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Tax & Financial Newsletter

This ***Tax and Financial Newsletter*** has three parts. First, is the five-step method to saving taxes. Deviating from these steps will cause your taxes to increase. The second part identifies several key deductions to take advantage of that may expire in 2012 and what *might* happen in 2013. The ***Newsletter*** concludes with ***Tax Tips!*** to consider for increasing and decreasing taxable income.

I. THE FIVE-STEP APPROACH TO SAVING INCOME TAXES

Most tax planning strategies utilize one or more of the following five steps to reduce taxes:

1. ***Exclude from taxation the income and gains that you can.*** Examples of income that can be excluded include tax-exempt interest, employer cafeteria plans and Roth IRAs.

2. ***Defer that which you must report.*** Contributing to certain qualified retirement plans may accomplish this. Read ahead to the next section for more information.

3. ***Reduce that which you must report.*** This means taking all the deductions and credits to which you are entitled. Though this may seem obvious, available deductions and credits are not always readily apparent.

4. ***Pay taxes on the rest.*** Some taxes simply cannot be avoided. Pay them.

5. ***Pay on the latest date possible without incurring penalties and interest.*** This includes strategically paying any estimated tax payments, and adjusting withholdings. Incurring penalties and interest is never necessary and only serves to offset tax saving strategies.

This five-step approach will invariably reduce taxes every year. However, while it is easy to focus on immediate tax savings, the most effective tax savings plans are forward thinking. Consider the next two sections for the best tax planning strategies to implement for 2012 and 2013.

II. CHANGES IN THE TAX LAW: WHAT TO TAKE ADVANTAGE OF IN 2012 AND WHAT *MIGHT* HAPPEN IN 2013.

There are many uncertainties in the tax laws going forward. Certain tax benefits available for 2012 may not be extended. To maximize tax savings, it is essential to take advantage of these deductions and credits while they are available. Additionally, tax rates may increase in 2013. Thus, in some circumstances, it may be advantageous to defer deductions to 2013 and recognize income in 2012. See Part III.

Individual Deductions

√ ***AGI Limits*:**
One important consideration in tax planning is your adjusted gross income (AGI). Some tax benefits are limited or disallowed entirely if your AGI is too high. For example, in 2012 there is no AGI limitation on itemized deductions. However, an itemized deduction limitation based upon AGI is scheduled to be reinstated in 2013.

√ ***Standard Deduction Planning*:**
In 2012, the standard deduction is $11,900 for married taxpayers filing jointly and $5,950 for single taxpayers. In 2013, the standard deduction for married taxpayers filing jointly is expected to be less than twice that of single taxpayers. Thus, if you are married and on the borderline as to whether you will itemize your deductions or take the standard deductions, adjusting the timing of your itemized deductions may be helpful.

√ ***Medical Expenses*:**
In 2012, medical expenses are deductible only to the extent they exceed 7.5% of your AGI. This percentage is scheduled to increase for most taxpayer to 10% in 2013, making it more difficult to benefit from medical expense deductions. For this reason, it may be wise to accelerate medical expenses into 2012.

√ ***State Taxes*:**
The election to deduct state and local *sales* taxes as an itemized deduction instead of state and local *income* taxes is not available for 2012. If you typically take advantage of the sales tax deduction, perhaps defer major purchases to 2013 in the event it is reinstated after 2012.

√ ***Charitable Contributions*:**
Charitable contributions are a great way to earn tax deductions. Though a mere pledge to donate in 2012 is not sufficient to gain the deduction in 2012, it is acceptable to use a credit card in 2012, even though the credit card will not be paid until 2013.

Remember, clothing and household items must be in good used condition or better. Additionally, contributions of money will be denied unless you maintain a cancelled check, bank record, or receipt from the recipient showing the name of the recipient, the date, and the amount of the contribution.

√ ***Child Tax Credit*:**
A tax credit of up to $1,000 per qualifying child under the age of 17 is available on this year's return, subject to AGI limitations. In 2012, up to $3,000 of this credit may be refundable. In 2013, however, this amount is scheduled to be reduced to $500 per child and subject to AGI phase outs. Thus, it may be beneficial to defer income to 2013 to take full advantage of the child credit.

√ ***Education Credits*:**
The American Opportunity Tax Credit is another credit that can be phased out based on AGI. It permits taxpayers to take a maximum credit of $2,500 (100% on the first $2,000, plus 25% of the next $2,000) for qualified tuition and fees paid on behalf of a student who is enrolled at least half-time. Unless extended by Congress, this credit will revert back to the Hope Scholarship credit, with lower dollar

amounts and more restrictive terms. Thus, it may be beneficial to defer income to 2013 to take full advantage of this credit.

√ ***Student Loan Interest*:**
In 2012, individuals may deduct up to $2,500 for student loan interest paid on any qualified education loan. This deduction is limited for single taxpayers with AGI above $60,000 and eliminated above $75,000. The deduction is limited for joint filers with AGI above $125,000 and eliminated above $155,000. In 2013, the range is reduced to $40,000 and $50,000 for single filers and $60,000 and $75,000 for joint filers. Thus, it may be beneficial to defer income to 2013 to take full advantage of the student loan interest deduction.

Business Deductions

√ ***Self-Employed Health Insurance Premiums*:**
Self-employed individuals can claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and dependents. Tax savings may result by paying a January 2013 premium in December 2012.

√ ***§ 179 Election*:**
If you purchase business equipment, you may make a Section 179 Election. This election allows you to currently deduct business property that would ordinarily be depreciable. In 2012, you can elect to expense up to $139,000 of equipment costs. In 2013, barring an act of Congress, the maximum amount permitted will be $25,000. Thus, consider purchasing business equipment prior to year-end for a more favorable Section 179 Election.

√ ***Bonus Depreciation*:**
Taxpayers can now claim 50% bonus depreciation for many business assets placed in service in 2012. Not all assets qualify though. Bonus depreciation will generally not apply in 2013, so now may be the time to purchase any necessary business assets.

Investment Planning

√ ***Short-Term Capital Gains*:**
Capital gains on property held one year or less are taxed at an individual's ordinary income tax rate. So if you have a borderline holding period, consider holding the asset a little longer to take advantage of the favorable long-term capital gains rates.

√ ***Long-Term Capital Gains*:**
In 2012, capital gains on property held for more than one year are taxed at a maximum rate of 15% (0% if an individual is in the 10% or 15% marginal tax bracket). If Congress does not extend the reduced capital gains rates beyond 2012, the maximum capital gains rate in 2013 will be 20% (10% for taxpayers in the 15% bracket). Thus, it may be advantageous to realize capital gains before year-end.

√ ***Dividends*:**
In 2012, qualifying dividends received are subject to rates similar to the capital gains rates. However, if Congress does not extend the reduced dividend rates, in 2013 dividends will be taxed at ordinary income rates, which could reach 39.6% or more.

Retirement Planning

√ ***Traditional IRAs.***
Individuals who do not actively participate in an employer pension plan can make deductible contributions to an IRA of up to $5,000. Individuals who are at least 50 years old can contribute an additional $1,000.

Even individuals who actively participate in an employer pension plan can make deductible contributions to an IRA. However, the deductibility of a single person's contributions will be limited if his or her AGI is $58,000 or greater. If AGI is $68,000 or greater, no deduction is allowed. For married persons filing jointly, the contribution deductibility is limited if their AGI is $92,000 or greater and entirely disallowed if their AGI is $112,000 or greater.

By contributing to a traditional IRA, you can achieve the dual benefits of saving on taxes and planning for the future.

If your spouse is a participant in an employer plan, but you are not, you may take the full contribution deduction. However, if your joint AGI is $173,000 or greater, the contribution deductibility is limited. The deduction is not allowed if your joint AGI is $183,000 or greater.

√ ***Roth IRAs.***
This alternative to the traditional IRA permits nondeductible contributions of up to $5,000 per year. The benefits of forgoing the deductible IRA are the contributions grow tax-free **and** are not taxed when they are distributed, provided there are no distributions until more than five years after the first contribution and the individual is at least 59½ years old.

For single persons, these contributions are limited when AGI exceeds $110,000 and disallowed when AGI exceeds $125,000. For married persons filing jointly, these contributions are limited when AGI exceeds $173,000 and disallowed when AGI exceeds $183,000.

III. *TAX TIPS!* FOR *INCREASING* AND *DECREASING* TAXABLE INCOME

When to Defer Income

The purpose of deferring income is to reduce current taxes and pay them next year. Generally, deferring income is beneficial if you expect your tax bracket to be higher in 2012 than in 2013, or the same in 2012 as 2013. However, be careful not to lower your tax bracket for 2012 only to report the same income in 2013 in a higher tax bracket. Deferring income to 2013 is advised only with caution because tax rates are generally expected to increase after 2012.

When and How to Accelerate Income

This year it may actually be beneficial to accelerate future income into 2012 because tax rates may be increasing. Below are some of the methods to accelerate income.

√ ***Accounts Receivable***: If you are self-employed and report income and expenses on a cash basis, issue bills and attempt collection before the end of 2012. Some clients or customers may be willing to pay for 2013 goods or services in advance.

√ ***Year-End Bonuses***: If your employer generally pays year-end bonuses after the end of the current year, ask to have your bonus paid to you before the beginning of 2013.

√ ***Retirement Plan Distributions***: If you participate in an employer retirement plan or have an IRA and are over age 59½, make any taxable withdrawals before 2013.

√ ***Roth IRA Conversions:*** Rolling over a qualified pension plan to a Roth IRA accelerates income. If all the requirements are met, only income taxes are due and no penalties. Moreover, after 2012, AGI limitations will make it difficult for most people to roll over their qualified pension plan to a Roth IRA.

Deduction Planning

Deduction timing is an important part of year-end tax planning. Though the planning is complex, taxpayers should consider factors such as AGI, alternative minimum tax, and their filing status, to get the most benefit out of tax deductions.

√ ***Deduction in Year Paid***: An expense is only deductible in the year in which it is actually paid. If your tax rate is going to increase in 2013, it may be beneficial to postpone deductions until 2013.

√ ***Promise to Pay***: A promise to pay or providing a note payable does not qualify as a deductible payment. However, you can take a deduction if you pay with borrowed money. Therefore, you can take deductions for credit card purchases made in 2012 even though you won't pay the actual credit card bill until 2013.

√ ***State Taxes:*** Consider paying all your state income tax liability before year-end. This strategy may be especially useful for 2012 as there are not any itemized deduction limitations based on AGI, and there may be limitations in 2013. Keep in mind, the alternative minimum tax may mitigate the advantages of paying state income taxes early.

√ ***Payment by Check***: Date checks before the end of the year and mail them before January 1, 2013 so the expenses can be deducted in 2012.

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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