Toscano & Ardito, P.C., CPAs

Specializing in Business, Financial & Tax Planning

2011 YEAREND TAX PLANNING

To All Our Valued Clients and Friends,

As we approach year-end, we would like to take this opportunity to first thank you for your continued loyalty to Toscano & Ardito. Our clients are the most important part of our firm. As always, we will continue to provide you with the highest quality service possible. Before we address our year-end tax saving strategies there are two important considerations to keep in mind.

First, remember that effective tax planning requires considering both this year and next year—at least. Without a multiyear outlook, you can't be sure maneuvers intended to save taxes on your 2011 return won't backfire and cost additional money in the future. For example, postponing a stock sale gain until next year would reduce your 2011 adjusted gross income (good), but increase the 2012 figure (bad). Higher income next year could make you ineligible for the child tax credit; reduce or eliminate the credits or deduction for college expenses; limit deductible losses from your rental real estate investments; and so on.

Second, be on the alert for the Alternative Minimum Tax (AMT) this year. It's an add-on tax over and above your "regular" tax. Although you may have never owed AMT in the past, your odds of being hit are higher now. Why? Because the tax brackets, standard deduction, and personal exemption allowances used in calculating your regular tax liability are all indexed annually for inflation. Most AMT parameters are not. The odds of owing the tax go up every year due to this factor alone. The risk goes up another notch or two if you deduct a significant amount of state and local taxes or miscellaneous itemized deductions (like unreimbursed employee business expenses) or claim multiple dependents. These deductions are not allowed against the AMT. Finally, if you exercised incentive stock options or recognized a large capital gain this year, consider yourself a likely AMT victim.

Here are a few tax-saving ideas to get you started. As always, you can call on us to help you sort through the options and implement strategies that make sense for you.

One way to reduce your 2011 tax liability is to look for additional deductions. Here's a list of suggestions to get you started:

Make Charitable Gifts of Appreciated Stock. If you have appreciated stock that you've held more than a year and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are no transaction fees involved.)

However, if the stock is now worth less than when you acquired it, sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available. Also, if you sell the stock at a loss, you can't immediately buy it back as this will trigger the wash sale rules. This means your loss won't be deductible, but instead will be added to the basis in the new shares.

Maximize the Benefit of the Standard Deduction. For 2011, the standard deduction is $11,600 for married taxpayers filing joint returns. For single taxpayers, the amount is $5,800. Currently, it looks like these amounts will be about the same for 2012. If your total itemized deductions are normally close to these amounts, you may be able to leverage the benefit of your deductions by bunching deductions in every other year. This allows you to time your itemized deductions so that they are high in one year and low in the next. You claim actual expenses in the year they are bunched and take the standard deduction in the intervening years.

For instance, you might consider moving charitable donations you normally would make in early 2012 to the end of 2011. If you're temporarily short on cash, charge the contribution to a credit card—it is deductible in the year charged, not when payment is made on the card. You can also accelerate payments of your real estate taxes or state income taxes otherwise due in early 2012. But, watch out for the AMT, as these taxes are not deductible for AMT purposes.

Bunch Deductions Subject to an Adjusted Gross Income Limit. Miscellaneous itemized deductions (such as unreimbursed employee business expenses) are deductible to the extent they exceed 2% of your Adjusted Gross Income (AGI). (Your AGI is the number at the bottom of the first page of your return.) Medical expenses are deductible only to the extent they exceed 7.5% of AGI. To lessen the affect of these AGI limitations, try to bunch your miscellaneous and medical expense deductions into every other year.

Making the Most of Year-end Securities Transactions

For 2011 sales, you'll generally owe only 15% on gains from investment assets held over one year (0% if the gains would otherwise fall into the 15% regular income tax bracket). Gains from investments held one year or less are taxed at your ordinary rates. So, the framework for year-end tax selling of investment securities is fairly simple. First, list those stocks, mutual fund shares, and bonds that you feel you could easily live without. You'll probably have some winners (current market value above your cost) and some losers (value below cost) on the list.

Between now and year-end, you can sell enough losers to offset any capital gains recognized earlier this year. Plus, you can sell enough to generate another $3,000 in losses ($1,500 for married filing separate status), which then can be deducted against your income from all other sources. Because selling the losers reduces your income, the odds are increased that you'll qualify for various other tax breaks.

If your year-to-date sales have resulted in an overall loss in excess of $3,000, you can sell enough winners between now and year-end to get back to the "negative $3,000" level. Cashing in gains to that extent won't add a cent to your federal tax bill, whether or not the assets have been held over 12 months. On the other hand, if your year-to-date sales are currently standing at zero or a net gain and you want to unload some winners, but no more losers, before year-end, try to sell only those you've owned over 12 months. Then, the resulting gains will be taxed at no more than 15%.

When selling stock or mutual fund shares, the general rule is that the shares you acquired first are the ones you sell first. However, if you choose, you can specifically identify the shares you're selling when you sell less than your entire holding of a stock or mutual fund. By notifying your broker of the shares you want sold at the time of the sale, your gain or loss from the sale is based on the identified shares. This sales strategy gives you better control over the amount of your gain or loss and whether it's long-term or short-term.

Secure a Deduction for Nearly Worthless Securities. If the dismal economy has left you with securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier just to sell the security if it has any marketable value. As long as the sale is not to a family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Employer Stock Options. If you own appreciated stock acquired by exercising Incentive Stock Options (ISOs) and are now considering selling as part of your overall year-end strategy, remember what it takes to qualify for the 15% rate. First, the shares must be held over two years from the option grant date (the date you received the ISO). Second, the shares must be held over 12 months after the exercise date (the date you acquired the stock by exercising your ISO). Selling sooner means all or part of your gain may be taxed at your higher ordinary tax rate.

What if you own nonqualified options? It may pay to exercise now, if there's just a modest spread between market value and your exercise price and you expect the stock to appreciate. You'll owe tax at your ordinary rate on the spread, but any future appreciation will qualify for the 15% rate if you've held the shares over 12 months by the time you sell.

If you already own shares from exercising nonqualified options, remember your post-exercise gains will qualify for the 15% rate as long as more than 12 months have passed since you acquired the stock. A shorter holding period means your gains will be taxed at your higher ordinary rate, unless you have offsetting capital losses from other transactions this year.

Ideas for Seniors Age 70½ Plus

Make Charitable Donations from Your IRA. IRA owners and beneficiaries who have reached age 70½ are permitted to make cash donations totaling up to $100,000 to IRS-approved public charities directly out of their IRAs. These so-called *Qualified Charitable Distributions*, or QCDs, are federal-income-tax-free to you, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to worry about restrictions that can delay itemized charitable write-offs. QCDs have other tax advantages too. Contact us if you want to hear about them.

Be careful—to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity. Also, this favorable provision will expire at the end of this year unless Congress extends it. So, this could be your last chance.

Take Your Required Retirement Distributions. The tax laws generally require individuals with retirement accounts to take withdrawals based on the size of their account and their age every year after they reach age 70½. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. There's good news for 2011 though—QCDs discussed above count as payouts for purposes of the required distribution rules. This means, you can donate all or part of your 2011 required distribution amount (up to the $100,000 limit on QCDs) and convert taxable required distributions into tax-free QCDs.

Also, if you turned age 70½ in 2011, you can delay your 2011 required distribution to 2012 if you choose. But, waiting until 2012 will result in two distributions in 2012—the amount required for 2011 plus the amount required for 2012. While deferring income is normally a sound tax strategy, here it results in bunching income into 2012. Thus, think twice before delaying your 2011 distribution to 2012—bunching income into 2012 might throw you into a higher tax bracket or have a detrimental impact on your other tax deductions in 2012.

Making the Most of Your Employee Benefits

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want to set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2012 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent care costs. Watch out, though, FSAs are "use-it-or-lose-it" accounts—you don't want to set aside more than what you'll likely have in qualifying expenses for the year.

Married couples who both have access to FSAs will also need to decide whose FSA to use. If one spouse's salary is likely to be higher than what's known as the FICA wage limit (which is $106,800 for this year and will likely be somewhat higher next year) and the other spouse's will be less, the one with the smaller salary should fund as much of the couple's FSA needs as possible. The reason is the 6.2% social security

tax levy for 2012 is set to stop at the FICA wage limit (and doesn't apply at all to money put into an FSA). Thus, for example, if one spouse earns $115,000 and the other $40,000 and they want to collectively set aside $5,000 in their FSAs, they can save $310 (6.2% of $5,000) by having the full amount taken from the lower-paid spouse's salary versus having 100% taken from the other one's wages. Of course, either way, the couple will also save approximately $1,400 in income and Medicare taxes because of the FSAs.

If you currently have a healthcare FSA, make sure you drain it by incurring eligible expenses before the deadline for this year. Otherwise, you'll lose the remaining balance. It's not that hard to drum some things up: new glasses or contacts, dental work you've been putting off, or prescriptions that can be filled early. Although, over-the-counter drugs (e.g., aspirin and antacids) no longer qualify for reimbursement by healthcare FSAs, bandages and medical equipment (e.g., thermometers and blood pressure monitoring devices) do qualify.

Adjust Your Federal Income Tax Withholding. If it looks like you are going to owe income taxes for 2011, consider bumping up the Federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay any taxes due less the amount paid in. However, as long as your total tax payments (estimated payments plus withholdings) equal at least 90% of your 2011 liability or, if smaller, 100% of your 2010 liability (110% if your 2010 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), penalties will be minimized, if not eliminated.

Don't Overlook Estate Planning

For 2011 and 2012, the unified federal gift and estate tax exemption is a relatively generous $5 million. However, the exemption will drop back to only $1 million in 2013 unless Congress takes action. In addition, the maximum federal estate tax rate for 2011 and 2012 is 35%. For 2013 and beyond, it is scheduled to rise from the current 35% to a painfully high 55%. Therefore, planning to avoid or minimize the federal estate tax should still be part of your overall financial game plan. Even if you already have a good plan, it may need updating to reflect the current $5 million exemption. Contact us for more information on the best ways to minimize estate taxes for someone in your situation.

Conclusion

Through careful planning, it's possible your 2011 tax liability can still be significantly reduced, but don't delay. The longer you wait, the less likely it is that you'll be able to achieve a meaningful reduction. The ideas discussed in this letter are a good way to get you started with year-end planning, but they're no substitute for personalized professional assistance. Please don't hesitate to call us with questions or for additional strategies on reducing your tax bill. We'd be glad to set up a planning meeting or assist you in any other way that we can.

Very truly yours,

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