health-insurance policies for self-employeds and 2% or more owners of S Corporations can be in the owner's or the company's name. If the policy is in the owner's name, the company must reimburse the shareholder in order for the premiums to be deductible.  A sole proprietor whose spouse works for the company can provide coverage for employees, spouses, and dependents. The owner's coverage then is included with the spouse's: a business deduction and tax-free to the employees and spouses.

Child Care – Employers may get a credit through 2012 of 25% of qualified expenses paid for employee child care, plus 10% of expenses for child-care resource and referral services. There is a $150,000 annual cap on costs.

Transportation Benefits – The allowance for mass transit drops to $125 in 2012 and the allowance for parking rises to $240. The benefit for bicycle commuters stays at $20 per month when a bike is used for a substantial part of the commute.

Flex plans – Employers with flex plans: caution. The full amount an employee elects to have taken out of pay for the year must be available at the start of the year. The employer is liable for any amount needed that has not yet been paid in, and the employee need not pay it back. The IRS says FSAs are equivalent to insurance.

## Qualified Retirement Plans

The IRS has a guide to retirement plans for small businesses. Called the Retirement Plans Navigator, it compares contribution limits, filing rules and operational requirements for the various types.

Firms with fewer than 500 employees can offer a combined 401(k) and defined benefit pension plan, called the DB(k), which must pay a benefit equal to 1% of final average pay for each year of service, for up to 20 years.

Enrollment must be automatic and participants must defer 4% of their pay unless they opt out, while the firm must match at least 2% of pay. The DB(k) may eventually become available to larger companies.

Firms can offer Roth 401(k)s but must amend earlier 401(k)s to add this feature. The IRS has a model amendment firms can use. Contributions are from after-tax dollars, but after five years and age 59½ all withdrawals are tax free. Contribution limits are much higher for Roth 401(k)s than for Roth IRAs. Disadvantages of Roth 401(k)s: non-discrimination and minimum-payout (after age 70½) rules apply, and employer matches may not be tax favored. So contributions to regular and Roth 401(k)s should be segregated. Employers must permit non-spousal IRA rollovers.

Small employers may be eligible for a credit for the start-up costs for a pension plan. First consider a Simplified Employee Pension plan (SEP) or a SIMPLE. With a SEP you contribute directly to employees' IRAs and avoid much paperwork and reports to the IRS. You must cover all eligible employees and you can't make matching contributions. An employer's contribution can't exceed the lesser of 1) 25% of the employee's pay up to a maximum of $250,000, or 2) $50,000.

Only employees who earn $5,000 or more need be covered by a SIMPLE. Employers must make contributions of either 2% of pay or match employee contributions up to 3% of salary, and all eligible employees must be covered. If you have low amounts of self-employment income (say, $25,000 or less), a SIMPLE may be just right for you; otherwise, consider a 401(k) or SEP.

Employers must put small ($5,000 or less) payouts from retirement plans into an IRA if a departing employee fails to specify a payout option. If this is done prudently, the employer is not liable for subsequent losses.

## Compensation

C Corporations – If you own a small C Corporation in a lower bracket, you might save on taxes by taking out more as low-taxed dividends and less as salary. (Not in Personal Service Corporations—they pay a flat 35% rate.) If the IRS thinks your C Corp salary is too high, it may reclassify some of it as a dividend. Profitable C Corps should pay at least some dividends each year. The higher the salary the company must pay you each year, the less likely is the IRS to say you're using salary to reduce profits. Make clear that bonuses are tied to performance.

S Corporations – Owners should pay themselves a reasonable salary. The IRS is ferreting out those who don't. If the IRS thinks you take too little in salary from an S Corp, it may reclassify some profits as compensation, on which you'll have to pay payroll taxes.

Deferred compensation plans can deduct payments of benefits to charities, whether or not the benefits are taxable to the payees. (Charities are often contingent beneficiaries if a primary beneficiary dies or disclaims his or her share.)

Employees with leave or vacation pay they are about to forfeit can use the vacation days by year-end or have the cash equivalent placed in their 401(k) accounts. Because they are not allowed to receive cash for it, the IRS says the contributions are free of income and FICA taxes. Make sure highly-paids don't have a disproportionate percentage of extra contributions. When employers contribute the dollar value of unused sick leave for retiring employees and buy additional medical coverage for them, the benefits are tax free so long as the workers cannot elect to take cash instead.

## Miscellaneous

If your business owes the IRS back payroll taxes, pay current tax liabilities before overdue taxes. You'll pay a new penalty if you miss current payments as well, and the IRS usually will let a business paying its current liabilities stay open.

If your C Corporation reports a loss for 2012, it must pay 100% of its year 2013 tax bill through estimated payments to avoid an underpayment penalty. If it owes $1 in tax for 2012, it need pay only $1 in estimated taxes for 2013. If the company is close to breakeven, try to achieve a small profit.

If you buy more than 40% of your 2012 asset purchases (excluding buildings) in the last quarter, regular depreciation on all 2012 purchases is figured on the mid-quarter basis, so assets bought near year-end get less current year depreciation. This is a complex area; seek professional advice.

In many cases owners of Limited Liability Companies will owe SECA (self-employment) taxes if they are personally liable for the LLC's debts, can sign contracts for the firm, work for an LLC that provides professional services, or work more than 500 hours a year. Talk to your advisor about your situation.

Be certain that assets are ready for business use before year-end or they may not qualify for this year's expensing.

## Farmers

Ranchers in 32 states gained more time to defer profit on sales made in 2007 because of severe drought: they have until the end of 2012 to defer gain by buying replacement animals. New farm machinery and some equipment can be written off over six years. The amount of a farm loss that can offset non-farm income for farmers who receive CCC loans or federal farm payments is capped at $300,000 or the farmer's five-year average net farm income. Excess losses are carried over.

Qualified farmers and ranchers can now deduct up to 100% of their AGI for conservation easements and the number of years over which a donor can take deductions increases to 16 years.

"Conservation reserve" payments (to keep tillable land idle) are subject to SECA tax as self-employment income (and might cause the farmer to lose Social Security benefits even if the farmer is retired or not engaged in farming). Cost-sharing payments to farmers who adopt conservationist practices are free of income and SECA taxes.

## Tips for Small Business

Be sure to give 1099 forms to workers you claim are contractors. The IRS is looking for misclassifications of workers as contractors (and violations of fringe benefit and executive pay rules). Firms that voluntarily correct misclassifications may be allowed to pay lower penalties. Not so if already under audit.

Even small businesses may qualify for the "manufacturing deduction" for gross receipts from the sale, lease or rental of tangible personal property made in the U.S. The deduction remains 9% of qualifying income, but is limited to 50% of the W-2 wages (no independent contractors) for qualified production activities during the year.

### Adding Spouse to Payroll - 2012

| | | |
|---|---|---|
| Without spouse on payroll | Eligible owner's income | $180,000 |
| | Spouse | -0- |
| | Family Income | $180,000 |
| | 401(k) deferral (1) | $17,000 |
| | Age 50 catch-up (1) | $5,500 |
| | Total 401(k) deferrals | $22,500 |
| With spouse on payroll | Eligible owner's income | $155,000 |
| | Spouse | $25,000 |
| | Family Income | $180,000 |
| | 401(k) deferral (2) | $34,000 |
| | Age 50 catch-up (2) | $11,000 |
| | Total 401(k) deferrals | $45,000 |

Business owners who want to set aside as much as they can for retirement may want to consider adding their spouse to the payroll before year-end. The extra FICA tax paid on the income shifted to the spouse is more than offset by the additional 401(k) contributions.

Extra FICA tax paid on $25,000 income to spouse: (13.3% Co & employee) $3,325

Many small businesses are legally obliged to make their premises accessible to the disabled. Many renovation charges qualify for the disabled access credit, which reduces the business's tax bill dollar for dollar. The first $250 of renovation expenses is excluded; then there's a 50% credit for the first $10,000 of qualified expenses, for a maximum credit of $5,000.

A married couple who jointly owns an unincorporated business can elect not to be treated as a partnership, and instead file tax returns as two sole proprietors.

Sole proprietors can include wages from another career in the income for their side business, so they might expense new equipment even if the business is in the red. Partnerships and S Corps can expense new equipment under Section 179 only to the extent they have taxable income, not to show a loss. Unused Section 179 expense can be carried over to future years.

# Index

## 2012 Income Tax Rates

| | Taxable Income | Tax Rate (%) | Total Tax |
|---|---|---|---|
| Married/Filing Jointly | $ 0 - 17,400 | 10 | 10% of the amount over $0 |
| | 17,401 - 70,700 | 15 | $ 1,740 + 15% of the amount over $17,400 |
| | 70,701 - 142,700 | 25 | 9,735 + 25% of the amount over $70,700 |
| | 142,701 - 217,450 | 28 | 27,735 + 28% of the amount over $142,700 |
| | 217,451 - 388,350 | 33 | 48,665 + 33% of the amount over $217,450 |
| | 388,351 - ∞ | 35 | 105,062 + 35% of the amount over $388,350 |
| Head of Household | $ 0 - 12,400 | 10 | 10% of the amount over $0 |
| | 12,401 - 47,350 | 15 | $ 1,240 + 15% of the amount over $12,400 |
| | 47,351 - 122,300 | 25 | 6,482.50 + 25% of the amount over $47,350 |
| | 122,301 - 198,050 | 28 | 25,220 + 28% of the amount over $122,300 |
| | 198,051 - 388,350 | 33 | 46,430 + 33% of the amount over $198,050 |
| | 388,351 - ∞ | 35 | 109,229 + 35% of the amount over $388,350 |
| Single | $ 0 - 8,700 | 10 | 10% of the amount over $0 |
| | 8,701 - 35,350 | 15 | $ 870 + 15% of the amount over $8,700 |
| | 35,351 - 85,650 | 25 | 4,867.50 + 25% of the amount over $35,350 |
| | 85,651 - 178,650 | 28 | 17,442.50 + 28% of the amount over $85,650 |
| | 178,651 - 388,350 | 33 | 43,482.50 + 33% of the amount over $178,650 |
| | 388,351 - ∞ | 35 | 112,683.50 + 35% of the amount over $388,350 |
| Married/Filing Separately | $ 0 - 8,700 | 10 | 10% of the amount over $0 |
| | 8,701 - 35,350 | 15 | $ 870 + 15% of the amount over $8,700 |
| | 35,351 - 71,350 | 25 | 4,867.50 + 25% of the amount over $35,350 |
| | 71,351 - 108,725 | 28 | 13,867.50 + 28% of the amount over $71,350 |
| | 108,726 - 194,175 | 33 | 24,332.50 + 33% of the amount over $108,725 |
| | 194,176 - ∞ | 35 | 52,531 + 35% of the amount over $194,175 |
| Estates & Trusts | $ 0 - 2,400 | 15 | 15% of the amount over $0 |
| | 2,401 - 5,600 | 25 | $ 360 + 25% of the amount over $2,400 |
| | 5,601 - 8,500 | 28 | 1,160 + 28% of the amount over $5,600 |
| | 8,501 - 11,650 | 33 | 1,972 + 33% of the amount over $8,500 |
| | 11,651 - ∞ | 35 | 3,011.50 + 35% of the amount over $11,650 |

**Exemption Per Person: $3,800**

## 2012 Standard Deduction

| | Under Age 65 | Age 65 and older |
|---|---|---|
| **Married/Filing Jointly** | $11,900 | $13,050 (one spouse 65 or older)<br>14,200 (both spouses 65 or older) |
| **Head of Household** | 8,700 | 10,150 |
| **Single** | 5,950 | 7,400 |
| **Married/Filing Separately** | 5,950 | 7,100 |

Blind taxpayers get an extra $1,150 if married; $1,450 if single or head of household.

Standard Deduction for an individual claimed as a dependent cannot exceed the greater of $950 or the dependent's earned income + $300, up to the normal Standard Deduction. If one spouse filing separately itemizes, the other gets no Standard Deduction.

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