

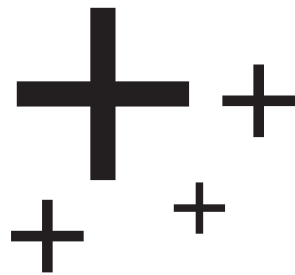


2011-2012 Tax Planning Guide

*YEAR-ROUND STRATEGIES TO MAKE
THE TAX LAWS WORK FOR YOU*



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Dear Clients and Friends,

If you think tax planning has become more complicated than ever, you're absolutely right. Not only have there been frequent and significant changes in tax law over the past year, but there's also the likelihood that there will be more soon. However, just what those changes will be and when they'll take effect is almost impossible to predict.

On top of that, there's still considerable uncertainty about the extent of the economic recovery and how it will affect your income. As a result, formulating a plan to minimize your taxes will require you to carefully consider different scenarios and adjust your strategies as developments occur.

We present this tax planning guide to help you understand how tax laws have changed and what steps you might take in light of those changes to minimize your income tax liability. We encourage you to look through it and note those strategies that seem most likely to benefit you. Then let us know how we can help you take advantage of them.

Just keep in mind that we don't have room in this guide to discuss every change or strategy that may pertain to your situation. So please check with us about other ways you might save tax. Also, don't wait until filing time! Tax planning is a year-round activity; to get the most benefit, you may need to act now.

We would very much like to talk with you about ways to minimize your taxes. Please contact us at your earliest convenience.

Best regards,

Rice Sullivan + Company

Mixed news for higher income taxpayers

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 kept ordinary-income and long-term capital gains rates from increasing this year and established “patches” for the AMT that may help reduce or eliminate your 2011 AMT liability. The act also offers some enhanced estate planning opportunities. And it extends and expands a number of other tax breaks. That’s the good news.

But many provisions of the law — including the extensions of the lower income and capital gains tax rates — are set to expire at the end of 2012 unless Congress extends them again. In light of this uncertainty, minimizing your taxes over the next few years will require especially careful planning and timely action, as well as a thorough understanding of various tax-saving strategies.

To this end, we’re pleased to offer this tax planning guide. While it covers the tax law changes and strategies most likely to apply to your situation, there are others we simply don’t have room to include here. So please check with your tax advisor to find out what’s best for you.

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Tax planning shouldn't be just a year end activity



A tremendous number of variables affect how a particular item of income is taxed and, ultimately, your overall tax liability for the year. And timing of income and deductible expenses can affect both the rate you pay and when you pay.

By regularly reviewing your year-to-date income, expenses and potential tax, you may be able to time income and expenses in a way that reduces, or at least defers, your tax liability. In other words, tax planning shouldn't be just a year end activity.

AMT triggers

The top AMT rate is only 28%, compared to the top ordinary-income tax rate of 35%. (See "What's new!" below for more on ordinary-income rates.) But the AMT rate typically applies to a higher taxable income base.

So before you take action to time income or expenses, determine whether you're already likely to be subject to the AMT — or whether the actions you're considering might trigger it. Many deductions used to calculate regular tax aren't allowed under the AMT (see Chart 1) and thus can trigger AMT liability. Some income items also might trigger or increase AMT liability:

- ◆ Long-term capital gains and dividend income, even though they're taxed at 15% for both regular tax and AMT purposes,
- ◆ Accelerated depreciation adjustments and related gain or loss differences when assets are sold, and
- ◆ Tax-exempt interest on certain private-activity municipal bonds. (For an exception, see the AMT Alert on page 11.)

Finally, in certain situations exercising incentive stock options (ISOs) can trigger significant AMT liability. (See the AMT Alert on page 6.)

Avoiding or reducing AMT

With proper planning, you may be able to avoid the AMT, or at least reduce its impact — or perhaps take advantage of

its lower maximum rate. But, planning for the AMT will be a challenge until Congress passes long-term relief.

Unlike the regular tax system, the AMT system isn't regularly adjusted for inflation. Instead, Congress must legislate any adjustments. Typically, it has done so in the form of a "patch" — an increase in the AMT exemption. Such a patch is in effect for 2011, but, as of this writing, not for 2012.

So it's critical to work with your tax advisor to determine whether:

You could be subject to the AMT this year. Consider accelerating income and short-term capital gains into this year, which may allow you to benefit from the lower maximum AMT rate. Also consider deferring expenses you *can't* deduct for

What's new!

2010 Tax Relief act provides two-year reprieve from 39.6% top tax rate

Who's affected: High-income taxpayers.

Key changes: The 2010 Tax Relief act extended the top 35% ordinary-income tax rate that was scheduled to return to 39.6% under the "sunset" provision of the 2001 tax act (along with the other 2001 tax act rates) through 2012. So income tax rate increases now aren't scheduled to occur until 2013.

Planning tips: This is good news for high-income taxpayers, because there had been much talk about extending the lower rates for only the lower and middle tax brackets, for only married couples making less than \$250,000 (less than \$200,000 for singles), or for only those making less than \$1 million. The extension of the 35% rate also means that for 2011 you can employ the traditional income-timing strategy of deferring income to the next year, where possible, to defer tax.



AMT purposes until next year — you may be able to preserve those deductions.

Additionally, if you defer expenses you *can* deduct for AMT purposes to next year, the deductions may become more valuable because of the higher maximum regular tax rate. Finally, carefully consider the tax consequences of exercising ISOs.

You could be subject to the AMT next

year. Consider taking the opposite approach. For instance, defer income to next year, because you'll likely pay a relatively lower AMT rate. And prepay expenses that will be deductible this year but that won't help you next year because they're not deductible for AMT purposes. Also, before year end consider selling any private activity municipal bonds whose interest could be subject to the AMT.

The AMT credit

If you pay AMT in one year on deferral items, such as depreciation adjustments, passive activity adjustments or the tax preference on ISO exercises, you may be entitled to a credit in a subsequent year.

In effect, this takes into account timing differences that reverse in later years. But the credit might provide only partial relief or take years before it can be fully used. Fortunately, the credit's refundable feature can reduce the time it takes to recoup AMT paid.

Timing income and expenses

Smart timing of income and expenses can reduce your tax liability, and poor timing can unnecessarily increase it.

If you don't expect to be subject to the AMT this year or next, consider deferring income to next year and accelerating deductible expenses into this year. This will defer tax, which is usually beneficial. But if you expect to be in a higher tax bracket next year, the opposite approach may be beneficial.

Chart 1

Regular tax vs. AMT: What's deductible?

Expense	Regular tax	AMT	For more information
State and local income or sales tax	✓		See page 4.
Real estate tax	✓		See page 12.
Mortgage interest	✓	✓	See page 12.
Interest on home equity debt not used to improve your principal residence	✓		See page 12.
Investment interest	✓	✓	See page 11.
Investment expenses	✓		See page 4.
Professional fees	✓		See page 4.
Unreimbursed employee business expenses	✓		See page 4.
Medical expenses	✓	✓	See page 4.
Charitable contributions	✓	✓	See page 16.

Also keep in mind that the otherwise applicable AGI limits reducing itemized deductions were eliminated for 2010, and this elimination has been extended through 2012. If you're normally subject to the limit, your deductions may provide you more tax savings this year — as long as they don't trigger the AMT.

Whatever the reason behind your desire to time income and expenses, here are some income items whose timing you may be able to control:

- ◆ Bonuses,
- ◆ Consulting or other self-employment income,
- ◆ U.S. Treasury bill income,
- ◆ Real estate or other nonpublicly traded property sales, and
- ◆ Retirement plan distributions, if not required.

And here are some potentially controllable expenses:

- ◆ State and local income taxes,
- ◆ Real estate taxes,
- ◆ Mortgage interest,
- ◆ Margin interest, and
- ◆ Charitable contributions.

Warning: Prepaid expenses can generally be deducted only in the year to which they apply. For example, you can prepay (by Dec. 31) real estate taxes that relate to this year but that are due next year, and deduct the payment on your return for this year. But you generally can't prepay real estate taxes that relate to next year and deduct the payment on this year's return.

Miscellaneous itemized deductions

Expenses that may qualify as miscellaneous itemized deductions are deductible for

regular tax purposes only to the extent they exceed, in aggregate, 2% of your AGI. Bunching these expenses into a single year may allow you to exceed this “floor.”

As the year progresses, record your potential deductions to date. If they’re close to or already exceed the 2% floor, consider paying accrued expenses and incurring and paying additional expenses by Dec. 31, such as:

- ♦ Deductible investment expenses, including advisory fees, custodial fees and publications,
- ♦ Professional fees, such as tax planning and preparation, accounting, and certain legal fees, and
- ♦ Unreimbursed employee business expenses, including travel, meals, entertainment and vehicle costs.

AMT ALERT! Miscellaneous itemized deductions aren’t deductible for AMT purposes and thus can trigger the AMT — or increase AMT liability. So don’t bunch such expenses into a year you may be subject to the AMT.

Medical expenses

Also subject to a floor are medical expenses. They’re generally deductible only to the extent that they exceed 7.5% of your AGI and aren’t reimbursable by insurance. So consider bunching nonurgent medical procedures and other controllable expenses into one year. If one spouse has high medical expenses and a relatively lower AGI, filing separately may allow that spouse to exceed the AGI floor and deduct some medical expenses that wouldn’t be deductible if the couple filed jointly.

AMT ALERT! For AMT purposes, only medical expenses exceeding 10% of your AGI are deductible. Also, because the AMT exemption for separate returns is considerably lower than the exemption for joint returns, filing separately to exceed the 7.5% floor for regular tax purposes could trigger the AMT.

Also remember that medical expenses that are paid through one of the following accounts aren’t deductible:

HSA. If you’re covered by qualified high-deductible health insurance, a Health Savings Account allows contributions of pretax income (or deductible after-tax contributions) up to \$3,050 for self-only coverage and \$6,150 for family coverage. (The limits will be \$3,100 and \$6,250, respectively, for 2012.) Account holders age 55 and older can contribute an additional \$1,000. HSAs bear interest or are invested and can grow tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit. The plan pays or reimburses you for medical expenses not covered by insurance. What you don’t use by the end of the plan year, you generally lose. If you have an HSA, your FSA is limited to funding certain “permitted” expenses.

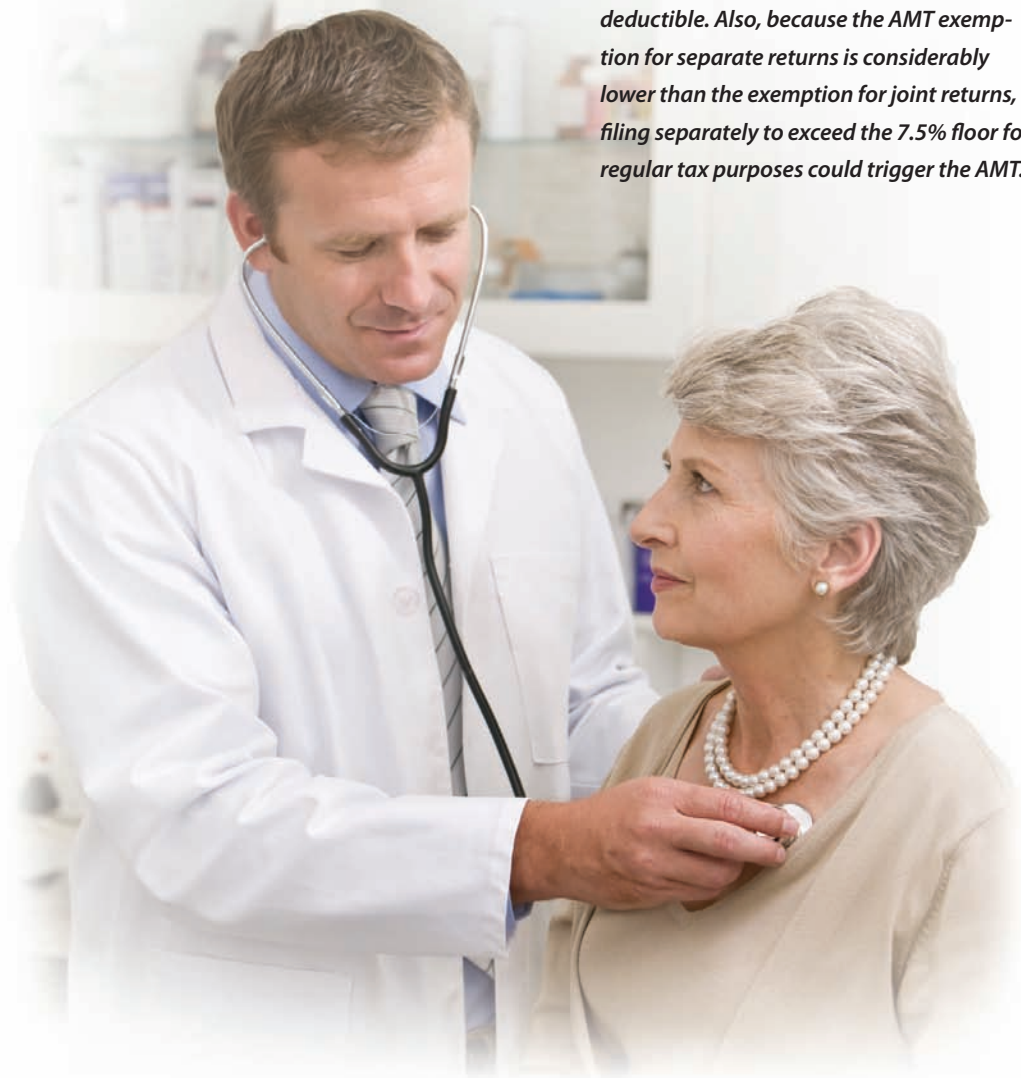
Warning: Beginning in 2011, you no longer can use HSA or FSA funds to pay for over-the-counter drugs unless they’re prescribed.

Sales tax deduction

The break allowing you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes is available for 2011 but, as of this writing, not for 2012. It can be valuable to taxpayers residing in states with no or low income tax or who purchase major items, such as a car or boat. If you’re considering such a purchase, you may want to make it by year end in case the break isn’t extended.

Employment taxes

In addition to income tax, you must pay Social Security and Medicare taxes on earned income, such as salary and



bonuses. For 2011, the employee portion of the Social Security tax on earned income has been reduced from 6.2% to 4.2%. The maximum taxable wage base for Social Security taxes for 2011 is \$106,800 (the same as for 2010). So the maximum tax savings from this break is \$2,136.

Unlike last year's Making Work Pay credit (which the Social Security tax break essentially replaces), no other income-based limit applies. So even high-income taxpayers can enjoy the maximum benefit.

Warning: All earned income is subject to the 2.9% Medicare tax (split equally between the employee and the employer).

Self-employment taxes

If you're self-employed, your employment tax liability typically doubles, because you also must pay the employer portion of these taxes. As a result, self-employment income can be taxed at an effective federal rate as high as 48% compared to about 43% for income from wages. Why isn't the difference greater? Because you receive a deduction for 50% of the self-employment taxes you pay.

However, for 2011 the self-employed's rate for the Social Security portion is also reduced by two percentage points, from 12.4% to 10.4%. This doesn't reduce a self-employed individual's deduction for the employer's share of these taxes — you can still deduct the full 6.2% employer portion of Social Security tax, along with one-half of the Medicare tax, for a full 7.65% deduction.

Owner-employees

There are special considerations if you're a business owner who also works in the business, depending on its structure:

Partnerships and limited liability companies. Generally, all trade or business income that flows through to you for

income tax purposes is subject to self-employment taxes — even if the income isn't actually distributed to you. But such income isn't subject to self-employment taxes if you're a limited partner or an LLC member whose ownership is equivalent to a limited partnership interest.

S corporations. Only income you receive as salary is subject to employment taxes. So to reduce your employment taxes, you may want to keep your salary relatively low and increase your distributions of company income (which generally isn't taxed at the corporate level).

But to avoid potential back taxes and penalties, you must take a "reasonable"

salary. What's considered "reasonable" is determined by the specific facts and circumstances, but it's generally what the company would pay an outsider to perform the same services.

C corporations. Only income you receive as salary is subject to employment taxes. You may prefer to take more income as salary (which is deductible at the corporate level) because the overall tax paid by both the corporation and you may be less.

Warning: The IRS is cracking down on misclassification of corporate payments to shareholder-employees, and Congress also has been looking at this issue, so tread carefully. ■

Case Study I

Avoiding underpayment penalties

Michael worked full-time, but he also did some consulting on the side, and his busy season tended to be the last quarter of the year. He was always careful to make quarterly estimated tax payments on time, but when he met with his tax advisor about his 2010 tax return, he learned he might be subject to underpayment penalties. Why? Because his consulting income spiked at the end of the year, and he hadn't paid enough tax during the year through estimated tax payments and withholding. Unless he can satisfy one of the exceptions, he will be subject to the underpayment penalty.

Here are some strategies that Michael's advisor suggested he could use to avoid facing underpayment penalties for 2011:

Know the minimum payment rules. To avoid penalties, your estimated payments or withholding must equal at least 90% of your tax liability for 2011 or 110% of your 2010 tax (100% if your 2010 AGI was \$150,000 or less or, if married filing separately, \$75,000 or less).

Use the annualized income installment method.

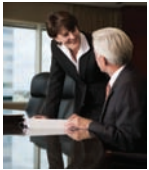
This method often benefits taxpayers who have large variability in income by month due to bonuses, investment gains and losses, or seasonal income (especially if it's skewed toward the end of the year). Annualizing computes the tax due based on income, gains, losses and deductions through each estimated tax period.

Estimate your tax liability and increase withholding.

If you determine you've underpaid, consider having the tax shortfall withheld from your salary or year end bonus by Dec. 31. Because withholding is considered to have been paid ratably throughout the year, this is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters.



Be tax-smart with NQDC, stock options and restricted stock



Executives are often rewarded for their business acumen with nonqualified deferred compensation (NQDC), stock options or restricted stock. To keep your taxes to a minimum, it's important to be just as smart when it comes to tax planning for these complicated forms of compensation. This means both understanding the unique rules that apply to each compensation type and taking steps to use them to your advantage.

NQDC plans

These plans pay executives in the future for services to be currently performed. They differ from qualified plans, such as 401(k)s (see page 20), in several ways. For example, NQDC plans can favor highly compensated employees, but any NQDC plan funding isn't protected from the employer's creditors.

One important NQDC tax issue is that employment taxes (see "Employment taxes" on page 4) are generally due once services have been performed and there's no longer a

substantial risk of forfeiture — even though compensation may not be paid or recognized for income tax purposes until *much* later. So your employer may withhold your portion of the employment taxes from your salary or ask you to write a check for the liability. Or it may pay your portion, in which case you'll have additional taxable income.

Keep in mind that the rules for NQDC plans are tighter than they once were, and the penalties for noncompliance can be severe: You could be taxed on plan benefits

at the time of vesting, and a 20% penalty and potential interest charges also could apply. So check with your employer to make sure it's addressing any compliance issues.

Incentive stock options

Incentive stock options (ISOs) receive tax-favored treatment but must comply with many rules. ISOs allow you to buy company stock in the future (but before a set expiration date) at a fixed price equal to or greater than the stock's fair market value (FMV) at the date of the grant.

Therefore, ISOs don't provide a benefit until the stock appreciates in value. If it does, you can buy shares at a price below what they're then trading for, as long as you've satisfied the applicable ISO holding periods. Here are the key tax consequences:

- ◆ You owe no tax when the ISOs are granted.
- ◆ You owe *no regular* income tax when you exercise the ISOs.
- ◆ If you sell the stock *after* holding the shares at least one year from the date of exercise and two years from the date the ISOs were granted, you pay tax on the sale at your long-term capital gains rate.
- ◆ If you sell the stock *before* long-term capital gains treatment applies, a "disqualifying disposition" occurs and any gain is taxed as compensation at ordinary-income rates.

AMT ALERT! In the year of exercise, a tax "preference" item is created on the difference between the stock's FMV and the exercise price (the "bargain element") that can trigger

the AMT. A future AMT credit, however, may mitigate this AMT hit.

If you've received ISOs, plan carefully when to exercise them and whether to immediately sell shares received from an exercise or to hold them. Waiting until just before the expiration date to exercise ISOs (when the stock value may be the highest, assuming the stock is appreciating) and holding on to the stock long enough to garner long-term capital gains treatment often is beneficial. But there's also market risk to consider.

In several situations, acting earlier can be advantageous:

- ♦ Exercise early to start your holding period so you can sell and receive long-term capital gains treatment sooner.
- ♦ Exercise when the bargain element is small or when the market price is close to bottoming out to reduce or eliminate AMT liability.
- ♦ Exercise annually so you can buy only the number of shares that will achieve a breakeven point between the AMT and regular tax and thereby incur no additional tax.
- ♦ Sell in a disqualifying disposition and pay the higher ordinary-income rate to avoid the AMT on potentially disappearing appreciation.

On the negative side, exercising early accelerates the need for funds to buy the stock, exposes you to a loss if the shares' value drops below your exercise cost, and may create a tax cost if the preference item from the exercise generates an AMT liability. With the help of your tax advisor, evaluate the risks and crunch the numbers using various assumptions to determine the best strategy for your situation.

Nonqualified stock options

The tax treatment of nonqualified stock options (NQSOs) is different from that of ISOs: NQSOs create compensation income

Chart 2

ISOs vs. nonqualified stock options

Tax treatment at exercise	Tax treatment at stock sale
<p>ISOs: No regular tax, but an AMT preference item is created on the bargain element (difference between FMV on exercise date and exercise price)</p> <p><i>Example¹:</i> $\\$30,000 - \\$10,000 = \\$20,000$ $\\$20,000 \times 28\% = \\$5,600^2$ tax</p>	<p>ISOs: Difference between sale price and exercise price taxed at long-term capital gains rate (generally 15%)³</p> <p><i>Example¹:</i> $\\$50,000 - \\$10,000 = \\$40,000$ $\\$40,000 \times 15\% = \\$6,000$ tax</p>
<p>ISO disqualifying disposition⁴: NA</p> <p><i>Example¹:</i> NA</p>	<p>ISO disqualifying disposition⁴: Difference between sale price and exercise price taxed at ordinary-income rate</p> <p><i>Example¹:</i> $\\$50,000 - \\$10,000 = \\$40,000$ $\\$40,000 \times 35\% = \\$14,000$ tax</p>
<p>Nonqualified stock options: Bargain element taxed at ordinary-income rate</p> <p><i>Example¹:</i> $\\$30,000 - \\$10,000 = \\$20,000$ $\\$20,000 \times 35\% = \\$7,000$ tax</p>	<p>Nonqualified stock options: Difference between sale price and FMV on exercise date taxed at applicable capital gains rate</p> <p><i>Example¹:</i> $\\$50,000 - \\$30,000 = \\$20,000$ $\\$20,000 \times 15\%^3 = \\$3,000$ tax</p>

¹ Assumes exercise price is \$10,000, FMV on exercise is \$30,000 and FMV at stock sale is \$50,000, and that tax is applied at the top 2011 rate.
² Only if you're subject to the AMT for the year of exercise. A tax credit may be available in a future year.
³ Assumes necessary holding period has been met for long-term capital gains treatment.
⁴ Stock is sold before it can qualify for long-term capital gains treatment.

(taxed at ordinary-income rates) on the bargain element when exercised (regardless of whether the stock is held or sold immediately), but they don't create an AMT preference item.

You may need to make estimated tax payments or increase withholding to fully cover the tax on the exercise. Also consider state tax estimated payments.

Restricted stock

Restricted stock is stock that's granted subject to a substantial risk of forfeiture. Income recognition is normally deferred until the stock is no longer subject to that risk or you sell it. You then pay taxes based on the stock's FMV when the restriction lapses and at your ordinary-income rate.

But you can instead make a Section 83(b) election to recognize ordinary income when you receive the stock. This election,

which you must make within 30 days after receiving the stock, can be beneficial if the income at the grant date is negligible or the stock is likely to appreciate significantly before income would otherwise be recognized. Why? Because the election allows you to convert future appreciation from ordinary income to long-term capital gains income and defer it until the stock is sold.

There are some disadvantages of a Sec. 83(b) election: First, you must prepay tax in the current year. But if a company is in the earlier stages of development, this may be a small liability. Second, any taxes you pay because of the election can't be refunded if you eventually forfeit the stock or its value decreases. But you'll have a capital loss when you sell or forfeit the stock.

Work with your tax advisor to map out whether the Sec. 83(b) election is appropriate for you in each particular situation. ■

Consider locking in lower rates while they're still available



The 15% long-term capital gains and qualified dividend rate that had been set to expire after 2010 has been extended — perhaps making taxes on your investments less of a concern for the time being. But the reprieve is only temporary: Without Congressional action, in 2013 the capital gains rate will rise to 20%, and dividends will return to being taxed at ordinary-income rates as high as 39.6%. So there may be actions you'll want to take now to lock in lower rates while they're still available.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. The 15% long-term capital gains rate is 20 percentage points lower than the highest ordinary-income rate of 35%. It generally applies to investments held for more than 12 months. (Higher long-term gains rates apply to certain types of assets — see Chart 3.) Holding

on to an investment until you've owned it more than a year may help substantially cut tax on any gain.

AMT ALERT! Substantial net long-term capital gains can trigger the AMT.

Remember that appreciating investments that don't generate current income aren't taxed until sold, deferring tax and perhaps allowing you to time the sale to your tax advantage — such as in a year when you

have capital losses to absorb the capital gain. Or, if you've cashed in some big gains during the year and want to reduce your 2011 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains.

The wash sale rule

If you're trying to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid the wash sale rule. For example, you may immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much

Case Study II

Just because you don't qualify doesn't mean you can't benefit from the 0% rate

Susan's son and daughter-in-law, Justin and Julia, just started a family. Justin is completing his medical residency and Julia is staying home with the baby, so they expect to be in only the 15% income tax bracket this year. They would like to buy a home while prices and interest rates are still relatively low, and Susan wants to help them with the down payment.

Initially, Susan plans to give them cash. But when she mentions to her tax advisor that she also plans to sell \$25,000 of highly appreciated stock, he suggests that she give the young couple the stock instead. Susan's basis in the stock is only \$5,000, so if she sells the stock, she'll owe \$3,000 of tax on the gain ($\$25,000 - \$5,000 = \$20,000$ of gain, $\times 15\%$). But if she gives it to Justin and Julia, they can sell the stock and owe no tax on the gain because they qualify for the 0% rate.





Warning: If the recipient is under age 24, he or she might be subject to the kiddie tax. (See "The 'kiddie tax'" on page 18.) Also, consider any gift tax consequences. (See page 22.)



Chart 3

What's the maximum capital gains tax rate?

Maximum tax rate for assets held	2011–2012	2013
12 months or less (<i>short term</i>)	35%	39.6%
More than 12 months (<i>long term</i>)	15%	20%

Some key exceptions	2011–2012	2013
 Long-term gain on collectibles, such as artwork and antiques	28%	28%
 Long-term gain attributable to certain recapture of prior depreciation on real property	25%	25%
 Gain on qualified small business stock held more than 5 years	14% ¹	14% ¹
 Long-term gain that would be taxed at 15% or less based on the taxpayer's ordinary-income rate	0%	10%

¹ Effective rate based on 50% exclusion from a 28% rate.

like the ones you sold. Or, you can wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

You also can do a bond swap, where you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

Loss carryovers

If net losses exceed net gains, you can deduct only \$3,000 (\$1,500 for married

taxpayers filing separately) of the net losses per year against ordinary income. You can carry forward excess losses indefinitely.

By determining whether, year to date, you have excess losses, you can time sales of other investments before year end to achieve your tax planning goals. For example, loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains. They'll be even more powerful if rates go up in 2013.

If, on the other hand, it looks like it could take a long time to fully absorb a large loss carryover, you might want to realize gains before year end to absorb excess losses — as

long as this will also help you accomplish your investment goals. Remember that capital gains distributions from mutual funds can also absorb capital losses.

If you don't have enough gains to absorb more losses and you want to minimize loss carryovers, from a tax perspective it may not be desirable to sell any more investments at a loss. Plus, if you hold on to an investment, it may recover its lost value.

But if you're ready to divest yourself of a poorly performing stock because you think it will continue to lose value — or because your investment objective or risk tolerance has changed — don't hesitate solely for tax reasons. Tax considerations shouldn't be the primary driver of investment decisions.

Paying attention to details

If you don't pay attention to the details, the tax consequences of a sale may be different from what you expect. For example, the trade date, not the settlement date, of publicly traded securities determines the year in which you recognize the gain or loss.

And if you bought the same security at different times and prices and want to sell high-tax-basis shares to reduce gain or increase a loss and offset other gains, be sure to specifically identify which block of shares is being sold.

Mutual funds

Investing in mutual funds is an easy way to diversify your portfolio. But beware of the tax pitfalls. First, mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

Second, earnings on mutual funds are typically reinvested, and unless you (or your investment advisor) keep track of these additions and increase your basis accordingly, you may report more gain than required when you sell the fund.

What's new!

100% gain exclusion for certain small business stock purchased by Dec. 31

Who's affected: Investors considering small business stock.

Key changes: Generally, taxpayers selling qualified small business (QSB) stock are allowed to exclude up to 50% of their gain if they've held the stock for more than five years. (See "Small business stock" below.) Because the 50% exclusion is computed based on an old tax rate of 28%, the 14% rate is only slightly less than the rate for other long-term gains. But under 2010 tax legislation, the exclusion is 100% for stock acquired after Sept. 27, 2010, and before Jan. 1, 2012. (If the stock was acquired after Feb. 17, 2009, and before Sept. 28, 2010, the exclusion is 75%.) The five-year holding requirement still applies.

Planning tips: You may want to purchase QSB stock by year end so you can potentially take advantage of the 100% gain exclusion. But keep in mind that the tax benefits are subject to additional requirements. Consult your tax and financial advisors to be sure investing in QSB stock is right for you.

Third, buying equity mutual fund shares later in the year can be costly tax-wise. Such funds often declare a large capital gains distribution at year end. If you own the shares on the distribution's record date, you'll be taxed on the full distribution amount even if it includes significant gains realized by the fund *before* you owned the shares. And you'll pay tax on those gains in the current year — even if you reinvest the distribution.

Small business stock

By purchasing stock in certain small businesses, you can diversify your portfolio. You also may enjoy preferential tax treatment:

Conversion of capital loss to ordinary loss. If you sell qualifying Section 1244 small business stock at a loss, you can treat up to \$50,000 (\$100,000, if married filing jointly) as an ordinary, rather than a capital, loss — regardless of your holding period. This means you can use it to offset ordinary income, reducing your tax by as much as 35% on this portion of the loss. Sec. 1244 applies only if total capital invested isn't more than \$1 million.

Tax-free gain rollovers. If within 60 days of selling qualified small business (QSB) stock you buy other QSB stock with the proceeds, you can defer the tax on your gain until you dispose of the new stock.

The rolled-over gain reduces your basis in the new stock. For determining long-term capital gains treatment, the new stock's holding period includes the holding period of the stock you sold. To be a QSB, a business must be engaged in an active trade or business and must not have assets that exceed \$50 million.

Exclusion of gain. Generally, taxpayers selling QSB stock are allowed to exclude up to 50% of their gain if they've held the stock for more than five years. But, depending on the acquisition date, the exclusion may be greater. (See "What's new!" above.)

The taxable portion of any QSB gain will be subject to the lesser of your ordinary-income rate or 28%, rather than the normal long-term gains rate. (See Chart 3 on page 9.) Thus, if the 28% rate and the 50% exclusion apply, the effective rate on the QSB gain will be 14% ($28\% \times 50\%$).

Keep in mind that all three of these tax benefits are subject to specific requirements and limits. Consult your tax and financial advisors to be sure an investment in small business stock is right for you.

Passive losses

If you've invested in a trade or business in which you don't materially participate,

remember that passive activity losses generally are deductible only against income from other passive activities. You can carry forward disallowed losses to the following year, subject to the same limits.

To avoid passive activity treatment, typically you must participate in a trade or business more than 500 hours during the year or demonstrate that your involvement constitutes substantially all of the participation in the activity. (Special rules apply to real estate; see "Real estate activity losses" on page 13.) If you don't pass this test, consider:

Increasing your involvement. If you can exceed 500 hours, the activity no longer will be subject to passive loss limits. If the business is structured as a limited liability company (LLC), possible changes in IRS regulations may reduce the number of hours you must be involved. Check with your tax advisor for the latest information.

Disposing of the activity. This allows you to deduct all the losses — including any loss on disposition (subject to basis and capital loss limitations). But the rules are complex, so consult your tax advisor.

Looking at other activities. Limit your participation in another activity that's generating income, so that you don't meet the 500 hours test, or invest in another income-producing trade or business that will be passive to you. Under both strategies, you'll then have passive income that can absorb your passive losses.

Income investments

While qualified dividends generally are taxed at the reduced rate of 15%, interest income generally is taxed at ordinary-income rates, which currently are as high as 35%. So dividend-paying stocks may be more attractive tax-wise than other income investments, such as CDs, money market accounts and bonds. But there are exceptions.



higher than the after-tax rate of return for a taxable investment, depending on your tax rate. (See Case Study III.)

AMT ALERT! Tax-exempt interest from private activity municipal bonds can trigger or increase AMT liability. However, any income from tax-exempt bonds issued in 2009 and 2010 (along with 2009 and 2010 re-fundings of bonds issued after Dec. 31, 2003, and before Jan. 1, 2009) is excluded from the AMT.

Investment interest expense

Investment interest — interest on debt used to buy assets held for investment, such as margin debt used to buy securities — is deductible for both regular tax and AMT purposes. But special rules apply.

Your investment interest deduction is limited to your net investment income, which generally includes taxable interest, nonqualified

dividends and net short-term capital gains (but not long-term capital gains), reduced by other investment expenses. Any disallowed interest is carried forward, and you can deduct it in a later year if you have excess net investment income.

You may elect to treat net long-term capital gains or qualified dividends as investment income in order to deduct more of your investment interest. But if you do, that portion of the long-term capital gain or dividend is taxed at ordinary-income rates.

Payments a short seller makes to the stock lender in lieu of dividends may be deductible as an investment interest expense. But interest on debt used to buy securities that pay tax-exempt income, such as municipal bonds, isn't deductible.

Also keep in mind that passive interest expense — interest on debt incurred to fund passive activity expenditures — becomes part of your overall passive activity income or loss, subject to limitations. ■

Some dividends are subject to ordinary-income rates. These may include certain dividends from:

- ♦ Real estate investment trusts (REITs),
- ♦ Regulated investment companies (RICs),
- ♦ Money market mutual funds, and
- ♦ Certain foreign investments.

Warning: You have only through 2012 to take advantage of the 15% rate on qualified dividends, unless Congress extends it.

The tax treatment of bond income varies. For example:

- ♦ Interest on U.S. government bonds is taxable on federal returns but generally exempt on state and local returns.
- ♦ Interest on state and local government bonds is excludible on federal returns. If the bonds were issued in your home state, interest also may be excludible on your state return.
- ♦ Corporate bond interest is fully taxable for federal and state purposes.
- ♦ Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Keep in mind that, although state and municipal bonds usually pay a lower interest rate, their rate of return may be

Case Study III

Comparing tax-exempt and taxable bond yields

Working with his financial advisor, David decides it's time to get more bonds in his portfolio. Being in the top tax bracket, he's leaning toward municipal bonds, because the interest will be tax-free, at least on his federal return. But the fact that an investment is tax-exempt doesn't necessarily mean that it's a better choice than a comparable taxable investment.

Municipal bonds, for example, typically offer lower yields than comparable corporate bonds. To compare apples to apples, David needs to calculate the tax-equivalent yield, which incorporates tax savings into the municipal bond's yield. The formula is simple: Tax-equivalent yield = actual yield / (1 - David's marginal tax rate).

For example, David considers a municipal bond with a 4.25% yield and a comparable corporate bond that offers a 6.25% yield. Because he's in the 35% tax bracket, the municipal bond's tax-equivalent yield is $.0425 / (1 - .35) = .0654$ (rounded), or 6.54%. In terms of the amount of income he'll get to keep, the municipal bond is a slightly better choice. If the municipal bond is also exempt from state and local taxes, it may be even more attractive.

But David also needs to consider other factors, such as risk and how well the bond will help achieve his overall investment goals.

Now may be the time to revisit real estate



With some areas of the country starting to rebound, savvy homebuyers and real estate investors are in the hunt for those diamond-in-the-rough properties that can yield big returns.

Whether you're looking for a new home or vacation home or a rental or investment property — or you simply want to make the most of your current property — the key is to take advantage of all the tax breaks available to you.

Home-related tax breaks

Whether you're putting your money into one home or several, it's important to make the most of available breaks:

Property tax deduction. If you're looking to accelerate or defer deductions, property tax is one expense you may be able to time. (See "Timing income and expenses" on page 3.)

AMT ALERT! *Property tax isn't deductible for AMT purposes. If you're subject to the AMT this year, a prepayment will hurt you rather than help you because you'll lose the benefit of the deduction.*

Mortgage interest deduction. You generally can deduct (for both regular tax and AMT purposes) interest on up to a combined total of \$1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your *principal* residence also may be deductible.

Home equity debt interest deduction.

Interest on home equity debt used to improve your principal residence — and interest on home equity debt used for any purpose (debt limit of \$100,000) — may be deductible. So consider using a

home equity loan or line of credit to pay off credit cards or auto loans, for which interest isn't deductible.

AMT ALERT! *If home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes and could trigger the AMT.*

Energy-related breaks. A wide variety of breaks designed to encourage energy efficiency and conservation are available. Consult your tax advisor for details.

Home office deduction

If your use of your home office is for your employer's benefit and it's the only use of the space, you can deduct a portion of your mortgage interest, real estate taxes, insurance, utilities, security system and certain other expenses. Further, you can take a deduction for the depreciation allocable to the portion of your home used for the office. You can also deduct direct expenses, such as business-only phone and fax lines and office supplies.

You must claim these expenses as a miscellaneous itemized deduction, which means you'll enjoy a tax benefit only if your home office expenses plus your other miscellaneous itemized expenses exceed 2% of

your AGI. If, however, you're self-employed, you can use the deduction to offset your self-employment income and the AGI "floor" won't apply.

Of course, there are numerous exceptions and caveats. If this break might apply to you, discuss it with your tax advisor in more detail.

Home rental rules

If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses associated with the rental won't be deductible.

If you rent out your principal residence or second home for 15 days or more, you'll have to report the income. But you also may be entitled to deduct some or all of your rental expenses — such as utilities, repairs, insurance and depreciation. Exactly what you can deduct depends on whether the home is classified as rental property for tax purposes (based on the amount of personal vs. rental use):

Nonrental property. You can deduct rental expenses only to the extent of your rental income. Any excess can be carried forward to offset rental income in future years. You also can take an itemized deduction for the personal portion of both mortgage interest and property taxes.

Rental property. You can deduct rental expenses, including losses, subject to the passive activity rules. You can't deduct any interest that's attributable to your personal use of the home, but you can take the personal portion of property tax as an itemized deduction. In some situations, it

may be beneficial to reduce personal use of a residence so it will be classified as a rental property.

Home sales

When you sell your principal residence, you can exclude up to \$250,000 (\$500,000 for joint filers) of gain if you meet certain tests. To support an accurate tax basis, maintain thorough records, including information on your original cost and subsequent improvements, reduced by casualty losses and any depreciation that you may have claimed based on business use.

Warning: Gain on the sale of a principal residence generally isn't excluded from income if the gain is allocable to a period of "nonqualified" use.

Losses on the sale of a principal residence aren't deductible. But if part of your home is rented or used exclusively for your business, the loss attributable to that portion will be deductible, subject to various limitations.

Because a second home is ineligible for the gain exclusion, consider converting it to rental use before selling. It can be considered a business asset, and you may be able to defer tax on any gains through an installment sale or a Section 1031



What's new!

Depreciation-related breaks extended and expanded

Who's affected: Owners of leasehold, restaurant or retail properties.

Key changes: Three depreciation-related breaks have been significantly enhanced:

- ♦ **Bonus depreciation.** Qualified leasehold-improvement property — if *new* — is eligible for bonus depreciation, and the 2010 Tax Relief act increases this additional first-year depreciation allowance to 100% for property acquired and placed in service after Sept. 8, 2010, and before Jan. 1, 2012. For property acquired and placed in service in 2012, bonus depreciation is, as of this writing, scheduled to return to 50%. And it will expire after 2012 if Congress doesn't take action.
- ♦ **Section 179 expensing.** For 2011 (but not for 2012), the Small Business Jobs Act of 2010 allows you to expense under Sec. 179 (rather than depreciate over a number of years) up to \$250,000 of qualified leasehold-improvement, restaurant and retail-improvement property. The break begins to phase out dollar for dollar when total asset acquisitions for the tax year exceed \$2 million. But unlike bonus depreciation, Sec. 179 expensing can be applied to *used* property.
- ♦ **Accelerated depreciation.** The 2010 Tax Relief act extends through 2011 the accelerated depreciation (a shortened recovery period of 15, rather than 39, years) available for qualified leasehold-improvement, restaurant and retail-improvement property. This might be beneficial for property ineligible for bonus depreciation and in excess of the Sec. 179 expensing limits.

Planning tips: If you're anticipating investments in qualified property in the next year or two, you may want to time them so you can benefit from the enhanced breaks available for 2011.

exchange. (See "Tax deferral strategies for investment property" at right.) Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion.

Real estate activity losses

Losses from investment real estate or rental property are passive by definition — unless you're a real estate professional. Then you can deduct real estate activity losses in full. To qualify as a real estate professional, you must annually perform:

- ♦ More than 50% of your personal services in real property trades or businesses in which you materially participate, and
- ♦ More than 750 hours of service in these businesses during the year.

Each year stands on its own, and there are other nuances to be aware of. If you're concerned you'll fail either test and be stuck with passive losses, consider increasing your hours so you'll meet the test. (For more on passive loss rules, see page 10.)

Tax-deferral strategies for investment property

It's possible to divest yourself of appreciated investment real estate but defer the tax liability. Such strategies may, however, be risky from a tax perspective until there's more certainty about future capital gains rates — if rates go up after 2012 as currently scheduled, tax deferral could be costly. So tread carefully if you're considering a deferral strategy such as the following:

Installment sale. An installment sale allows you to defer gains by spreading them over several years as you receive the proceeds.

Warning: Ordinary gain from certain depreciation recapture is recognized in the year of sale, even if no cash is received.

Sec. 1031 exchange. Also known as a "like-kind" exchange, this technique allows you to exchange one real estate investment property for another and defer paying tax on any gain until you sell the replacement property. **Warning:** Restrictions and significant risks apply. ■

Ensuring your business helps you achieve personal financial goals



Business owners have some tax planning concerns that are different from those of an executive who works for a corporation. When a business is a flow-through entity (such as a partnership or an S corporation), owners need to be concerned about how its annual performance will affect their own income tax liability. But they also need to look at how their business can help them achieve their long-term personal financial goals.

Retirement saving

If most of your money is tied up in your business, retirement can be a challenge. So if you haven't already set up a tax-advantaged retirement plan, consider setting one up this year. Keep in mind that, if you have employees, they generally must be allowed to participate in the plan, provided they work enough hours. Here are a few options that may allow you to make large contributions:

Profit-sharing plan. This is a defined contribution plan that allows discretionary employer contributions and flexibility in plan design. You can make deductible 2011 contributions (see Chart 4 for limits) as late as the due date of your 2011 income tax return, including extensions — provided your plan exists on Dec. 31, 2011.

SEP. A Simplified Employee Pension is a defined contribution plan that provides benefits similar to those of a profit-sharing plan. But you can establish a SEP in 2012 and still make deductible 2011 contributions (see Chart 4 for limits) as late as the due date of your 2011 income tax return, including extensions. Another benefit is that a SEP is easier to administer than a profit-sharing plan.

Defined benefit plan. This plan sets a future pension benefit and then actuarially calculates the contributions needed to attain that benefit. The maximum annual benefit for 2011 is generally \$195,000 or 100% of average earned income for the highest three consecutive years, if less. Because it's actuarially driven, the 2011 contribution needed to attain the projected future annual benefit may exceed the maximum contributions allowed by other plans, depending on your age and the desired benefit.

You can make deductible 2011 contributions until the due date of your return, provided your plan exists on Dec. 31, 2011.

Warning: Employer contributions generally

are required and must be paid quarterly if there was a shortfall in funding for the prior year.

Exit planning

An exit strategy is a plan for passing on responsibility for running the company, transferring ownership and extracting your money from the business. This requires planning well in advance of the transition. Here are the most common exit options:

Buy-sell agreements. When a business has more than one owner, a buy-sell agreement can be a powerful tool. The agreement controls what happens to the business when a specified event occurs, such as an owner's retirement, disability or death. Among other benefits, a well-drafted agreement:

- ◆ Provides a ready market for the departing owner's shares,
- ◆ Sets a price for the shares, and
- ◆ Allows business continuity by preventing disagreements caused by new, unwanted owners.

Chart 4

Profit-sharing plan vs. SEP: How much can you contribute?

Profit-sharing plan	SEP
2011 maximum contribution: \$49,000 or \$54,500.	2011 maximum contribution: \$49,000.
Eligibility: You can't contribute more than 100% of your compensation. To qualify for the higher limit, your plan must include a 401(k) arrangement and you must be eligible to make catch-up contributions (that is, be age 50 or older). Additional rules may further limit your contribution.	Eligibility: You can't contribute more than 25% of your eligible compensation. Additional rules may further limit your contribution.

A key issue with any buy-sell agreement is providing the buyer(s) with a means of funding the purchase. Life or disability insurance often helps fulfill this need and can give rise to several tax and nontax issues and opportunities.

One of the biggest advantages of life insurance as a funding method is that proceeds generally are excluded from the beneficiary's taxable income. There are exceptions, however, so be sure to consult your tax advisor.

Succession within the family. You can pass your business on to family members or close relatives by giving them interests, selling them interests or doing some of each. Be sure to consider your income needs, how family members will feel about your choice, and the gift and estate tax consequences.

Now may be a particularly good time to transfer ownership interests. If your business has lost value, you can transfer a greater number of shares without giving away more value for gift tax purposes, and valuation discounts may further reduce the taxable value. On top of that, for 2011, the lifetime gift tax exemption is \$5 million, compared to \$1 million for 2010. You also can leverage your \$13,000 annual gift tax exclusions. (See page 22 for more on gift and estate planning.)

Nonfamily succession. If family members aren't interested in or capable of taking over your business, one option is a management buyout. This can provide for a smooth transition because there may be little learning curve for the new owners. Plus you avoid the time and expense of finding an outside buyer.

Selling to an outsider. This can also be an excellent option. If you can find the right buyer, you may even be able to sell the business at a premium.

Sale or acquisition

Whether you're selling your business as part of your exit strategy or acquiring another company to help grow it, the tax

Case Study IV

ESOPs benefit both owners and employees

Paul is planning to retire in about 10 years and wants to create a viable succession plan. His business makes up the bulk of his investments, so he's concerned that his portfolio lacks both diversity and liquidity. He also wants to help ensure he retains good employees to keep the business competitive, both now and after he retires.

Another business owner he knows, Carol, suggests he look into a solution that has worked well for her: an employee stock ownership plan (ESOP). She explains that an ESOP is a qualified retirement plan that benefits employees. Paul can fund the ESOP as he would a profit-sharing plan, and the ESOP can then purchase his shares in the company. Provided that he sells at least 30% of the company to the ESOP, he can defer tax on his gains if he rolls them into qualified securities. Carol also suggests that he consider a leveraged ESOP, which involves a loan to the ESOP and may provide additional tax benefits.



consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

Asset vs. stock sale. With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. Buyers generally want an asset sale to maximize future depreciation write-offs.

Taxable sale vs. tax-deferred transfer. A transfer of corporation ownership can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying reorganization. But the transaction must comply with strict rules.

Although it's generally better to postpone tax, there are some advantages to a taxable sale:

- ♦ The parties don't have to meet the technical requirements of a tax-deferred transfer.
- ♦ The seller doesn't have to worry about the quality of buyer stock or other business risks of a tax-deferred transfer.

- ♦ The buyer benefits by receiving a stepped-up basis in its acquisition's assets and not having to deal with the seller as a continuing equity owner.

Installment sale. A taxable sale may be structured as an installment sale, due to the buyer's lack of sufficient cash or the seller's desire to spread the gain over a number of years, or when the buyer pays a contingent amount based on the business's performance. But an installment sale can backfire. For example:

- ♦ Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- ♦ If tax rates increase, the overall tax could wind up being more. (Remember, the favorable 15% rate on long-term capital gains is scheduled to end after Dec. 31, 2012.)

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition. ■

How donating can help you hit a tax-saving high note



Not only does giving to charity allow you to do good, but it also can be one of the most flexible tax-saving tools available to you. Why? Because you have complete control over when and how much you give. You can give more in years where you need to maximize your deductions, less in years where you don't. But take care: Many rules and limits apply that can affect the size of your deduction.

Cash donations

Outright gifts of cash (which include donations made via check, credit card and payroll deduction) are the easiest. The key is to substantiate them. To be deductible, cash donations must be:

- ♦ Supported by a canceled check, credit card receipt or written communication from the charity if they're under \$250, or
- ♦ Substantiated by the charity if they're \$250 or more.

Deductions for cash gifts to public charities can't exceed 50% of your AGI. The AGI limit is 30% for cash donations to nonoperating private foundations. Contributions exceeding the applicable AGI limit can be carried forward for up to five years.

AMT ALERT! Charitable contribution deductions are allowed for AMT purposes, but your tax savings may be less if you're subject to the AMT. For example, if you're in the 35% tax bracket for regular income tax purposes but the 28% tax bracket for AMT purposes, your deduction may be worth only 28% instead of 35%.

Stock donations

Publicly traded stock and other securities you've held more than one year are long-term capital gains property, which can

make one of the best charitable gifts. Why? Because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property.

Donations of long-term capital gains property are subject to tighter deduction limits — 30% for gifts to public charities, 20% for gifts to nonoperating private foundations. In certain, although limited, circumstances it may be better to deduct your tax basis (generally the amount paid

for the stock) rather than the fair market value, because it allows you to take advantage of the higher AGI limits that apply to donations of cash and ordinary-income property (such as stock held one year or less).

Don't donate stock that's worth less than your basis. Instead, sell the stock so you can deduct the loss and then donate the cash proceeds to charity.

Charitable remainder trusts

To benefit a charity while helping ensure your own financial future, consider a CRT:

- ♦ For a given term, the CRT pays an amount to you annually (some of which may be taxable).
- ♦ At the term's end, the CRT's remaining assets pass to one or more charities.

Case Study V

Taking a deduction today while benefiting charities over time

Alice enjoyed a windfall this year from selling her business. Because she's both charitably inclined and concerned about her tax liability, she'd like to start making large charitable contributions. But she doesn't know which charities she wants to benefit.

Alice talks to her tax advisor, and he recommends she consider a private foundation. She can take a large tax deduction this year while still retaining significant control over how her donation will be used. But foundations must comply with complex rules, which can make them expensive to run. Also, the AGI limits for deductibility of contributions to nonoperating foundations are lower. (See "Cash donations" and "Stock donations.")

So her advisor suggests that, if she'd like to influence how her donations are spent but avoid a foundation's tight rules and high expenses, she consider a donor-advised fund (DAF). Many larger public charities offer them. He offers one warning, though: To deduct her DAF contribution, she must obtain a written acknowledgment from the sponsoring organization that it has exclusive legal control over the assets contributed.

- ◆ When you fund the CRT, you receive an income tax deduction for the present value of the amount that will go to charity.
- ◆ The property is removed from your estate.

A CRT can also help diversify your portfolio if you own non-income-producing assets that would generate a large capital gain if sold. Because a CRT is tax-exempt, it can sell the property without paying tax on the gain at the time of the sale. The CRT can then invest the proceeds in a variety of stocks and bonds.

You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

Charitable lead trusts

To benefit charity while transferring assets to loved ones at a reduced tax cost, consider a CLT:

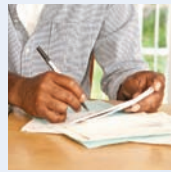
- ◆ For a given term, the CLT pays an amount to one or more charities.
- ◆ At the term's end, the CLT's remaining assets pass to one or more loved ones you name as remainder beneficiaries.
- ◆ When you fund the CLT, you make a taxable gift equal to the present value of the amount that will go to the remainder beneficiaries.
- ◆ The property is removed from your estate.

For gift tax purposes, the remainder interest is determined assuming that the trust assets will grow at the Section 7520 rate. The lower the Sec. 7520 rate, the smaller the remainder interest and the lower the possible gift tax. If the trust's earnings outperform the Sec. 7520 rate, the excess earnings will be transferred to the remainder beneficiaries tax-free. Because the Sec. 7520 rate currently is low, now may be a good time to take the chance that your actual return will outperform it. (For more on the gift tax, see page 22.)

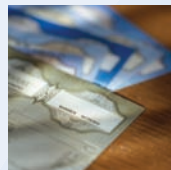
You can name yourself as the remainder beneficiary or fund the CLT at your death, but the tax consequence will be different. ■

Chart 5

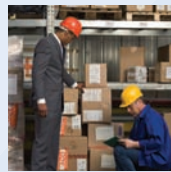
What's your donation deduction?



Cash. This also includes gifts made by check, credit card or payroll deduction. You may deduct 100%.

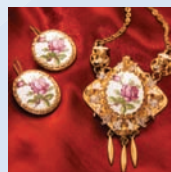


Long-term capital gains property. This might be stocks or bonds held more than one year. You may deduct the current fair market value.



Ordinary-income property. Examples include stocks and bonds held one year or less, inventory, and property subject to depreciation recapture. You generally may deduct only the lesser of fair market value or your tax basis.

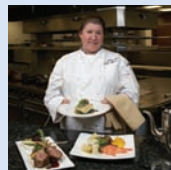
Tangible personal property. Your deduction depends on the situation:



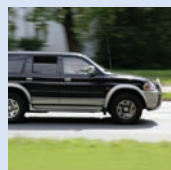
- ◆ If the property *isn't* related to the charity's tax-exempt function (such as an antique donated for a charity auction), your deduction is limited to your basis.
- ◆ If the property *is* related to the charity's tax-exempt function (such as an antique donated to a museum for its collection), you can deduct the fair market value.



Use of property. Examples include use of a vacation home and a loan of artwork. Generally, you receive no deduction because it isn't considered a completed gift. There may, however, be ways to structure the gift to enable you to get a deduction.



Services. You may deduct only your out-of-pocket expenses, not the fair market value of your services. You can deduct 14 cents per charitable mile driven.



Vehicle. Unless it's being used by the charity, you generally can deduct only the amount the charity receives when it sells the vehicle.



IRA funds. If you're age 70½ or older, you can distribute up to \$100,000 from your IRA (Roth or traditional) directly to charity. No charitable deduction is allowed for any amount that would otherwise have been taxable, but you save the tax you would otherwise have owed. A donation from your traditional IRA can be used to help satisfy your required minimum distribution.

Note: Your 2011 charitable donation deductions may be reduced if they exceed certain limits based on your AGI, the type of donation and the type of charity receiving the donation. If you receive some benefit from the charity in connection with your donation, such as services or products, your deduction must be reduced by the value of the benefit you receive. Various substantiation requirements also apply. Consult your tax advisor for additional details.

Providing for children while instilling financial responsibility



If you're a parent, you likely want to do everything you can financially for your children, including ensuring they get a top-notch education. But you also want to teach them financial responsibility. If you're a grandparent, your goals are likely much the same — plus you probably have estate planning on your mind. Knowing how you and your children (or grandchildren) can take advantage of the tax breaks available is an important step toward achieving these goals.

The “kiddie tax”

The income shifting that once — when the “kiddie tax” applied only to those under age 14 — provided families with significant tax savings now offers much more limited benefits. Today, the kiddie tax applies to children under age 19 as well as to full-time students under age 24 (unless the students provide more than half of their own support from earned income).

For children subject to the kiddie tax, any unearned income beyond \$1,900 (for 2011) is taxed at their parents' marginal rate rather than their own, likely lower, rate. Keep this in mind before transferring income-generating assets to them.

IRAs for teens

IRAs can be perfect for teenagers because they likely have many years to let their accounts grow tax-deferred or tax-free. The 2011 contribution limit is the lesser of \$5,000 or 100% of earned income. Traditional IRA contributions generally are deductible, but distributions will be taxed. On the other hand, Roth IRA contributions aren't deductible, but qualified distributions will be tax-free. (For an example of how the two might compare for a teen, see Case Study VI.)

If your children or grandchildren don't want to invest their hard-earned money, consider giving them the amount they're eligible to contribute — but keep the gift tax in mind. (See page 22.) If they don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. **Warning:** They must perform actual work and be paid in line with what you'd pay nonfamily employees for the same work.

Saving for education

Coverdell Education Savings Accounts (ESAs) and 529 savings plans offer a tax-smart way to fund education expenses:

- ◆ Contributions aren't deductible for federal purposes, but plan assets grow tax-deferred.
- ◆ Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, equipment, supplies and, generally, room and board) are income-tax-free for federal purposes and may be tax-free for state purposes.
- ◆ You remain in control of the account — even after the child is of legal age.
- ◆ You can make rollovers to another qualifying family member.

Which plan is better depends on your situation and goals. You may even want to set up both an ESA and a 529 plan for the same student.

ESA pluses and minuses

Perhaps the biggest ESA advantage is that you have direct control over how and where your contributions are invested. Another advantage is that tax-free distributions aren't limited to college expenses; they also can fund elementary and secondary school costs.

However, if Congress doesn't act to extend this treatment, distributions used for pre-college expenses will be taxable starting in 2013. Additionally, the annual ESA contribution limit per beneficiary is only \$2,000 through 2012, and it will go down to \$500 for 2013 if Congress doesn't act. Contributions are further limited based on income.

Generally, contributions can be made only for the benefit of a child under age 18.

Amounts left in an ESA when the beneficiary turns 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

529 plan pluses and minuses

529 college savings plans can be used to pay a student's qualified expenses at most postsecondary educational institutions. The provision that expanded the definition of “qualified expenses” to also include computers, computer technology and Internet service expired after 2010; check with your tax advisor to see if it's been extended.

For many taxpayers, 529 plans are better than ESAs because they typically offer much higher contribution limits (determined by

the sponsoring state). Plus, there are no income limits for contributing — and there's generally no beneficiary age limit for contributions or distributions.

The biggest downside may be that you don't have direct control over investment decisions; you're limited to the options the plan offers. Additionally, for funds already in the plan, you can make changes to your investment options only once during the year or when you change beneficiaries.

But each time you make a *new* contribution, you can select a different option for that contribution, regardless of how many times you contribute throughout the year. And you can make a tax-free rollover to a different 529 plan for the same child every 12 months.

529 plans are also available in the form of a prepaid tuition program. If your contract is for four years of tuition, tuition is guaranteed regardless of its cost at the time the beneficiary actually attends the school. The downside is that there's uncertainty in how benefits will be applied if the beneficiary attends a different school.

Your state may offer tax benefits to residents who invest in its own 529 plan.

Jumpstarting a 529 plan

To avoid gift taxes on 529 plan contributions, you must either limit them to \$13,000 annual exclusion gifts or use part of your lifetime gift tax exemption. A special break for 529 plans allows you to front-load five years' worth of annual exclusions and make a \$65,000 contribution (or \$130,000 if you split the gift with your spouse). That's *per beneficiary*.

If you're a grandparent, this can be a powerful estate planning strategy. (See page 22 for more on gift and estate planning.)

American Opportunity credit


When your child enters college, you may not qualify for the American Opportunity credit because your income is too high, but your child might. The maximum credit is \$2,500 per year for the first four years of

Case Study VI

Traditional vs. Roth IRA: Which is better for a teen?

Choosing a Roth IRA is a no-brainer if a teen doesn't earn income exceeding the standard deduction (\$5,800 for 2011 for single taxpayers), because he or she will gain no benefit from the ability to deduct a traditional IRA contribution. But what if a teen earns enough that he or she will owe current income tax? Let's look at an example.

When Ashley turns age 16, she starts to do administrative work for her mother's business, part-time during the school year and full-time during the summers, earning around \$12,000 per year — enough that a portion of her income will be taxed. Her father wants her to learn the benefits of tax-advantaged compounding and suggests that she start contributing to an IRA.



But first they need to decide whether she should contribute to a traditional or Roth account. So they do some projections. The projections consider only contributions she'll make until she graduates from college at age 22 and gets a full-time job. They assume that the income she contributes to a Roth IRA would first be taxed and that her rate is 10%. So her annual traditional IRA contribution would be \$5,000 while her annual Roth IRA contribution would be only \$4,500 (\$5,000 – 10% of \$5,000). They also assume a 6% rate of return.

Although the age-67 balance of the Roth IRA is \$57,769 less than that of the traditional IRA, Ashley will be able to withdraw the Roth IRA funds tax-free. Let's say that starting at age 67 she wanted to net \$50,000 per year from her IRA, and her tax rate was 35%. She'd need to withdraw nearly \$77,000 from a traditional IRA, compared to \$50,000 from a Roth IRA. So income taxes could quickly eat up the additional balance in the traditional account. In fact, after less than 10 years, the traditional IRA would be exhausted, while the Roth IRA would continue for another five-plus years. The total distributions net of tax would be significantly higher for the Roth IRA.

Balance at age 67	
Traditional IRA	\$577,690
Roth IRA	\$519,921
Total distributions net of tax	
Traditional IRA	\$475,357
Roth IRA	\$762,394

Note: This example is for illustrative purposes only and isn't a guarantee of future results.

postsecondary education. And both the credit and a tax-free ESA or 529 plan distribution can be taken as long as expenses paid with the distribution aren't used to claim the credit.

If your dependent child claims the credit, however, you must forgo your dependency exemption for the child (and the child can't

take the exemption). Before 2010, your dependency exemption might have been partially phased out based on your AGI anyway, so this decision may have been an easy one. But through 2012, that AGI limit has been lifted. So you'll need to work with your tax advisor to see whether the exemption or the credit will provide the most tax savings overall for your family. ■

Leveraging the power of tax-advantaged plans



Although you're allowed to contribute only a limited amount to tax-advantaged retirement plans, those tax advantages make the plans especially powerful for taxpayers in the top income tax brackets. So don't ignore these plans just because what you can invest in them annually may be small compared to what you invest elsewhere. Yet to fully leverage their power, you also need to watch out for inherent tax traps.

Retirement plan contributions

Contributing the maximum you're allowed (see Chart 6) to an employer-sponsored defined-contribution plan, such as a 401(k), 403(b), 457, SARSEP or SIMPLE, is likely a smart move:

- ◆ Contributions are typically pretax, so they can reduce your taxable income.
- ◆ Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- ◆ Your employer may match some or all of your contributions — also on a pretax basis.

If you participate in a 401(k), 403(b) or 457 plan and the plan allows it, you may designate some or all of your contributions as Roth contributions. (Employer matches aren't eligible.) Roth contributions won't reduce your taxable income, but qualified distributions will be tax-free. Because no AGI limits apply, such contributions may be especially beneficial for higher-income earners who are ineligible to contribute to Roth IRAs. Under recent legislation, you may be able to make a rollover from your traditional

account to a Roth account under the same plan, but there will be tax consequences similar to those of a Roth IRA conversion. (See below for more information on conversions.)

If you're a business owner or self-employed, you may be able to set up a plan that allows you to make much larger contributions. (See page 14 for details.)

Roth IRA conversions

If you have a traditional IRA, consider whether you might benefit from converting

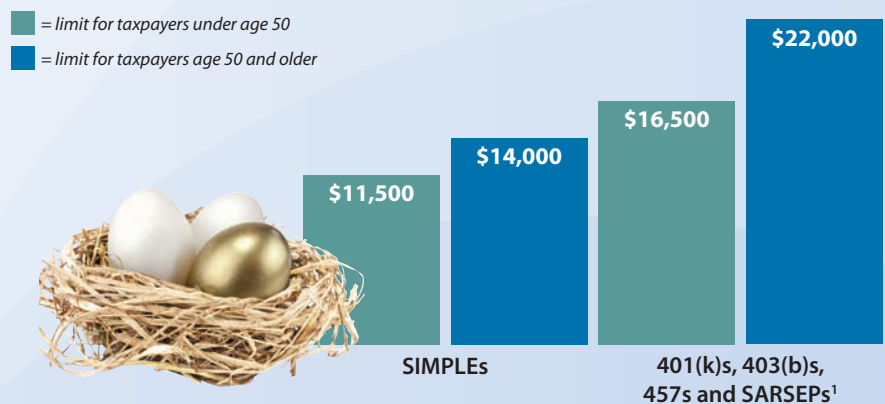
all or a portion of it to a Roth IRA. A conversion can allow you to turn tax-deferred future growth into tax-free growth. It also can provide estate planning advantages: Roth IRAs don't require you to take distributions during your life, so you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

If, for example, you name your child as the beneficiary, he or she will be required to start taking distributions upon inheriting the Roth IRA. But the distributions will be tax-free and spread out over his or her lifetime, and funds remaining in the account can continue to grow tax-free for many years to come. (See page 22 for more on estate planning.)

There's no longer an income-based limit on who can convert. But, unlike when the limit was first lifted last year, the converted amount is now taxable in the year of the

Chart 6

No increase in retirement plan contribution limits for 2011



¹ Includes Roth versions where applicable.
 Note: Other factors may further limit your maximum contribution.

conversion. Whether a conversion makes sense for you depends on a variety of factors, such as your age, whether you can afford to pay the tax on the conversion, your tax bracket now and expected tax bracket in retirement, and whether you'll need the IRA funds in retirement.

Early withdrawals

With a few exceptions, retirement plan distributions made before age 59½ are subject to a 10% penalty, in addition to income tax. This means that, if you're in the top federal tax bracket of 35%, you can lose close to half of your withdrawal to federal taxes and penalties. If you're subject to state income taxes and/or penalties, the total taxes and penalties may easily exceed 50%. Additionally, you'll lose the potential tax-deferred future growth on the amount you've withdrawn.

If you have a Roth account, you can withdraw up to your contribution amount free of tax and penalty. But you'll still be losing the potential tax-free growth on the withdrawn amount.

So if you're in need of cash, you're likely better off tapping taxable investment accounts than dipping into your retirement plan. Long-term gains from sales of investments in taxable accounts will be taxed at the lower long-term capital gains rate (currently 15%), and losses on such sales can be used to offset other gains or carried forward to offset gains in future years. (See page 8 for more information on the tax treatment of investments.)

Early distribution rules are also important to be aware of if you change jobs or retire. See Case Study VII.

Required minimum distributions

Normally, once you reach age 70½ you must take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and defined contribution plans. If you don't comply, you can owe a penalty equal to 50%

Case Study VII

Tread carefully with your retirement plan when leaving a job

Eric and Kevin both change jobs in 2011 and need to decide what to do with their \$500,000 retirement plans under their former employers. Here are the options they consider:

Staying put. They can leave their money in their old plans. But because they plan to participate in their new employers' plans, this may not be the best option. Why? Because keeping track of multiple plans can make managing retirement assets more difficult. Plus they'll be limited to the investment options those plans offer.

A rollover to the new employer's plan. This may be a good solution because it will leave them each with only one retirement plan to keep track of. But, again, their investment options will be limited to what these plans offer.

A rollover to an IRA. Although this will require them to keep track of two plans, it may be the best alternative because IRAs offer nearly unlimited investment choices.

So Eric and Kevin both decide to make rollovers to traditional IRAs.

Eric requests a direct rollover from his old plan to his IRA. Because he never personally receives the funds, he owes no income tax or penalties.

Kevin, however, doesn't request a direct rollover. Instead, he receives a lump-sum check. Much to his surprise, the check is for only \$400,000, because his employer withheld 20% for federal income taxes.

After consulting with his tax advisor, he learns that he needs to make an indirect rollover to his IRA within 60 days to avoid tax and potential penalties. (He may be able to receive a refund of the \$100,000 withheld when he files his 2011 tax return, depending on his overall tax liability for the year.)

He also learns that if he doesn't roll over the gross amount of \$500,000 — which will require him to make up for the withheld amount with other funds — he'll be subject to income tax on the \$100,000 difference. And, because he's under age 59½, he'll also owe the 10% early withdrawal penalty.



of the amount you should have withdrawn but didn't. You can avoid the RMD rule for a Roth 401(k), Roth 403(b) or Roth 457 by rolling the funds into a Roth IRA.

So, should you take distributions between ages 59½ and 70½, or more than the RMD after age 70½? Distributions in any year your tax bracket is low may be beneficial. But also consider the lost future tax-deferred growth

and, if applicable, whether the distribution could: 1) cause your Social Security payments to become taxable, 2) increase Medicare prescription drug charges, or 3) affect other deductions or credits with income-based limits.

If you've inherited a retirement plan, consult your tax advisor regarding the distribution rules that apply to you. ■

Tax law changes provide some new opportunities, but uncertainty remains



There's good news and bad news this year when it comes to estate planning. On the positive side, the 2010 Tax Relief act prevents pre-2001 tax act law (lower exemptions and higher rates) from going into effect in 2011 as originally scheduled.

The act also provides some new tax-saving opportunities. But, on the negative side, these provisions apply only through 2012. Thus, much uncertainty remains, making estate planning an ongoing challenge.

Estate tax

The 2010 Tax Relief act retroactively brought back the estate tax for 2010 (along with the unlimited step-up in basis), but with an exemption increase and a rate reduction compared to 2009. It extended these levels through 2012. (See Chart 7.) The act also temporarily provides exemption "portability" between spouses. (See "What's new!" at right.)

If you have a loved one who died in 2010 and you haven't already consulted a tax advisor, be sure to do so. The option is available to follow the pre-2010 Tax Relief

act estate tax repeal / limited step-up in basis regime instead of the new regime, but which is better depends on a variety of factors.

GST tax

The generation-skipping transfer tax generally applies to transfers (both during life and at death) made to people two generations or more below you, such as your grandchildren.

The GST tax also had been repealed for 2010, and the 2010 Tax Relief act brought it back with the same exemption amounts

as for the estate tax through 2012. However, the act set the GST tax rate for 2010 at 0%. The GST tax rate goes back up to match the top estate tax rate for 2011 and 2012. (See Chart 7.)

Gift tax

Gifts to your spouse are tax-free under the marital deduction (a limit applies to noncitizens), but most other gifts are potentially taxable. The gift tax was never repealed, and it follows the estate tax exemptions and top rates for 2011 and 2012. (See Chart 7.) Any gift tax exemption used during life reduces the estate tax exemption available at death.

If you can afford to do so without compromising your own financial security, consider using part or all of your gift tax exemption this year and next, in case the \$5 million exemption isn't extended beyond 2012.

But keep in mind that you can exclude certain gifts of up to \$13,000 per recipient

Chart 7

Transfer tax exemptions and highest rates

	2009	2010	2011	2012	2013
Gift tax exemption	\$ 1 million	\$ 1 million	\$ 5 million	\$ 5 million ¹	\$ 1 million
Estate tax exemption ²	\$3.5 million	\$ 5 million ³	\$ 5 million	\$ 5 million ¹	\$ 1 million
GST tax exemption	\$3.5 million	\$ 5 million	\$ 5 million	\$ 5 million ¹	\$ 1 million ¹
Highest estate and gift tax rates and GST rate	45%	35% ³ (0% GST tax)	35%	35%	55% ⁴

¹ Indexed for inflation.

² Less any gift tax exemption already used during life. For 2011 and 2012, these amounts are "portable" between spouses.

³ Estates can elect to follow the pre-2010 Tax Relief act regime (estate tax repeal + limited step-up in basis).

⁴ The benefits of the graduated gift and estate tax rates and exemptions are phased out for gifts/estates over \$10 million.



What's new!

More flexibility — temporarily — for married couples

Who's affected: Married couples and their loved ones.

Key changes: Under the 2010 Tax Relief act, if one spouse dies in 2011 or 2012 and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption.

Planning tips: Although similar results can be achieved by making asset transfers between spouses during life and/or setting up certain trusts at death, making this election will be much simpler and provide flexibility if proper planning hasn't been done before the first spouse's death.

Still, this election is currently available for only two years unless Congress extends it. Also, exemption portability doesn't protect future growth on assets from estate tax as effectively as applying the exemption to a credit shelter trust does. So married couples should still consider making asset transfers and setting up trusts to ensure that they take full advantage of both spouses' exemptions. Also be aware that the provision doesn't apply to the generation-skipping transfer tax exemption.



each year (\$26,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without using up any of your gift tax exemption. So first consider maximizing your annual exclusion gifts.

Tax-smart giving

Giving away assets now will help you reduce the size of your taxable estate. Here are some additional strategies for tax-smart giving:

Choose gifts wisely. Take into account both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- ♦ To minimize *estate tax*, gift property with the greatest future appreciation potential.
- ♦ To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it.
- ♦ To minimize *your own income tax*, don't gift property that's declined in value. Instead, sell the property so you can take the tax loss and then gift the sale proceeds.

Plan gifts to grandchildren carefully.

Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts that don't qualify for the exclusion to be completely tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the discounts total 30%, in 2011 you can gift an ownership interest equal to as much as \$18,571 tax-free because the discounted value doesn't exceed the \$13,000 annual exclusion. **Warning:** The IRS may challenge the value; a professional appraisal is strongly recommended.

Gift FLP interests. Another way to benefit from valuation discounts is to set up a family limited partnership (FLP). You fund the FLP and then gift limited partnership interests. **Warning:** The IRS scrutinizes FLPs, so be sure to set up and operate yours properly.

Pay tuition and medical expenses. You may pay these expenses for a loved one without the payment being treated as a taxable gift, as long as the payment is made directly to the provider.

Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. Here are some trusts you may want to consider:

- ♦ A credit shelter (or bypass) trust can help minimize estate tax by taking advantage of both spouses' estate tax exemptions.
- ♦ A qualified domestic trust (QDOT) can allow a non-U.S.-citizen spouse to benefit from the unlimited marital deduction.
- ♦ A qualified terminable interest property (QTIP) trust is good for benefiting first a surviving spouse and then children from a prior marriage.
- ♦ A qualified personal residence trust (QPRT) allows you to give your home to your children today — removing it from your taxable estate at a reduced tax cost (provided you survive the trust's term) — while you retain the right to live in it for the trust's term.
- ♦ A grantor-retained annuity trust (GRAT) works similarly to a QPRT but allows you to transfer other assets; you receive payments from the trust for a certain period.

Finally, a GST — or “dynasty” — trust can help you leverage both your gift and GST tax exemptions, and it can be an excellent way to lock in the current \$5 million exemptions.

Insurance

Along with protecting your family's financial future, life insurance can be used to pay estate taxes, equalize assets passing to children who aren't involved in a family business, or pass leveraged funds to heirs free of estate tax. Proceeds are generally income-tax-free to the beneficiary. And with proper planning, you can ensure proceeds aren't included in your taxable estate. ■

TAX RATES

Chart 8

2011 individual income tax rate schedules

Tax rate		Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately	
10%	\$ 0 – \$ 8,500	\$ 0 – \$ 12,150	\$ 0 – \$ 17,000	\$ 0 – \$ 8,500	
15%	\$ 8,501 – \$ 34,500	\$ 12,151 – \$ 46,250	\$ 17,001 – \$ 69,000	\$ 8,501 – \$ 34,500	
25%	\$ 34,501 – \$ 83,600	\$ 46,251 – \$119,400	\$ 69,001 – \$139,350	\$ 34,501 – \$ 69,675	
28%	\$ 83,601 – \$174,400	\$119,401 – \$193,350	\$139,351 – \$212,300	\$ 69,676 – \$106,150	
33%	\$174,401 – \$379,150	\$193,351 – \$379,150	\$212,301 – \$379,150	\$106,151 – \$189,575	
35%	Over \$379,150	Over \$379,150	Over \$379,150	Over \$189,575	

Tax rate		AMT brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately	
26%	\$ 0 – \$175,000	\$ 0 – \$175,000	\$ 0 – \$175,000	\$ 0 – \$ 87,500	
28%	Over \$175,000	Over \$175,000	Over \$175,000	Over \$ 87,500	

AMT exemption				
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Amount	\$ 48,450	\$ 48,450	\$ 74,450	\$ 37,225
Phaseout ¹	\$112,500 – \$306,300	\$112,500 – \$306,300	\$150,000 – \$447,800	\$ 75,000 – \$223,900

¹ The alternative minimum tax (AMT) income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Note: Consult your tax advisor for AMT rates and exemptions for children subject to the kiddie tax.

Chart 9

2011 corporate income tax rate schedule

Tax rate	Tax bracket
15%	\$ 0 – \$ 50,000
25%	\$ 50,001 – \$ 75,000
34%	\$ 75,001 – \$ 100,000
39%	\$ 100,001 – \$ 335,000
34%	\$ 335,001 – \$10,000,000
35%	\$10,000,001 – \$15,000,000
38%	\$15,000,001 – \$18,333,333
35%	Over \$18,333,333



Note: Personal service corporations are taxed at a flat 35% rate.

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September 2011 – August 2012 Tax Calendar

Here are highlights of when various forms, payments and actions are due during this period.

Individuals and employees

Repeating deadlines

Tip income	Employees must report tip income of \$20 or more for a given month to their employers by the 10th of the following month. Exceptions (because the 10th falls on a weekend or holiday): Sept. 12 and Dec. 12, 2011, and March 12, June 11 and Nov. 12, 2012.
Estimated tax	Individuals' payments due: Sept. 15, 2011, and Jan. 16, April 16 and June 15, 2012.

Key dates

Oct. 17, 2011	2010 filing deadline for individuals who requested an automatic extension.
Jan. 31, 2012	Individuals must file Form 1040 and pay tax due to avoid penalties for underpaying the Jan. 16 installment of 2011 estimated taxes.
April 16, 2012	Individuals must file their 2011 tax returns (Form 1040, 1040A or 1040EZ) or request an automatic six-month extension (Form 4868) and pay any tax due.
	Last date to make 2011 contributions to an IRA.
	Individuals must file their 2011 gift tax returns (Form 709) or an automatic six-month extension (Form 8892) and pay any gift tax due.
	Household employers must file Schedule H (Form 1040) if wages paid in 2011 exceed the annual limit.
June 15, 2012	Individuals living outside the United States must file their 2011 tax returns (Form 1040) or request a four-month extension (Form 4868) and pay any tax due.

Businesses and employers

Repeating deadlines

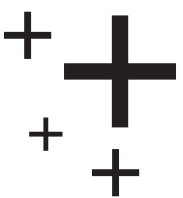
Withholding and FICA taxes	Employers must file Form 941 and pay any tax due: Nov. 1, 2011, and Jan. 31, May 1 and Aug. 1, 2012.
Estimated tax	Calendar-year corporation payments due: Sept. 15 and Dec. 15, 2011; April 16 and June 15, 2012.

Key dates

Sept. 15, 2011	2010 filing deadline for calendar-year corporations and partnerships that requested an automatic extension.
Dec. 31, 2011	Last date for employers to establish a retirement plan for 2011 (other than a SEP or SIMPLE).
Feb. 28, 2012	Employers must file Form W-2 (Copy A) and transmittal Form W-3 with the Social Security Administration. (Electronic filers have until April 1.)
	Businesses must file Form 1099 for 2011 interest, dividends and miscellaneous payments.
March 15, 2012	Corporations must file their 2011 tax returns (Form 1120 or 1120-A) or request an automatic six-month extension (Form 4868) and pay any tax due.
April 16, 2012	Calendar-year partnerships must file their 2011 tax returns (Form 1065 or 1065-B for partnerships, Form 1041 for trusts and estates) or request an automatic six-month extension (Form 7004) and pay any tax due.
May 15, 2012	Tax-exempt organizations must file their 2011 calendar-year information returns (Form 990, 990-EZ, 990-PF or 990-T) and pay any tax due.
Aug. 1, 2012	Employers must file their retirement plan reports (Form 5500 or 5500-EZ) or request an extension.

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