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Tax & Financial Newsletter

This *Tax and Financial Newsletter* has three parts. First, it lists *Tax Tips!* to consider before the year-end to help reduce your tax bill coming up April 15, 2012. The second part is a discussion of why basic estate planning, using Wills and Living Trusts, is a good idea. The *Newsletter* concludes with using a Trust as the beneficiary of a decedent's IRA or similar pension plan to potentially solve some common problems with pension plans, including 401(k)'s.

CHECKLIST OF *TAX TIPS!* FOR THE REST OF 2011

√ All tax reduction methods utilize one or more of these five principles. First, ***exclude*** from taxation the income and gains that you can. Second, ***defer*** that which you must report. Third, ***reduce*** that which you must report. Fourth, ***pay*** taxes on the rest. Fifth, pay ***on the latest date*** possible without incurring penalties and interest.

√ Businesses should consider making expenditures that qualify for the business property expensing option. For 2011, the expensing limit is $500,000, the investment ceiling limit is $2,000,000, and a limited amount of expensing may be claimed for qualified real property. However, unless Congress changes the rules, for 2012, the dollar limit will drop to $139,000, the beginning-of-phase out amount will drop to $560,000, and expensing won't be available for qualified real property.

√ Businesses also should consider making expenditures that qualify for 100% bonus first year depreciation if bought and placed in service this year. This 100% first-year write-off generally will not be available next year unless Congress acts to extend it. For 2012, the bonus depreciation amount is scheduled to be reduced to 50%. Thus, enterprises planning to purchase new depreciable property this year or the next should try to accelerate their buying plans, if doing so makes sound business sense.

√ For assets used more than 50% for business, but typically less than 100%, consider purchasing the asset at the very end of the year and using it 100% for business for the remaining portion of the year to take advantage of a higher §179 expense election business percentage.

√ Pay in late December 2011 your state estimated tax payment(s) that are due January 15, 2012; consider paying in late December 2011 any anticipated state taxes due in April 2012 for tax year 2011. This strategy is excellent when a taxpayer has a one-time large gain and the state taxes are due in April of the following year. By paying in December the large tax deduction for state taxes is in the same year as the large gain. The result is smoothing out taxable income which generally reduces taxes.

√ Make qualified research expenses before the end of 2011 to claim a research credit, which won't be available for post-2011 expenditures unless Congress extends the credit.

√ Dispose of your interests in those flow-through entities in which you have "suspended" loss carryforwards.

√ Make sure you have tax basis in all your partnerships, LLCs, and S corporations to deduct any losses. Increasing your tax basis can be accomplished by several methods.

√ Step up your level of participation in partnerships, S corporations, or LLCs to qualify as an "active participant" for flow-through entities reporting losses.

√ Avoid underpayment of estimated tax payment penalties by increasing your withholdings from your December 2011 paychecks.

√ Maximize 401(k) contributions before year-end and take advantage of employer matching contributions.

√ Set up pension plans before year-end and fund those plans. In many cases if a plan is "set up" by December 31, you can contribute to the plan as late as October 15, 2012 for a 2011 tax deduction.

√ For 2011, property qualifying for the non-business energy property credit includes windows (including skylights), exterior doors, insulation, metal roofs, advanced main air circulating fans, natural gas, propane, or oil furnace or hot water boilers, and other energy efficient building property that meets certain energy standards. For 2011, the credit is 10% of the cost of the improvement(s) up to a maximum credit of $500 (therefore, if you took any credit prior to 2011, your total cannot exceed $500). The property must be installed by the end of 2011 to qualify. For 2011, only $200 of the credit can be applied to windows. Also, for 2011, the energy standards are relaxed. The credit expires at the end of 2011.

√ Increase contributions to your health savings account (HSA). Individuals in an HSA may make deductible contributions to it subject to certain limits. For calendar year 2011, assuming a full year of coverage, the maximum contribution for self-only coverage is $3,050. For family coverage, the maximum coverage is $6,150.

√ Contribute to your favorite charity; consider gifting appreciated property to a charitable organization for a deduction equal to its fair market value. Clean out your home by donating non-cash charitable contributions to Goodwill, etc. The donated goods must be in good condition.

√ Consider the special provision that is expiring this year that gives taxpayers who have reached 70 ½ the ability to distribute tax-free to charity up to $100,000 from their traditional or Roth IRA. Ordinarily, such distributions would be taxable to the individual, who would not be able to offset the income fully because of the percentage limitations on charitable contribution deductions.

√ If you are single and maintain a separate household for your parents including in a nursing home or assisted living center, and provide more than one-half their support, you may qualify to file head of household. If you don't qualify as providing more than one-half support for both of your parents,

annual interest rate for a long term notes and 1.9% for short term notes.

√ An easy estate planning strategy is to make gifts up to $13,000 before year-end ($26,000 for married couples) to each donee.

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Basic Estate Planning Using Wills and Living Trusts is a Good Idea

Estate planning involves arranging your affairs to carry out your wishes for your property when you pass away by utilizing the pertinent estate laws. Estate laws include the laws of wills, taxes, insurance, property, trusts, and family law. There are four factors that increase the importance of taking care of your affairs in a timely fashion. The factors are: (1) your age; (2) the amount and types of property you own; (3) whether blended families or special need children are involved; and, (4) the probability of family disharmony over property divisions or who will be in charge of the estate. Different estate planning tools and procedures can be utilized to reduce problems and disputes.

The basic estate planning document is a Will. Subject to some exceptions, a simple Will can appoint who will be in charge of your estate and who gets what. A more complex Will can provide for guardianships for minor or disabled children, establish trusts that will manage property, and even save estate or income taxes. However, one thing a Will does not do, is avoid probate. Having only a Will can be similar to having no Will at all. In both cases, depending on the property, probate may be required.

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Problems with Probate

Probate is a court controlled legal process that transfers your assets pursuant to a Will, or pursuant to state law if a Will does not exist. It is an expensive public forum which is time consuming and can invite trouble. There are about ten legal steps or procedures involved to complete a basic probate. Those steps typically include at least two court hearings, several public legal notices, lots of mailings, court filings relating to indentifying heirs, appointing a personal representative, identifying and disclosing assets, selling property, determining creditors, ascertaining who gets paid, accountings, and beneficiary distributions, etc. In addition, certain time frames must be met which prolong the process.

The biggest problem with probate may be that information about your assets and debts is publicly disseminated in open court. This creates a cheap ticket for an aggrieved party to start a legal battle. Add that environment to the fact the decedent is not available to defend claims and expensive litigation may ensue. The litigation takes the form of dubious creditor claims, legal battles over who is the estate's representative, and the classic Will contest by a disgruntled heir. Make no doubt, similar types of disharmony can also occur without probate proceeding. But, comparatively, probate proceedings are more fertile ground for litigation than other types of estate litigation. One way to reduce the probability of problems is to use a Revocable or Living Trust.

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Living Trust – Probate Solution

The Living Trust can accomplish what a Will can accomplish without probate. A trust is a legal entity where a trustee holds title of property for the benefit of beneficiaries. A grantor creates the Living Trust, transfers his or her property to the trust, and is usually the current beneficiary and the trustee. The trust assets are managed by the trustee according to the terms of the trust. Upon the death of the grantor, a second person or entity becomes the trustee. The successor trustee distributes the trust's assets according to the directions in the trust. Thus, as long as assets are re-titled in the trust, a Living Trust works similar to a Will without the guaranteed expensive court involvement.

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Tax Planning for a Decedent's IRA—Solving Some Common Problems

A Living Trust or Will, however, will not always avoid taxes. *Estate* and *income* taxes are a common problem for many estates. Fortunately, *estate* taxes are not as onerous as they used to be and generally apply only to multi-million dollar estates. *Income* taxes on the other hand can be a big problem in any size estate if IRAs and similar pension plans such as 401(k)'s exist. IRS rules require distributions from a decedent's IRA (or pension plan), and the distributions are subject to ordinary income tax rates.

Perhaps the best way for a decedent to avoid income taxes on their IRA is by naming a tax-exempt charity as the beneficiary. The custodian of the IRA distributes the money to the charity and because the charity is not subject to *income* taxes on the gift, no income taxes are due. However, the charitable IRA option requires that plenty of assets exist for the family otherwise.

The typical situation is an IRA owner desires their surviving spouse or adult children to be the IRA's next beneficiaries instead of a charity. In most of these cases, the IRA "rolls over" to a surviving spouse with no *income* taxes due. Then, perhaps he or she takes required minimum distributions from the IRA over their anticipated lifetime and pays the taxes on the distributions each year. Similarly, a decedent may designate their adult children as beneficiaries of the IRA and the kids take the required minimum distributions over their expected lifetimes and pay the taxes over many years. These typical situations are tax efficient because the *income* taxes are paid in increments over a long period of time, taxed at individual rates, and the investments enjoy a lengthy tax-deferral growth period.

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Decedent's IRA – Problems with Individuals as Beneficiaries

There can be drawbacks to the typical situations though. For example, the surviving spouse or adult child may and can spend the IRA all at once. These new beneficiaries also have the power to change the contingent beneficiaries to someone other than who the original IRA owner designated. Another issue could be that minor children are involved or that the IRA

is very large. To mitigate against these potential mismanagement circumstances, a good solution may be to designate a trust as the IRA beneficiary and have family members benefit from the underlying trust which subject the beneficiary to restrictions that would not otherwise exist. There are, however, tax traps to watch out for when naming a trust an IRA beneficiary.

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Decedent's IRA – Tax Traps for Trusts as Beneficiary

Tax traps get triggered when certain rules are not followed resulting in the IRA distributing its assets to the trust over a short period of time instead of the expected lifetimes of the beneficiaries. The short distribution period causes income taxes to increase because tax payments have to be paid quickly as opposed to incrementally over a long period. Thus, the distributions are subject to higher trust tax rates versus lower individual tax rates. The investment's growth potential is now decreased because the tax deferral benefit of an IRA disappears earlier.

Avoiding, or at least mitigating, these cascading tax traps requires careful attention to the IRA's beneficiary designation documents and the trust's language. For example, a "classic set up" is to properly designate beneficiaries to "stretch" out the IRA distributions to the trust over the expected life or lifetimes of beneficiaries. Then require the trust to pass the annual IRA distributions out to the family members each year. Also, perhaps have the trust name a successor beneficiary if the original family member dies prior to receiving the entire IRA. Of course to better fit a particular case, there are variations to this classic set up. But, nevertheless, a trust as the beneficiary of an IRA may be an excellent estate planning tool.

The statements contained herein are basic overviews of the covered subjects. Many of the provisions have special rules, expiration dates, and exceptions and may not be applicable for your circumstances. Further, the opinions of the author contained herein are to be viewed as opinions only and not legal, tax or accounting advice. Please call 918-599-7755 to see how you can make the most of these suggestions, or if you need help arranging your personal and business affairs to reduce your taxes and increase your profits.

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