2012 YEAR-END tax planning GUIDE

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2012

According to the IRS, from 2001 to 2010, approximately 4,430 changes were made to the tax code, an average of more than one a day. In 2010 alone, an estimated 579 changes were made. And more changes are in store that may open — or close — the door to opportunities to reduce income taxes.

Year-End Tax Planning for 2012 gives you tips on how to take advantage of favorable federal tax law provisions and compensate for unfavorable ones — tips that you may discover can help you reduce your 2012 income-tax liability considerably. With our ever-changing tax law, keeping up to date is important. In *Year-End Tax Planning for 2012*, we explain key aspects of the current tax law and how those rules may apply to your situation. We also look ahead at changes we may see in 2013 and later.

We urge you to begin planning soon — while you still have time to investigate the many opportunities available to reduce your 2012 taxes. Of course, your personal and business situations are unique. The strategies discussed in *Year-End Tax Planning for 2012* may or may not be appropriate for you. Be sure to secure professional tax advice before attempting to implement any of the ideas presented.

Strategies for INDIVIDUAL taxpayers

A good way to start your year-end tax planning is by taking a look at last year's individual income-tax return — Form 1040. You can use your 2011 information to help you assess your current tax situation and identify potential strategies for lowering your 2012 taxes.

FILING STATUS AND EXEMPTIONS

You need to know your filing status to determine your tax bracket (see table below), the extent to which certain phaseouts and limitations apply to you, and how large a standard deduction you may claim if you don't itemize deductions. Married couples generally receive more favorable tax treatment filing jointly, but not always. Depending on your respective itemized deductions (see page 8) and income, you could owe less tax by filing separately.

You can claim a personal exemption for yourself, your spouse, and for any qualified dependent. In 2012, each exemption you claim reduces your taxable income by $3,800.

2012 TAX RATES & TAXABLE INCOME BRACKETS

Rate (%)	Single	Head of household	Married filing jointly (& surviving spouses)	Married filing separately
10	$0 – 8,700	$0 – 12,400	$0 – 17,400	$0 – 8,700
15	$8,701 – 35,350	$12,401 – 47,350	$17,401 – 70,700	$8,701 – 35,350
25	$35,351 – 85,650	$47,351 – 122,300	$70,701 – 142,700	$35,351 – 71,350
28	$85,651 – 178,650	$122,301 – 198,050	$142,701 – 217,450	$71,351 – 108,725
33	$178,651 – 388,350	$198,051 – 388,350	$217,451 – 388,350	$108,726 – 194,175
35	Over $388,350	Over $388,350	Over $388,350	Over $194,175

Do you have a child in college? Check to be sure he or she still qualifies as your dependent. There are some very specific requirements. For example, your child must be younger than 24 as of year-end, be enrolled as a full-time student for some part of at least five calendar months during the year, and live with you for more than half the year (treating temporary absences from home due to education, illness, military service, and certain other special circumstances as time spent living with you). Also, your child cannot provide more than half of his or her own support.

INCOME

Form 1040 requires you to list all the income you received during the year from various sources. You can use the accompanying worksheet to estimate your 2012 income.

Weigh when to receive income

The year in which you receive income can make a difference in how much tax you'll pay on the income. If receiving income — from a bonus or sales commission, for example — would put you in a higher tax bracket, the traditional tax planning technique is to delay receiving that taxable income until after the end of the year if it's economically feasible. By delaying income, you also defer your taxes on that income.

You might delay income by:

- Asking your employer to postpone paying your year-end bonus or a late-year commission until after the first of the year.
- Investing excess cash in Treasury bills that don't mature until next year or in certificates of deposit that won't let you take out interest without penalty until 2013. In each case, all the interest earned would be reported on your 2013 return — to be filed in 2014.

But delaying income may not be the tactic to take in 2012. Unless Congress acts, the top four income tax rates in effect for 2012 — 25%, 28%, 33%, and 35% — will be replaced by the higher — 28%, 31%, 36%, and 39.6%, respectively — rates in effect prior to 2001. The 10% bracket will disappear altogether (the lowest bracket will be 15%), and the tax brackets will return to a configuration that will be less favorable to many taxpayers. The bottom line is that, absent further legislation, more of your income will be taxed at higher rates in 2013. So you might want to accelerate income into 2012, rather than deferring it to 2013, even though taxes will have to be paid earlier.

ESTIMATE YOUR 2012 INCOME	
Wages, salaries, tips, etc.	$
Interest and dividends	$
Business income (loss)	$
Farm income (loss)	$
Capital gain (loss)	$
Rents, royalties, partnerships, S corporations, trusts, etc.	$
Unemployment compensation	$
Alimony received	$
Taxable Social Security benefits	$
Taxable distributions from IRAs, pensions, and annuities	$
Taxable refunds of state and local income taxes	$
Other income	$
Total Estimated Income	**$**

TAX ALERT

In addition to higher income-tax rates in 2013, higher earners are also scheduled to pay an additional 0.9% Medicare tax on wages and self-employment income exceeding $250,000 for joint filers, $125,000 for married taxpayers filing separately, and $200,000 for other individual taxpayers.

Also starting in 2013, a new 3.8% Medicare tax will be imposed on taxpayers who have any amount of net investment income *and* modified adjusted gross (AGI) that is greater than:

- $200,000 (single; head of household)
- $250,000 (married filing jointly)
- $125,000 (married filing separately)

The 3.8% tax will apply to the lesser of net investment income or the amount of modified AGI exceeding the applicable threshold.

If you suspect your tax rate will be higher in 2013, see if you can:

- Arrange to receive a bonus or commission payment in 2012 rather than in 2013.
- Make a withdrawal from your traditional individual retirement account (IRA) earlier than planned, if you're over age 59½ or qualify for another exception to the 10% early withdrawal penalty.

Contribute more to an employer-sponsored retirement plan

One of your long-term financial targets may be a comfortable retirement. Larger pretax contributions to an employer's retirement savings plan in 2012 can help you hit that target and reduce the amount of taxable wages you have to report on your return. You'll save current taxes while you are putting aside money for your retirement.

ACTION ALERT

If your employer offers a retirement savings plan — such as a 401(k), 403(b), 457(b), or SIMPLE plan — take advantage of it and increase your contributions before year-end. Note that your plan may allow you to make additional catch-up contributions if you've reached age 50 and maximized your regular salary deferrals. Your contributions and investment earnings generally won't be taxed until you receive distributions from the plan.

RETIREMENT PLAN CONTRIBUTION LIMITS FOR 2012

Type of plan	Under age 50	Age 50 or older
401(k)/403(b), 457(b), SEP*	$17,000	$22,500
SIMPLE IRA	$11,500	$14,000

Note that not all employer plans permit participants who have reached age 50 to contribute the higher amounts indicated. And additional contribution limitations could apply.

* Only SEP plans established before 1997 (SAR-SEPs) may allow employees to make pretax contributions.

You may have access to a Roth account through your employer's 401(k), 403(b), or 457(b) retirement savings plan. Roth accounts also provide long-term tax advantages. Roth contributions are made after tax, so you gain no immediate tax benefit from contributing. However, any investment earnings in a Roth account accumulate tax deferred and qualified distributions won't be taxed on withdrawal after you've met a five-tax-year holding period and reached age 59½ (or in certain other limited circumstances).

Take advantage of FSA benefits

With an employer-sponsored flexible spending arrangement (FSA), you elect to pay qualified health or dependent care expenses on a pretax basis, thus reducing your taxable income. The plan reimburses you from the account for amounts you spend on expenses allowed by the plan. (Some plans allow employees to use a plan-provided debit or credit card to pay expenses directly.) Under the health care reform law, a dollar cap of $2,500 applies to contributions to a health FSA for 2013.

ACTION ALERT

Are you faced with a choice between claiming the dependent care credit and taking advantage of a dependent care FSA offered by your employer? If your top tax rate is more than 15%, using an FSA generally is more advantageous. Under an FSA, you may contribute up to $5,000 ($2,500 if married filing separately) a year on a pretax basis to be used to pay dependent care costs. The FSA income exclusion saves you income tax at your top rate, while the dependent care credit rate for many taxpayers is limited to 20%.

Plan investment gains and losses

For 2012, the tax rates on net long-term capital gains are significantly lower than the top rate of 35% that may apply to short-term capital gains, interest, wages, and other ordinary income. These favorable capital gains rates are due to go up in 2013.

A capital gain is considered long term if you hold your investment *more than one year* before you sell it. Our table shows the 2012 and scheduled 2013 long-term capital gains rates for different types of investments. Although taxes shouldn't be the only factor you consider when planning investment transactions, waiting until you've met

the long-term holding period before you sell an appreciated investment can save you taxes.

ACTION ALERT

To take advantage of the favorable 2012 capital gains rates, you may want to review your investments and consider realizing some of your long-term capital gains prior to year-end. To keep your position, you can always reinvest some or all of the sale proceeds in the same or similar investments.

ACTION ALERT

For some taxpayers, the effective tax rate they'll pay on capital gains in 2013 may be even higher due to the 3.8% Medicare tax. Placing a greater portion of your investment funds into tax-exempt bonds after 2012 may help reduce your tax exposure. Look at your situation now to see if this action would fit your investment objectives.

Another way to reduce taxes on capital gains is to use any net capital losses you may have realized in 2012 or carried over from an earlier tax year to offset the gains. Capital losses are generally deductible in full against capital gains, and any capital losses in excess of capital gains may offset up to $3,000 of ordinary income ($1,500 if married filing separately). You may carry forward any excess capital losses you aren't able to deduct under these rules for use in later tax years, subject to the same limitations.

If you have significant gains in 2012, it might make sense to realize some offsetting losses on investments you no longer want to hold. But be sure to weigh all relevant factors before you make investment decisions.

LONG-TERM CAPITAL GAINS RATES	2012	2013
Most investments (if ordinary tax rate is above 15%)	15%	20%*
Most investments (if ordinary tax rate is 10% (in 2012) or 15%)	0%	10%**
Collectibles	28%	28%
Real estate (amount up to prior allowable depreciation; rest of gain is taxed the same as gain on most investments)	25%	25%

* For net capital gain from assets held more than five years, the 20% rate is reduced to 18% if the holding period for the assets began after December 31, 2000.

** For net capital gain from assets held more than five years, the 10% rate is reduced to 8%.

Aside from timing your gains and losses, you can:

- Tax-swap securities to accelerate losses without significantly changing your investment position. When you tax-swap securities, you sell securities at a loss for tax purposes and replace them with the same or similar securities. Watch out for the tax law's "wash-sale" rules, though. If you sell securities at a loss and purchase substantially identical securities within 30 days before or after the sale, your loss will be disallowed. You can get around this rule by selling securities on which you have a paper loss and replacing them with securities of another company in the same industry having similar prospects. Alternatively, you can "double up" on the securities, wait 31 days, and then sell your original securities at a loss.
- Pay attention to any dividend payments during the wash-sale period. If these dividends are reinvested in additional shares, you may lose your ability to deduct part of your original loss.
- Take a capital gains distribution from your mutual fund in a check rather than reinvesting the distribution. Then, sell fund shares. As long as the shares sell for less than the amount you paid for them, you generate a capital loss that can offset some or all of the distributed gain.

Keep an eye on dividends

In 2012, qualifying dividends are generally taxed at a maximum rate of 15% — or 0% for dividends otherwise taxable in the lowest two ordinary tax brackets. Most dividend income received from domestic corporations and qualified foreign corporations is eligible for these favorable rates, as long as you hold the underlying stock

for a minimum period: generally at least 61 days during the 121-day period beginning 60 days before the stock's "ex-dividend" date (the date on which the stock begins trading without rights to the most recently declared dividend). The holding period is longer for certain preferred stock dividends.

- Before you sell dividend-paying stocks, check to see if you've held the stock long enough to lock in a favorable tax rate on your dividend income.
- Timing is also important with late-year mutual fund investments. Hold off investing in a fund until after the fund's ex-dividend date. Otherwise, the most recently declared dividend will be credited and taxable to you. In effect, part of your investment will be returned to you immediately as taxable income.

TAX ALERT

Absent action by Congress, the favorable tax rates on qualified dividends will go away beginning in 2013. Dividends will be taxed at ordinary income rates as high as 39.6%.

Delay tax on retirement plan distributions

If you leave a job in 2012, you may receive an "eligible rollover distribution" from your employer's retirement plan. Rolling over your distribution to an IRA or a new employer's plan can avoid current income tax on the distribution and allow you to continue building your retirement savings.

ACTION ALERT

If a portion of a lump-sum distribution you are receiving from your employer's retirement plan includes appreciated employer stock, consider taking the stock instead of rolling it over if the distribution qualifies for "net unrealized appreciation" (NUA) tax treatment. Basically, you'll have to pay current income tax, but only on the stock's basis (generally, its value when it was added to your account). Any increase in the stock's value after that time won't be taxed until you sell the stock and realize a capital gain. Thus, you stand to benefit from deferral and a favorable long-term capital gains rate. These rules are complex, so proceed cautiously.

Limit taxes on Social Security benefits

Retired taxpayers are sometimes caught off guard when they learn their Social Security benefits aren't necessarily tax free. When "provisional income" — modified AGI (including tax-exempt municipal bond interest) plus half of the Social Security benefits — exceeds certain levels, a portion of the Social Security benefit must be included in income for tax purposes. Look carefully at your year-end transactions to determine if realizing additional income in 2012 will increase the amount of benefits subject to income tax.

ACTION ALERT

To avoid or limit income tax on your Social Security benefits, consider taking additional income you may need in 2012 from a Roth IRA if you have one. Unlike distributions from traditional IRAs, qualified Roth IRA distributions aren't included in income for purposes of determining whether Social Security benefits are taxable.

ADJUSTED GROSS INCOME

Once you've accounted for all your income, Form 1040 asks you to figure your adjusted gross income. AGI is nothing more than a total of your

WILL YOUR SOCIAL SECURITY BENEFITS BE TAXABLE?

ON A JOINT RETURN*	
If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $32,000	0%
Between $32,000 and $44,000	50%
Over $44,000	85%

ON A SINGLE OR HEAD-OF-HOUSEHOLD RETURN	
If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $25,000	0%
Between $25,000 and $34,000	50%
Over $34,000	85%

* The provisional income threshold is zero for a married person filing separately who does not live apart from his or her spouse for the entire year.

income from various sources minus certain "adjustments" (also called "above-the-line" deductions) allowed by law. The accompanying worksheet lists adjustments that are deductible in computing AGI.

Minimizing AGI gives you a variety of tax advantages, so be sure you don't overlook any adjustments you are entitled to use. These above-the-line deductions generally are more valuable than itemized deductions of the same amount because they reduce your AGI and help preserve other tax breaks that are subject to AGI limits. They are available to nonitemizers as well as taxpayers who itemize their deductions.

Put money away in an IRA

Your contributions to a traditional IRA may reduce your AGI and your income tax. In 2012, contributions up to $5,000 — $6,000 if you're age 50 or older — will be fully deductible if you (and your spouse) are not considered active participants in certain employer-sponsored retirement plans. You (or your spouse) must have earned income equal to or greater than your IRA contribution amount. There are income restrictions on deductible contributions if you (or your spouse) do participate in a plan at work. To contribute to your traditional IRA, you must be under age 70½ and you (or your spouse) must earn compensation.

With a Roth IRA, contributions aren't tax deductible, but qualified distributions will be *tax free* when certain requirements are met. As with a traditional IRA, you (or your spouse) must have earned compensation to contribute to a Roth IRA. Contributions to Roth IRAs are phased out as modified AGI exceeds certain thresholds. For 2012, the phaseout ranges are: $173,000 to $183,000 for married couples filing jointly, $110,000 to $125,000 for heads of household and single filers, and $0 to $10,000 for married persons filing separately.

Set up and contribute to a self-employed plan

If you're self-employed full-time or in a sideline business, contributions to a retirement plan for yourself and any eligible employees are generally tax deductible (subject to tax law limits). Plan investment earnings are tax deferred, and benefits are not taxed until distributed. Here are several retirement savings options:

SIMPLE IRA. You generally may establish a SIMPLE IRA anytime between January 1 and October 1 to contribute for the year.

Simplified Employee Pension (SEP). You generally have until the due date of your (or your firm's) income-tax return (including extensions) to set up a SEP plan for 2012.

Solo 401(k). This plan must be set up by the end of your business's tax year. In addition to a 401(k) deferral, you also can make a tax-deductible profit sharing contribution. (Limits apply.)

Keogh plan. A Keogh plan must be in place before the end of the year to be effective for 2012. Then, you'll have until the tax filing deadline (plus any filing extensions) to contribute. The maximum contribution varies depending on the type of Keogh plan established.

See page 15 for more information about tax-favored retirement plans.

COMPUTE YOUR AGI	
Your Estimated Income (from page 3)	$
Adjustments*	
Alimony paid	$
Traditional IRA contributions	$
Student loan interest	$
Moving expenses	$
Health savings account contributions	$
Self-employment tax deduction	$
Self-employed health insurance costs	$
Self-employed SEP, SIMPLE, and qualified retirement plan contributions	$
Penalty on early withdrawal of savings	$
Total adjustments	**$**
ADJUSTED GROSS INCOME (AGI): (Total income minus total adjustments)	**$**

* This list is not all-inclusive, and various requirements and limitations apply.

Don't miss other above-the-line deductions

Here are a few deductions you or your family members may be able to claim. Others are listed in the "Compute Your AGI" worksheet on the previous page.

Student loan interest. In 2012, you may be able to claim an above-the-line deduction of up to $2,500 of interest paid on qualified higher education loans. In 2012, the deduction phases out for joint filers with modified AGI between $125,000 and $155,000 and for single taxpayers with AGI between $60,000 and $75,000.

ACTION ALERT

You can't deduct any interest you might pay on your child's student loan, since only the person legally obligated to make the interest payments may claim the deduction. But your child could claim a deduction for interest you paid in 2012 on his or her loans (treated as a gift) as long as the child isn't your dependent.

Self-employment tax. This tax consists of a Social Security tax and a Medicare tax. The rate for the Social Security portion of the self-employment (SE) tax continues to be 10.4% through the end of 2012. It's scheduled to return to the usual 12.4% in 2013. The Social Security tax applies to self-employment earnings of up to $110,100. The 2.9% Medicare tax applies to all self-employment income.

For 2012, you may deduct up to 59.6% of the Social Security tax you pay in computing your AGI. You also may deduct 50% of your Medicare tax.

Self-employed health insurance costs. If you're self-employed, you may be entitled to deduct 100% of health and dental insurance costs for yourself, your spouse, your dependents, and any qualifying children who haven't attained age 27 as of the end of the tax year. Your deduction can't be more than your earned income from the trade or business for which you established health coverage. (Other requirements apply.)

ITEMIZED DEDUCTIONS

Another step in planning your taxes is to project your itemized deductions. Every tax deduction you can claim will help reduce your tax liability. To estimate the tax benefit of a deduction, multiply the amount of the deductible expense by your marginal tax rate (the rate that applies to your last dollar of taxable income).

ACTION ALERT

A traditional year-end strategy is to try to increase your itemized deductions by paying deductible expenses in the current year that you'd pay the next year anyway. This strategy could be particularly valuable in 2012. As the tax law currently stands, in 2013, higher income taxpayers may see their itemized deductions reduced when an overall limitation on itemized deductions that was in effect before 2010 is reinstated.

Deduct other taxes paid

Individuals who itemize can claim deductions for real property taxes and for state and local income taxes paid. You also can deduct such items as personal property taxes, foreign real property taxes, and foreign income taxes (especially on investment income). Alternatively, you may be able to claim the foreign tax credit.

To increase your itemized deductions:

- Pay state or local income taxes early by making any January 2013 estimated-tax payments in late 2012.
- Increase your state or local tax withholding for the rest of the year.

Note: These strategies may not be beneficial if alternative minimum tax (AMT) could be an issue for you in 2012.

Claim all your home mortgage interest

One of the advantages of home ownership is the ability to deduct mortgage interest payments. You may deduct qualified residence interest on *acquisition indebtedness* and *home equity indebtedness* (within limits). So, when making large purchases such as a new

car, you may want to consider using a home equity line of credit. That way, you'd potentially be able to deduct your loan interest.

Generally, you may also:

- Deduct mortgage "points" (prepaid interest) in full in the year you purchase or build your main home.
- Choose to spread out the deduction of purchase points over the life of the loan if, for example, you won't have enough deductible expenses to itemize deductions in 2012.
- Deduct in full, in the year you enter the loan, points paid on mortgage loans for home improvements.
- Deduct any points you pay to refinance an existing mortgage ratably over the life of the loan.

Don't overlook investment interest

Investment interest is an itemized deduction that's easy to miss. You may deduct interest you pay in 2012 on funds borrowed to buy or carry taxable investments (interest on a margin account, for example). But your deductible interest is limited to your net investment income for the year, with any excess interest expense you can't deduct currently carried forward to subsequent years, subject to that year's limitation.

Net investment income for this purpose doesn't include net capital gain — or qualified dividends — unless you forgo the favorable tax rate on that income and subject your gains or qualified dividends to tax at your higher ordinary income-tax rate.

TAX ALERT

Investment interest is one of several itemized deductions that are not subject to the itemized deduction limitation scheduled to go into effect for higher income taxpayers beginning in 2013.

Give to charity

Making year-end donations can increase your itemized deduction for charitable contributions. You might:

- Prepay planned 2013 contributions to charity in 2012, using a credit card, if you wish.
- Make year-end charitable gifts of appreciated securities or other property you've held more than one year. You may claim a charitable deduction equal to the full fair market value of the property you donate (subject to certain limitations and restrictions). Such gifts help you avoid the capital gains tax that would apply if you sold the asset first and then donated the proceeds.
- Create a charitable remainder trust if you would like to make a substantial gift to charity but retain an income from the property for life or a period of years. With a charitable remainder trust, you receive a current income-tax deduction for a gift that will actually be made in the future.

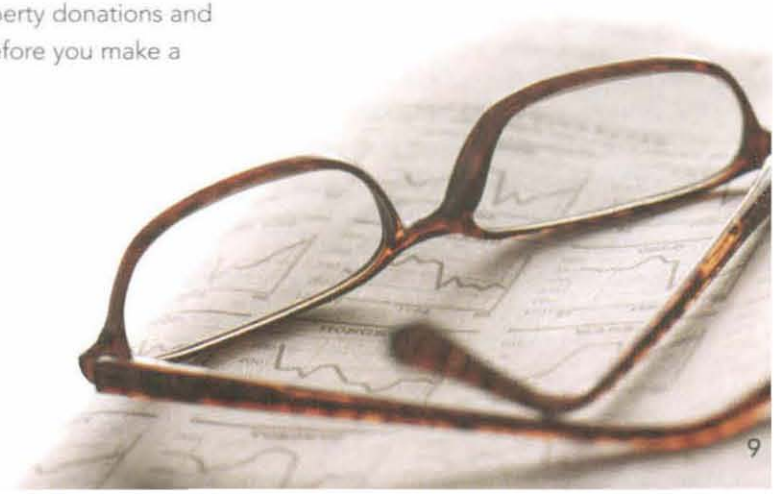
Get professional advice about the tax aspects of property donations and charitable trusts before you make a commitment.

Add up "floor expenses"

Certain itemized deductions are subject to "floor" amounts set by law. Only amounts over and above the floor are deductible. Looking at your deductible expenses now may save you from an unpleasant surprise at tax time. Deductions subject to floors include medical expenses, which are deductible only to the extent they exceed 7.5% of your AGI in 2012, and unreimbursed employee business expenses and miscellaneous expenses, which are deductible only to the extent they together exceed 2% of AGI.

One way to deduct more of your medical and miscellaneous deductions is to "bunch" two years of expenses into one year so you exceed the deduction floor. To boost your deductions for 2012, consider:

- Paying 2013 professional dues, subscriptions, and investment management fees in late 2012. These are all included in the "miscellaneous" category.
- Scheduling elective surgery, dental work, and eye appointments for late 2012 if you'll incur deductible out-of-pocket expenses in 2012.



And don't forget to include:

- Medical expenses you paid for your parents if you provide more than half their support (and certain other requirements are met).
- The cost of a weight-loss program you attend under a doctor's orders to lose weight because of obesity or for other health reasons.
- Premiums paid for qualified long-term care insurance. Within limits, these premiums are deductible as medical expenses.
- Unreimbursed expenses paid for qualified long-term care services. These expenses are also deductible as medical expenses.

ACTION ALERT

Bunching medical expenses, if you can, may be particularly valuable in 2012. In 2013, the AGI threshold for claiming these expenses is scheduled to increase to 10% for taxpayers under age 65. So you may have a better chance of being able to claim the deduction this year. Note, however, that medical expenses are another of the few deductions that are not subject to the limitation on itemized deductions for higher income taxpayers that's scheduled to be reinstated in 2013.

Remember to claim deduction carryovers

You may carry over to future tax years the unused portion of many deductions that are subject to limits. If you have any carryovers from earlier years of charitable contributions, home office expenses, investment interest, and so on, try to use them in 2012.

TAX AND CREDITS

Double-check your estimates

The IRS can assess underpayment penalties if you don't pay enough income taxes during the year through payroll withholding and/or quarterly installments of estimated tax. As part of your planning, you'll want to see if your tax payments are on track. In general, you should aim to pay at least (1) 90% of your projected 2012 tax or (2) 100% of your 2011 tax. However, the required percentage of your 2011 tax is 110% instead of 100% if your 2011 AGI was more than $150,000 ($75,000 if you're a married taxpayer filing separately).

ACTION ALERT

As an employee, your best option for avoiding a tax penalty if you find you're behind on tax payments may be to have your employer withhold more tax from your pay for the rest of the year.

Beware of the alternative minimum tax

In late 2010, Congress came through once again with an AMT "patch" that retained higher AMT exemption amounts through 2011. However, unless Congress acts again, more people may be subject to AMT in 2012, as AMT exemptions are scheduled to drop to much lower amounts. (See the table for a comparison.) If your AMT is higher than your regular tax, you pay the additional amount on top of your regular tax. The AMT rates are 26% and 28%.

Basically, the AMT system is designed to ensure that taxpayers pay a minimum amount of tax when they use certain tax breaks to reduce their regular tax liability. The AMT calculation is complex. For planning purposes, it may be helpful to identify some of the items that can trigger AMT:

- A higher-than-average number of dependency exemptions
- A large deduction for state income taxes
- The exercise of incentive stock options
- Interest from certain "private activity" municipal bonds
- A large capital gain

AMT EXEMPTION AMOUNTS

	2012	2011
Unmarried filers	$33,750	$48,450
Married filing jointly	$45,000	$74,450
Married filing separately	$22,500	$37,225

The AMT exemptions are phased out once AMT income exceeds certain levels.

Offset tax with child-related credits

While deductions and exemptions lower taxable income, credits actually offset income tax, dollar for dollar. In 2012, you can claim a *child tax credit* of $1,000 for each qualifying child who is under age 17 on December 31. This credit begins to be phased out with modified AGI in excess of $110,000 for married taxpayers filing joint returns, $75,000 for unmarried taxpayers, and $55,000 for married taxpayers filing

separately. Be aware that the child credit is slated to drop to $500 in 2013.

Look into claiming the household and dependent care credit if you pay child care expenses so that you (and your spouse) can work. Up to $3,000 of expenses ($6,000 for two or more dependents) can qualify, and the minimum credit rate is 20%. Your child must be under age 13. This credit is also allowed for household and other expenses of caring for a disabled spouse or other qualifying adult while you work. As the tax law stands, the credit will be less generous beginning in 2013.

Take advantage of education breaks

The tax law also has a few breaks to help taxpayers with qualifying higher education expenses. Our accompanying table compares the American Opportunity Credit with the Lifetime Learning Credit. Looking ahead to 2013, unless Congress legislates otherwise, the American Opportunity Credit will be going away to be replaced by the less generous Hope Scholarship Credit.

- If you are eligible to claim your student child as a dependent, but choose not to, the child may be able to claim an American Opportunity or Lifetime Learning Credit for qualified tuition and related expenses *you* paid. This move can be a family tax saver if you earn too much to claim the credit yourself and your child has enough income to owe taxes. Note that the child *cannot* claim the personal exemption you've given up.
- Paying tuition for your child's first semester of 2013 in 2012 might increase your education credit(s) for this year.

Contribute the 2012 maximum of $2,000 per beneficiary to a Coverdell Education Savings Account (ESA) if you meet income requirements. This amount is scheduled to be cut to $500 in 2013. In 2012, tax-free distributions are allowed for certain elementary, secondary, and extended day program expenses, as well as for qualified higher education expenses. As the tax law currently stands, tax-free distributions will be limited to qualified higher education expenses starting next year.

TUITION BREAKS FOR 2012

	American Opportunity Credit	Lifetime Learning Credit
Maximum amount	$2,500 per student	$2,000 per tax return
Qualifying education	First four years of undergraduate	Undergraduate, graduate, job training courses
Income limits	No credit if modified AGI reaches $90,000 (unmarried) or $180,000 (married joint) Phaseout applies	No credit if modified AGI reaches $62,000 (unmarried) or $124,000 (married joint) Phaseout applies

Note: You may not claim both credits in the same year for the same student's expenses. Other restrictions apply.

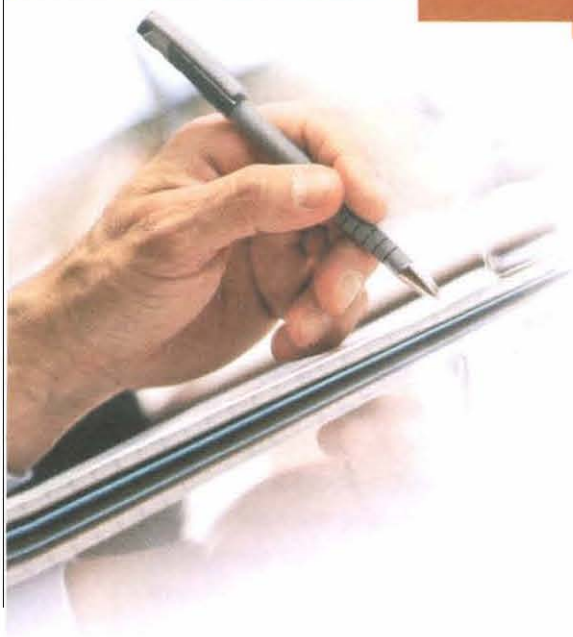
ACTION ALERT

If you've been saving for a child's or grandchild's college expenses in a Coverdell ESA and that child has qualified elementary or secondary school expenses in 2012, consider withdrawing funds from the account to pay those expenses before year-end 2012. You might also consider making a contribution to a Section 529 plan* to restore the college savings you withdraw, especially if you've already made the maximum ESA contribution for 2012. Like a Coverdell ESA, a Section 529 plan offers the potential for tax-deferred growth and plan withdrawals for qualifying higher education expenses are tax free.

Review your estate plan

And, while you're considering taxes, you may want to review your estate plan. The current gift- and estate-tax exclusion amount allows you to transfer up to $5.12 million gift- and estate-tax free. In 2013, this exclusion amount is scheduled to be cut to $1 million. In addition, the "portability" rules permitting a surviving spouse to use a deceased spouse's unused exclusion amount are slated to expire at the end of 2012.

** Certain benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions and how they may be used. Before investing, consider the investment objectives, risks, and charges and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.*



Opportunities for BUSINESS owners

Business tax planning is a year-round activity. But the last several months of the year may present specific opportunities to minimize taxes on your business income.

INCOME

Your business structure determines how your business income will be taxed. And, while taxes are only one consideration in choosing a business form, they can be an important one.

Compare business forms

As a preliminary to your year-end business tax planning, look at your current form of doing business. You may discover that another form would be more beneficial. With certain exceptions, a corporation that has an S election in place doesn't pay federal corporate income taxes. Instead, S corporation income, losses, deductions, and credits "pass through" to the owners to be reported on their tax returns. Thus, S corporation income generally is taxed only once — to the shareholders — unlike regular C corporation income, which is taxed twice — once to the corporation and again to the shareholders when it is paid out as dividends.

Like a corporation, a limited liability company (LLC) generally provides owners with protection from personal liability for business debts and obligations. But most LLC owners can choose to have their businesses treated as partnerships for income-tax purposes. Partnership treatment means:

- Income, losses, deductions, and credits pass through to the individual owners (called "members") to be reported on their individual returns.
- LLC income isn't subject to double taxation.
- An LLC can specially allocate income and expenses among its owners to the same extent a partnership can.

TAX ALERT

Remember, as the tax law currently stands, starting in 2013, the top individual tax rate (and, thus, the top rate for LLC and partnership income) is scheduled to rise to 39.6% — 4.6 percentage points higher than the 35% corporate tax rate for C corporations (see table). This could be a factor in reviewing your business form.

Plan earnings distributions for best tax results

Consider these tax factors when making decisions about distributing corporate earnings.

- Corporate earnings paid out to you as compensation are included in your taxable income, but are deductible by the corporation. Thus, the income is taxed only once — to you.
- Individual tax rates may be higher in 2013 and later. Take this factor into account when planning year-end 2012 bonuses.
- If you pay out earnings as compensation, be aware that the compensation must be "reasonable" for it to be deductible by the corporation.

The IRS can assess a corporate accumulated earnings tax penalty on companies that accumulate excessive amounts of earnings and profits. This penalty is 15% in 2012. It's scheduled to rise to 39.6% (the same as the top individual marginal tax rate) in 2013.

ACTION ALERT

If your corporation has built up significant earnings and profits, distributing excess cash as dividends in 2012 may be advantageous since shareholders are taxed on qualified dividends at no more than 15%. (Requirements apply.) Absent further legislation, dividends will be taxed at ordinary rates as high as 39.6% in 2013. A distribution may also help the corporation avoid the accumulated earnings tax penalty in 2012 and the higher penalty rate currently scheduled for 2013. But be sure a thorough analysis has been performed before making a decision.

DEDUCTIONS

An easy way to lower your business's taxable income is to increase deductions. So take care not to overlook any deductions your business may be entitled to claim.

CORPORATE TAX RATES

If your company is a C corporation other than a personal service corporation,* you can estimate your corporation's regular 2012 federal income taxes using this table.

If taxable income is over	But not over	Your tax is	Of the amount over
$0	$50,000	15%	$0
$50,000	$75,000	$7,500 + 25%	$50,000
$75,000	$100,000	$13,750 + 34%	$75,000
$100,000	$335,000	$22,250 + 39%	$100,000
$335,000	$10,000,000	$113,900 + 34%	$335,000
$10,000,000	$15,000,000	$3,400,000 + 35%	$10,000,000
$15,000,000	$18,333,333	$5,150,000 + 38%	$15,000,000
$18,333,333		A flat 35%	

* Personal service corporations pay a flat 35% tax.

Use losses to your advantage

No business owner welcomes a net operating loss (NOL). However, if you expect your company to show a loss this year, plan to use it to your best tax advantage. An NOL generally may be carried back two years. By carrying back an NOL, you may secure a refund of income taxes paid for those years. Unused NOLs may be carried forward to offset future taxable income for as long as 20 years. A special election to forgo the carryback period is also available.

ACTION ALERT

Identify any bad debts lingering in the aftermath of the economic downturn. If your company uses the accrual method of accounting, you generally may deduct business bad debts when they become totally or partially worthless. You'll need documentation to support the deduction, so be sure to keep good records of your failed collection attempts.

Take advantage of "bonus" depreciation while you can

In 2012, businesses can claim a first-year depreciation "bonus" equal to 50% of the adjusted basis (or cost) of qualified property acquired and placed in service after December 31, 2011, and before January 1, 2013. Many types of new machinery, equipment, and other fixed assets qualify. Note:

- The 50% bonus depreciation is subtracted from the property's cost basis *before* the regular first-year depreciation is computed.
- While real estate generally won't qualify for the depreciation bonus, certain improvements to the interior of a leased nonresidential building may qualify.

ACTION ALERT

Since bonus depreciation generally won't be available for 2013 purchases, consider purchasing new fixed assets (with a loan if necessary) that you'll need next year if you'll be able to claim 50% bonus depreciation (or the Section 179 deduction discussed below) for those assets in 2012.

Because bonus depreciation isn't limited to taxable income, the deduction can contribute to or create a net operating loss. This might be an advantage for a C corporation that can carry back the loss and secure a tax refund. Similarly, a net operating loss generated by a flow-through entity, such as an S corporation or partnership, can provide a tax benefit to the owners individually.

Elect Section 179 treatment for purchases

As an alternative to depreciating assets, your business may be able to elect under Section 179 of the tax code to currently deduct ("expense") the cost of qualifying new or used assets. For 2012, the Section 179 expensing limit is generally $139,000. The amount of the available expensing election is reduced dollar for dollar as annual asset purchases rise from $560,000 to $699,000. For 2013, expensing is limited to $25,000 of purchases, and the phaseout begins once 2013 asset acquisitions exceed $200,000.

You can't expense more than the amount of your taxable income from active trades or businesses. Real property doesn't qualify for the expensing election. And any part of an asset's cost that is expensed can't also be depreciated.

Some ways to best take advantage of expensing:

- If your company purchased both new and used fixed assets and your purchases will exceed the Section 179 expensing limit, use a combination of the 50% first-year depreciation bonus for some of the new assets, along with the Section 179 election for the used assets.
- Where a company is going to elect Section 179 expensing for only some of its asset acquisitions and depreciate others, it may make sense to use the Section 179 election for the assets with the longest lives.

Look at using regular depreciation

Your business may elect out of claiming 50% bonus depreciation for all qualifying assets placed in service during 2012 or for certain asset classes and instead claim regular depreciation under the Modified Accelerated Cost Recovery System (MACRS). Section 179 treatment is also elective.

Why might you want to elect out? This choice could be advantageous in some situations. For example, it might be to your benefit if you want to preserve depreciation deductions for future years when you expect your business income to be taxed at a significantly higher rate. (Be sure to do a present value analysis first.)

Claim the manufacturing/production deduction

Business taxpayers that are involved in domestic manufacturing, construction, engineering or architectural services related to construction projects, or other eligible production activities

DEPRECIATION ASSET CLASSES

Property class	Assets included
3-year	Tractor units for over-the-road use
5-year	Automobiles, trucks, computers, copiers and other office machinery
7-year	Office furniture and fixtures, farm machinery and equipment
10-year	Vessels, barges, tugs
15-year	Certain land improvements
20-year	Farm buildings (other than certain single-purpose structures)
25-year	Water utility property
Residential rental property (27.5-year)	Apartment buildings, single-family rental properties
Nonresidential real property (39-year)	Office buildings, stores, warehouses

These asset classes are used when computing depreciation under the Modified Accelerated Cost Recovery System (MACRS). The lists of property included in each class aren't all-inclusive.

shouldn't overlook the "domestic production activities deduction." For 2012, the maximum deduction is 9% of the lesser of: (1) qualified production activities income or (2) taxable income before taking the deduction into account. (Sole proprietors use their adjusted gross income, with certain modifications, instead of their taxable income.) However, the deduction may not exceed 50% of W-2 wages allocable to domestic production gross receipts. If your company is eligible, the deduction could reduce your taxes — and increase your after-tax profits — without any additional outlay of cash.

Deduct new-business start-up costs

If you're launching a new business this year, you may incur expenses before the business actually begins operating. Examples include the costs of conducting market surveys, traveling to find customers or suppliers, advertising, and training employees. You may elect to deduct up to $5,000 of these expenses in 2012 as long as the business is up and running by year-end. (The $5,000 limit is reduced dollar for dollar once total start-up costs exceed $50,000.) The remainder of your start-up costs can be deducted ratably over a 180-month period.

Contribute to retirement plans

As a business owner, you can lower your business taxes — and help accumulate funds for your own retirement — by maximizing contributions to tax-favored retirement plans. Check out the table for the 2012 contribution and deduction limits for various retirement plans. Let us know if you need assistance choosing a suitable plan.

Accelerate/increase deductions

While you're thinking about your deductible expenses, you may also want to consider ways you might accelerate deductible expenses into 2012 to increase your business deductions and lower taxes. Here are a few ideas:

- You might have equipment or vehicle repairs done or purchase supplies before year-end if these expenses would be incurred in 2013 anyway.
- If you're an accrual-method taxpayer, you have a little more freedom to accelerate deductions. Look at deducting employee bonuses that you don't plan to pay until early next year (within the first 2½ months of 2013). But note that you generally can't use this strategy for employees who own a greater-than-50% interest in the business, and other restrictions may apply.

COMPARING RETIREMENT PLANS

	401(k)	Profit Sharing	Simplified Employee Pension (SEP)	SIMPLE IRA
Employee contributions allowed?	Yes: see page 4 for 2012 deferral limits	No	No (except for certain plans established before 1997)	Yes: see page 4 for 2012 deferral limits
Employer contribution required?	No — however, employer contributions are allowed	Yes — contributions can be discretionary	Yes — discretionary contributions	Yes — must match employee deferrals up to 3% of pay or contribute 2% of pay for all eligible employees
Maximum annual contribution	Smaller of $50,000 or 100% of participant's compensation	Same as 401(k)	Smaller of $50,000 or 25% of participant's compensation	Employee deferral plus required employer contribution
Maximum deduction	25% of all participants' compensation plus employee deferrals	25% of all participants' compensation	Same as profit sharing plan	Same as maximum contribution

Compensation is generally limited to $250,000 in 2012. Calculating the contribution limit for a self-employed individual's profit sharing contribution involves a special computation. SIMPLE IRAs are available only to small employers.

- You also may be able to deduct vacation pay that is vested at year-end and will be paid within 2½ months after year-end.
- To deduct charitable contributions your accrual-method corporation will make in the first 2½ months of 2013, make sure you note the charitable obligation in the corporate minutes before the end of 2012 (assuming the company uses a calendar year).
- Increasing business use of a car that you drive for both business and personal purposes can boost your total write-off for the vehicle. When actual expenses are deducted, your deduction depends on the ratio of business miles to total miles driven. If you use the standard mileage rate, increasing business mileage will give you a higher deduction.

TAX CREDITS

As they do for individual taxpayers, tax credits can offset your business income tax, dollar for dollar.

ACTION ALERT

2012 may be the last year to claim the employer-provided child care credit for buying, rehabilitating, or expanding property to be used as part of an employer's qualified child care facility and for amounts paid or incurred under a contract to provide child care resource and referral services to employees. Be sure to take advantage of this credit if you can, while you can.

SEE IF YOU QUALIFY FOR TAX CREDITS

General business credit	
Investment	10% (or more) of the costs of (1) qualified rehabilitation of a building first placed in service before 1936 and certified historic structures (regardless of when placed in service) or (2) installation of solar, geothermal, or combined heat and power system property
FICA tip	The amount of a food and beverage establishment employer's FICA tax obligation attributable to employee tips received in excess of tips treated as wages for purposes of satisfying minimum wage requirements (whether or not the tips are reported)
Employer-provided child care	25% of expenses to buy, build, rehabilitate, or expand property that will be used as part of an employer's child care facility plus 10% of amount paid under a contract to provide child care resource and referral services to employees, up to a maximum credit of $150,000 a year (not available after 2012 tax year)
Disabled access	For eligible small businesses, 50% of eligible access expenditures greater than $250 and not more than $10,250
Small employer health insurance	Up to 35% of employer contributions for employee health insurance (through 2013; up to 50% starting in tax year 2014)
Small employer pension plan start-up	50% of administrative and retirement-related education expenses ("qualified start-up costs") for the first three plan years, up to a maximum credit of $500 a year

Note that this list of credits isn't all-inclusive. Various requirements apply.

ALTERNATIVE MINIMUM TAX

Like individual taxpayers, larger corporations can find themselves subject to alternative minimum tax. When it applies, the corporate AMT rate is 20%, and the exemption amount is $40,000 (subject to an income-based phaseout with alternative minimum taxable income between $150,000 and $310,000).

Your corporation will be *exempt* from AMT if it satisfies a gross receipts test. The exemption generally applies where a corporation's average annual gross receipts for all three-tax-year periods beginning after 1993 and ending before the current tax year are $7.5 million or less. (There's a lower $5 million threshold for the first three-tax-year period taken into account in the test.)

THE CLOCK IS TICKING

Now that you've reached the end of this guide, we hope you have a better understanding of the need for tax planning and the short time frame you have for taking advantage of year-end planning opportunities. As skilled professionals, we have the experience, knowledge, and expertise to help you with your planning needs. For more information on any of our services, call us today.

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