2011 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

As the end of 2011 approaches, there are many actions to consider that could reduce your 2011 taxes. Year-end planning is particularly challenging this year given the growing national debate over comprehensive tax reform, the rapid pace of recent tax law changes, and the extensive list of current tax breaks that are scheduled to ***expire at the end of 2011.*** Regardless of these looming uncertainties, there are many "time-tested" year-end tax savings techniques that you should consider ***for 2011.***

We are sending you this letter to remind you of the *traditional* year-end tax planning strategies that help lower your taxable income and postpone the payment of your taxes to later years. In this letter we also help you navigate the many *new* tax planning opportunities available to individuals under recent law changes. **Planning Alert!** Since many tax breaks are currently scheduled to ***expire after 2011*** (and others ***after 2012***), it is extremely important that you act timely to obtain maximum benefits! **Tax Tip.** Even though the weak economy has caused a drop in the income of many individuals, this decrease in income may actually produce additional tax benefits. If your income is down for 2011 as compared to recent years, you may be eligible for deductions and credits that you did not get in previous years because your income exceeded the phase-out thresholds. So, ***please pay close attention to the income thresholds*** for the various deductions and credits discussed in this letter, which we ***highlight prominently*** in each section.

Caution! Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, AMT can be triggered by taking large capital gains, having high levels of dividend income, or exercising incentive stock options. Therefore, **we suggest that you call our firm before implementing any tax planning technique discussed in this letter.** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy. **Please Note!** This letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.**

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SIGNIFICANT TAX BREAKS EXPIRING AFTER 2011

A host of current tax breaks for individual taxpayers are scheduled to expire at the ***end of 2011,*** unless Congress takes action to extend these provisions. **Caution!** Although Congress has traditionally extended a majority of expiring tax breaks in the past, there is no guarantee that it will do so in the future. **Tax Tip.** Regardless of how Congress ultimately addresses these expiring tax breaks, there are real tax savings available if you take advantage of these provisions **before the end of 2011.**The following are some of the more popular tax breaks that we have enjoyed over the past several years, but are ***currently scheduled to expire after 2011:*** **1)** school teachers' deduction (up to $250) for certain school supplies; **2)** election to deduct state and local sales tax; **3)** deduction (up to $4,000) for qualified higher education expenses; **4)** higher deduction and carryover limits for charitable contributions of "conservation easements"; **5)** deduction for home mortgage "insurance premiums"; **6)** "District of Columbia" first-time homebuyer's credit; **7)** tax-free transfers from IRAs to charities for those at least age 70½, **8)** temporary exclusion of 100% of gain on the sale of certain small business stock; **9**) 2% Social Security tax holiday; **10)** "refundable "adoption credit; and **11)** credit for energy-efficient improvements to your principal residence (**Caution!** This 30% credit of up to $1,500 cumulative for 2009 and 2010 dropped to a maximum life-time credit of $500 for installations during 2011).

Planning Alert! If you would like to take advantage of any of these provisions, but you need more information, please call our office so we can help you take the necessary steps to lock in these deductions before it is too late. The following provides more details on several of these expiring items that warrant special attention as we approach the end of 2011:

The Two Percent Social Security Tax Holiday For "2011 Only." For **2011 only,** there is *a **2%*** reduction in Social Security taxes for both employees and self-employed individuals. Therefore, **if you are an employee, for 2011,** the normal 6.2% "employee" portion of your Social Security tax rate is reduced to 4.2%. Thus, your take-home pay for 2011 is generally being increased by 2% of each dollar of compensation that you earn. However, since Social Security taxes apply only to the first $106,800 of compensation in 2011, your maximum savings will generally be $2,136 (i.e., $106,800 x 2%). Likewise, if you are self-employed, your Social Security taxes are reduced by 2% of your self-employment income for 2011 (up to $106,800). Therefore, if your self-employment income is $106,800 or more, your self-employment taxes will be reduced by $2,136. **Tax Tip!** This temporary Social Security tax reduction will not impact your future Social Security benefits. **Planning Alert!** Accelerating 2012 compensation or self-employed income **into 2011** will save you 2% on your Social Security tax to the extent the income acceleration does not cause you to exceed the $106,800 earned income cap.

The Temporarily Increased And Refundable Adoption Credit. For tax years beginning in 2010 or 2011, two significant changes were made to the adoption credit: **1)** the maximum adoption tax credit for 2011 was **increased to $13,360 per child,** and **2)** the credit became *"refundable"* (this generally means that, to the extent the credit exceeds your income taxes before the credit, the IRS will send you a check for the excess). **For 2011,** the adoption credit is phased-out as your modified adjusted gross income increases from **$185,210 to $225,210** (whether you're married filing a joint return, or single). **Tax Tip.** Generally, for *"domestic"* adoptions, you are allowed the adoption credit in the tax year *following the year* the qualifying adoption expense is "paid." However, the credit is allowed for adoption expenses paid in the ***same tax year*** that the ***adoption is finalized.*** Therefore, qualified expenses for a "domestic" adoption paid **during 2011** will generally qualify for a maximum credit in **2012 of $12,650 and the credit will not be refundable.** However, if you can *finalize* the adoption on or before **December 31, 2011,** your **2011 expenses** will qualify for a maximum credit **of $13,360 in 2011 and the credit will be refundable. Planning Alert!** As mentioned above, by finalizing an adoption before 2012, you may qualify for a higher credit and the credit will be refundable. **Foreign Adoptions.** Expenses paid in attempting to adopt a child who is not a citizen or resident of the United States do not qualify for the adoption credit unless and until the adoption is actually *finalized*. Consequently, if you are currently pursuing the adoption of a foreign child, you will be entitled to the adoption credit for 2011 ***only if*** you finalize the adoption *by* the ***end of 2011.*** In addition, if the foreign adoption is finalized in 2011, you would qualify for a higher credit ($13,360 rather than $12,650) and the credit would be "refundable".

Temporary 100% Exclusion For "Qualified Small Business Stock" Expires After 2011. If you sell "qualified small business stock" (QSBS) **acquired after September 27, 2010 and before January 1, 2012,**

you may be able to exclude the **entire gain** from taxable income if you hold the stock for more than 5 years (the gain will also be exempt from the alternative minimum tax). QSBS is generally stock of a non-publicly traded domestic “C” corporation engaged in a qualifying business, purchased directly from the corporation, and **held for more than 5 years;** where the issuing corporation meets certain active business requirements and has assets at the time the stock is issued of $50 million or less. Businesses engaged in a professional service, banking, insurance, financing, leasing, investing, hotel, motel, restaurant, mining, or farming activity generally *do not* qualify. **Planning Alert!** If you are considering investing in a small business, we will gladly help you evaluate whether structuring your investment as QSBS will work to your overall tax advantage. However, you must act promptly to take advantage of this narrow window of opportunity to qualify for the 100% exclusion. Only stock acquired **from September 28, 2010 through December 31, 2011** qualifies for the 100% exclusion (after you satisfy the 5-year holding requirement). Also, to qualify, you must purchase the stock directly from the corporation that is issuing the stock or from an underwriter of the stock (stock purchased from other third parties does not qualify).

Tax-Free IRA Payments To Charities If You Are At Least 70½. For the past several years, we have had a popular (but *temporary*) rule that allows taxpayers, who have reached age 70½, to have their IRA trustee contribute up to $100,000 from their IRAs directly to a qualified charity, and exclude the distribution from income. **Planning Alert!** To qualify, the check from your IRA must be made out “directly” to your designated charity. Since this tax break is currently scheduled to **expire after 2011,** you should make arrangements for the transfer with your IRA trustee ***well before the end of 2011*** if you want to take advantage of this provision.

Deducting Sales Taxes. For the past several years, we have had a *temporary* rule that allowed taxpayers to “elect” to deduct “either” state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes, or states where the state income taxes paid is generally less than the sales taxes paid. **Planning Alert!** This provision is currently scheduled to **expire after 2011,** and is not available for 2012 unless Congress decides to extend it. **Tax Tip.** If you plan to deduct sales tax for 2011 and you are considering the purchase of a big ticket item (e.g., car, boat), accelerating the purchase from **2012 into 2011** will preserve the sales tax deduction (if Congress does not extend this provision beyond 2011).

The Qualified Tuition Deduction. If you pay for *qualified* higher education tuition and fees for yourself, your spouse, or your dependents, you may qualify for an education expense deduction. This maximum $4,000 deduction is available whether or not you itemize. You are allowed the maximum $4,000 deduction only if your adjusted gross income ("AGI") does not exceed $130,000 on a joint return ($65,000 if single). If your AGI is between $130,000 and $160,000 ($65,000 and $80,000 if you're single) your maximum deduction drops to $2,000. **Caution!** If your AGI exceeds $160,000 (if joint) or $80,000 (if single) by even $1, the entire deduction is lost. **Planning Alert!** This deduction is **currently scheduled to expire after 2011.** Even though Congress has extended this provision in prior years when it was scheduled to expire, there is no guarantee that it will do so again. **Tax Tip.** If you expect to take this deduction and your income is close to the $130,000 or $160,000 limits ($65,000 or $80,000 if you're single), we should discuss your situation and see if we can take steps to keep your income below those thresholds **for 2011.**

CONSIDER FUTURE TAX RATES BEFORE DEFERRING INCOME

Classic year-end tax planning typically includes strategies that lower your current taxable income and postpone the payment of taxes to later years. A traditional technique to accomplish both of these goals is to defer the current recognition of taxable income to later years. However, as you consider any tax strategy that would defer taxable income beyond 2011, please keep in mind that individual tax rates are scheduled to increase ***after 2012.***

- **Currently Scheduled Tax Rate Increases.** Over the past several months, President Obama has proposed several tax increases on higher-income taxpayers as part of his deficit reduction proposals. Because of the political uncertainty of these proposals, it is impossible to predict with any certainty what the tax rates will be in the future. However, the existing individual income tax rates for all income levels are currently scheduled to remain in place ***through 2012.*** Consequently, the current 10% through 35%

tax brackets for ordinary income, and the maximum 15% tax rate for long-term capital gains and qualified dividends (zero percent if the dividends or capital gains would otherwise fall in the 10% or 15% tax brackets) **continue through 2012.** **Caution!** Starting ***in 2013,*** absent Congressional action, the top individual income tax rates will generally increase to: **1)** 39.6% for ordinary income; **2)** 39.6% for qualified dividends; and **3)** 20% for long-term capital gains. **Planning Alert!** In addition, starting ***in 2013,*** the *Health Care Act* imposes a new Medicare Surtax of 3.8% on the *investment income* (e.g., interest, dividends, capital gains) of higher-income individuals, and a Medicare Surtax of .9% on the *earned income* (e.g., W-2 income, self-employment income) of higher-income individuals. In addition, the following provisions could further impact your tax rate after 2011 or 2012:

●● **No Personal Exemption Or Itemized Deduction Phase-Out Through 2012.** For the past two decades, higher-income individuals have been subject to phase-out provisions that reduced their *personal exemptions* and *itemized deductions* as their income exceeded certain amounts. These phase-outs are eliminated for ***2010, 2011, and 2012***. **Planning Alert!** Starting ***in 2013,*** these personal exemption and itemized deductions phase-out rules are scheduled to be reinstated, potentially causing the highest "effective" income tax rate for many higher-income individuals to be above the scheduled rate of 39.6% on ordinary income.

●● **Marriage Penalty Relief Extended.** Several tax provisions were enacted back in 2001 to reduce the so-called "marriage penalty" (i.e., provisions in the tax law causing married individuals filing jointly to pay more tax than if they were unmarried filing single returns). These relief provisions were originally scheduled to expire after 2010. However, the provisions (e.g., an enhanced standard deduction and larger 10% and 15% brackets for married taxpayers filing jointly) have now been extended ***through 2012.*** **Planning Alert!** Without this relief, the marriage penalty is most significant when each spouse has about the same amount of taxable income. If you and your spouse have about the same amount of income, the expiration of these "marriage penalty relief provisions" after 2012 could indirectly increase your "effective" tax rates on your joint return.

●● **Alternative Minimum Tax "Patch" Also Expires After 2011.** For the past several years, Congress has enacted a series of temporary increases in the alternative minimum tax (AMT) exemption amounts to ensure that most lower and middle income taxpayers were not subject to the AMT. The current increased AMT exemption amounts ***expire after 2011,*** and non-refundable personal income tax credits will not offset the AMT ***after 2011.*** **Planning Alert!** In the past, Congress has always extended this AMT "patch" before its scheduled expiration date took effect, but this is not guaranteed for the future.

POSTPONING TAXABLE INCOME

Since currently scheduled tax rate increases do not occur **until 2013,** it continues to be a good idea to defer income into 2012 if you believe that your marginal tax rate for 2012 will be equal to or less than your 2011 marginal tax rate. In addition, deferring income into 2012 could increase various credits and deductions for 2011 that would otherwise be phased out as your adjusted gross income increases. **Tax Tip.** This classic tax planning strategy may be particularly valuable for 2011 if it also keeps your 2011 income below the phase-out thresholds for the many tax breaks that are currently scheduled to expire after 2011 (e.g., "refundable" adoption credit, $4,000 qualified higher education expense deduction, deduction for home mortgage "insurance premiums"). If, after considering your anticipated 2012 tax rates, you believe that deferring taxable income into 2012 will save you taxes, consider the following strategies:

Self-Employed Business Income. If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2012. **Planning Alert!** If you have already received the check in 2011, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Installment Sales. If you plan to sell certain appreciated property in 2011, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify, the gain will be taxed to you as you collect the principal payments on the note. **Planning Alert!** Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe that your chances of getting paid are at risk. **Caution!** On a seller-financed sale, most property that qualifies for the installment method also generates a long-term capital gain (e.g., closely-held stock, partnership interests except for certain recapture items, investment realty, improved realty used in a business or held for investment). As discussed above, the maximum long-term capital gains rate is presently scheduled to **increase from 15% to 20% after 2012.** You should consider this scheduled increase in the long-term capital gains rate before agreeing to accept an installment note with payments due beyond the 2012 tax year.

"Minimum Required Distributions" From Retirement Plans And IRAs. If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries such as an individual or a "qualified trust." If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a "contingent beneficiary" in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within **five years** after the year of your death. This will cause your beneficiaries to lose valuable tax deferral options. **Planning Alert!** The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, **relating to retirement plans, that should be taken before the end of 2011:**

- **Post Mortem Planning For Retirement Plan And IRA Distributions.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2011, there are certain planning techniques you should consider as soon as possible. **Tax Tip.** If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2011, the best tax results can generally be achieved by making any necessary changes **no later than December 31, 2011.** If you need assistance, please call our office as soon as possible so we can advise you.

- **IRA Owners Who Attain Age 70½ During 2011.** If you reached age 70½ at any time during 2011, you must begin distributions from a traditional IRA account **no later than April 1st of 2012.** A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. If you wait until 2012 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2012, which will cause you to take two payments in 2012. This "bunching" of the first two annual payments into one tax year (2012) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2011. **Tax Tip.** If you reached age 70½ in 2011, and you own an IRA or other qualified retirement account, please call us and we will help you navigate these rules to your best advantage.

- **Rollovers By Surviving Spouses.** If an individual ***over age 70½*** died during 2011 and the beneficiary of the decedent's IRA or qualified plan is the surviving spouse, and the *surviving spouse* is ***over 59½,*** the surviving spouse should consider rolling the decedent's qualified plan or IRA amount into his or her name **on or before December 31, 2011.** If the decedent's retirement account is rolled into an IRA in the surviving spouse's name **before 2012,** then **1)** provided the surviving spouse has not reached age 70½, no distributions are required in 2012, and **2)** if the surviving spouse is at least 70½, the required minimum distribution in 2012 will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. **Therefore, converting the account into the surviving spouse's name on or before December 31, 2011, could substantially reduce the amount of the required minimum distribution for 2012 where the decedent was at least 70½.** **Planning Alert!** If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse's name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments based on the surviving spouse's life expectancy.

SHOULD YOU CONVERT YOUR "TRADITIONAL IRA" TO A "ROTH IRA?"

Although postponing taxable income can frequently save you overall taxes, some tax saving strategies may actually result in accelerating taxable income. The most classic example of this involves your decision to convert your traditional IRA into a Roth IRA. When you convert a traditional IRA to a Roth IRA, you generally must pay tax on the amount converted as if you withdrew the funds from the traditional IRA.

- **Should I convert in 2011?** Whether to convert (rollover) your traditional IRA to a Roth IRA (Roth conversion) continues to be a hot topic, and there are many variables that impact this decision. Probably the most significant is your current tax rates as compared to the rates in effect when the funds are withdrawn from the IRA. Therefore, uncertainty as to future tax rates creates a significant amount of uncertainty as to whether a Roth conversion is right for you. **Tax Tip.** If the recession has caused a significant, but temporary, decline in your income for 2011, you may be a good candidate for converting all or a portion of your regular IRA to a Roth. This is particularly true if: **1)** your temporary drop in 2011 income places you in a much lower tax bracket than will apply when the funds are withdrawn from the IRA,**2)** you believe that the value of your IRA is currently at or near an all time low, **3)** you expect your IRA to appreciate in the relatively near future, and **4)** you have funds outside the IRA to pay the income taxes caused by the conversion and your after-tax rate of return on the outside funds is less than the rate of return in the IRA. **Planning Alert!** If you want the conversion to be **effective for 2011,** you must transfer the amount from the regular IRA to the Roth IRA **no later than December 31, 2011** (you do not have until the due date of your 2011 tax return). **Caution!** Don't attempt a Roth conversion or implement a Roth conversion strategy **without calling us first.** There is a host of factors you should evaluate before deciding to convert your traditional IRA to a Roth.

TAKING ADVANTAGE OF DEDUCTIONS

Accelerating "Above-The-Line" Deductions Into 2011. As a cash method taxpayer, you can generally accelerate a 2012 deduction into 2011 by "paying" it in 2011. Accelerating an **"above-the-line"** deduction (e.g., IRA or Health Savings Account (HSA) deduction, health insurance premiums for self-employed individuals, qualified student loan interest, qualified tuition deduction, qualified moving expenses, deductible alimony) into 2011 may allow you to reduce your "adjusted gross income" (AGI) below the thresholds needed to qualify for many other tax benefits (e.g., child credit, education credits, adoption credit, ability to contribute to a deductible IRA, etc). However, **"itemized"** deductions (i.e., below-the-line deductions) do **not** reduce your "adjusted gross income" and, therefore, will not affect your 2011 deductions and credits that are reduced as your income increases. *Itemized deductions* generally include charitable contributions, state and local income and property taxes, medical expenses, unreimbursed employee travel expenses, and home mortgage interest. **Tax Tip.** "Payment" typically occurs in 2011 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2011. **Be careful,** if you post-date the check to 2012 or if your check is rejected, no payment has been made in 2011. **Planning Alert!** The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment will not be deductible in 2011.

Accelerating "Itemized" Deductions Into 2011. If your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years. **Tax Tip.** The easiest deductions to shift from 2012 to 2011 are *charitable contributions*, *state and local taxes*, and your January, 2012 home *mortgage interest payment*. For 2011, the standard deduction is $11,600 on a joint return and $5,800 for single individuals. If you are blind or age 65, you get an additional standard deduction of $1,150 if you're married ($1,450 if single). **Watch Out For AMT!** Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Before you accelerate 2012 itemized deductions into 2011, to be safe, we should first do a "with and without" computation so we can determine the AMT impact of this strategy.

"Bunching" Medical Expenses. Many taxpayers ignore the medical expense deduction because medical expenses are deductible only if they exceed 7.5% of your AGI (10% for AMT purposes). However, if you have medical expenses that are discretionary, you may be able to "bunch" them into 2011 or 2012 and exceed the 7.5% floor. For example, braces are discretionary, and medical procedures such as laser eye surgery may be discretionary and qualify for the medical expense deduction. **Tax Tip.** You can include in your medical expenses the following: medical insurance premiums, transportation essential for medical care, lodging (but not meals) while away from home primarily for medical care, and changes to your house to accommodate a physical handicap. Tuition payments to a special school for a child with severe mental or physical disabilities (which could include medically diagnosed attention deficit hyperactivity disorder) may also qualify as a medical expense. However, the IRS requires that a doctor recommend that a child attend the school, and the school generally must determine the portion of the tuition payment that relates directly to the medical needs of the child. Also, the costs of programs and prescription drugs to help people stop smoking qualify as a medical expense. **Planning Alert!** Under the *2010 Health Care Act*, **starting in 2013** (2017, if age 65 or older), medical expense will be allowed as an itemized deduction only if they **exceed 10%** (up from 7.5%) of your AGI.

- **Qualified Long-Term Care Services.** Generally, deductible medical expenses include the cost of maintenance or personal care services prescribed by a "licensed health care practitioner" for a "chronically ill" individual. You must meet technical requirements before you may deduct these types of expenses as medical deductions. Please call our office if you need additional details.

- **IRS Medical Mileage Rate.** The standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is **19 cents per mile** from **January 1, 2011 through June 30**, **2011** and **23.5 cents per mile** from **July 1, 2011 through December 31, 2011**.

Take Advantage Of Health Savings Accounts (HSAs). Qualifying contributions to health savings accounts (HSAs) are fully deductible whether or not you itemize deductions, and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying "high deductible health plan" (HDHP). **For 2011,** if you have "family" coverage, your HDHP must have a minimum annual deductible of $2,400 ($1,200 for self only coverage). For 2011, your maximum contribution to an HSA is $3,050 ($4,050 if 55 or older) for self-only coverage, and $6,150 ($7,150 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less. **Tax Tip.** Your contribution to your HSA reduces your AGI which, in turn, could free up other deductions and credits that phase out as your income exceeds certain thresholds. **Planning Alert!** As long as you are covered by a qualifying high deductible health plan by **December 1, 2011,** you will be able to contribute up to the maximum 2011 contribution limitation (e.g., $6,150 for family coverage in 2011), subject to potential recapture rules. **Caution!** Beginning in 2011, you may only reimburse drugs from the HSA without tax or penalty if you have a prescription for the drug or if the drug is insulin. IRS says, however, that if you obtain a prescription for an over-the-counter drug, it may be reimbursed tax-free and without penalty. If your HSA reimburses over-the-counter drugs for which you do not have a prescription or other non-qualifying medical expenses, the reimbursement is includable in your income and is generally subject to a 20% penalty.

Don't Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, adoption assistance). Flex plans have a key deadline. For most *calendar-year* plans, you must clean out your 2011 account by March 15, 2012, or forfeit any funds that aren't used for qualifying expenses. **Planning Alert!** This March 15, 2012 deadline applies only to flex plans **that have been amended** to give participants 2½ months after year-end to use up current year contributions to the plan. If your calendar-year flex plan has not been amended, you must use up your account by **December 31, 2011 or forfeit the balance.** **Non-Prescription Drugs.** As mentioned above, beginning in 2011, reimbursements for drugs and medicines will be tax free only for a prescribed drug or insulin. **Tax Tip.** If you have been using a tax-favored reimbursement arrangement to reimburse yourself for *over-the-counter* medications (e.g., to treat a chronic medical problem such as allergies or asthma), your reimbursement will be tax free only if you first get a prescription for the over-the-counter drug. **Caution!** Starting in **2013,** the *Health Care Act* places a $2,500 annual cap on employer and/or employee contributions to *health flexible spending arrangements* (FSAs).

Maximizing Employee Business Expenses. If you are incurring unreimbursed employee business expenses, you must reduce those expenses by 2% of your adjusted gross income. "Bunching" these expenses into 2011 or 2012 so the 2% threshold is exceeded may reduce your taxes. You can bunch 2012 expenses into 2011 by prepaying the 2012 amounts in 2011. **Planning Alert!** Unreimbursed employee-business expenses are not deductible at all for purposes of computing your alternative minimum tax. **Tax Tip.** If you are a "statutory employee" (e.g., full-time life insurance salesperson, certain commissioned drivers, certain home workers) you are not subject to the 2% limitation for employee business expenses. The "statutory employee" box on your Form W-2 should be checked if you are classified as a statutory employee.

- **Taking Advantage Of Employer's "Accountable Plan."** As an employee, you can avoid the 2% reduction rule and the AMT exposure for employee business expenses, if you document your business expenses and get reimbursed by your employer under an "accountable plan." We can help you establish a proper reimbursement arrangement with your employer. **Planning Alert!** Employees should always formally seek reimbursement from their employers for legitimate employee business expenses, or obtain a representation from their employer that it will not reimburse such expenses. Otherwise, IRS says the employee may not take a deduction for the expense.

- **IRS Standard Mileage Rates Changed In The Middle of 2011.** The IRS "business standard mileage" reimbursement rate from **January 1, 2011** through **June 30, 2011** was **51 cents-per-mile.** The rate increased to **55.5 cents per mile** from **July 1, 2011** through **December 31, 2011.**

Home Office Deduction. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. If you're self-employed, you have to establish that you use your home office "regularly and exclusively" to perform management or administrative duties for your business and that there is no other fixed location where you perform substantial management or administrative duties relating to that trade or business. If you are an employee, in addition to meeting these requirements, you must also establish that your home office is "for the convenience of your employer" (this generally means you're not provided an office at work). **Tax Tip.** The IRS says that if you have a qualifying home office, you can deduct any travel from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement should be excluded from your income if reimbursed under an "accountable reimbursement arrangement." If you are an employee and your home office expenses are not reimbursed, the home office expense deduction will be reduced by 2% of your adjusted gross income and will not be deductible at all, for purposes of the Alternative Minimum Tax.

Charitable Contributions. You may save taxes by utilizing the following year-end planning techniques:

- **Be Sure To "Pay" Your Charitable Contribution In 2011.** A charitable contribution deduction is allowed for 2011 if the check is mailed **on or before December 31, 2011,** or the contribution is made by a credit card charge in 2011. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay off the note or pledge.

- **Contributions Of Appreciated Property.** If you are considering a significant 2011 contribution to a public charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute appreciated long-term capital gain property, rather than selling the property and contributing the cash proceeds to charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation. **Planning Alert!** If you want to use "loss" stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, you will get the same charitable deduction (equal to the value of the contributed stock), but you will lose the capital loss deduction. **Tax Tip.**If you plan to transfer appreciated realty or stock for 2011, make sure that you begin the paperwork early enough so that all documentation is completed by **December 31, 2011.** In addition, to take a charitable contribution deduction for property valued in excess of $5,000, you must have a qualified receipt and an appraisal by a qualified appraiser. Furthermore, you need a qualified receipt (as discussed in the following paragraphs) for all noncash contributions.

- **Substantiation Requirements For Contributions Of $250 Or More.** If you contribute $250 or more to a charity, you are allowed a deduction only if you receive a *qualifying* **written receipt** from the charity by the time your return is filed. **Planning Alert!** You must receive this receipt **before** we file your 2011 return, and you should retain the receipt in your tax files in case you are later audited. IRS says a cancelled check is **not** sufficient where the contribution is $250 or more! In addition, for all noncash contributions, the receipt must contain the date and location of the charitable contribution and a description of the property contributed. Also, no deduction will be allowed for charitable contributions of clothing or household items, unless the items are in "good used condition or better." **Tax Tip.** You should consider contributing your clothing and household items to charitable thrift shops that have a policy of accepting only items that are in good condition.

- **Contributions Of Less Than $250.** In order to deduct a charitable contribution made in cash, by check, or by other monetary means of less than $250, the contribution must be supported by **1)** a bank record (e.g., a cancelled check), or **2)** a receipt, letter or other *written* communication **from the charity** showing the name of the donee organization, the date of the contribution, and the amount of the contribution. **Tax Tip.** Without these records, you are allowed no deduction at all, regardless of amount. Since a cancelled check satisfies these new requirements, you should consider replacing your cash contributions with a check. If you contribute by payroll deduction, IRS says that you will satisfy this requirement if you have a pay stub or W-2 setting forth the contribution amount and a pledge card prepared by the charity. For *noncash contributions,* IRS says you must have a receipt showing the name of the charity, the date and location of the charitable contribution, and a description of the property contributed.

- **Donations of Motor Vehicles, Boats, and Aircraft.** There are stringent reporting and documentation requirements for the donor and the charity that must be satisfied in order to claim a charitable deduction in excess of $500 for a "qualified vehicle." A "qualified vehicle" generally includes motor vehicles designed for highway use, boats, or airplanes. Generally, if you deduct more than $500 for a "qualified vehicle," your deduction is limited to the gross sales proceeds received by the charity on the sale of that vehicle. In addition to this deduction limitation, a deduction exceeding $500 is not allowed at all unless you receive a Form 1098-C from the charity and attach a copy to your income tax return. **Tax Tip.** If your deduction is $500 or less, your deduction is not limited to the sales price of the vehicle, and you are not required to file a Form 1098-C with your tax return. However, you must still obtain a qualifying receipt from the charity as discussed in the previous paragraphs.

- **IRS Charitable Mileage Rate.** The standard IRS charitable deduction mileage rate for use of your vehicle for qualified charitable purposes is **14 cents** per mile **for the entire 2011 year.**

Maximizing Home Mortgage Interest Deduction. If you are looking to maximize your 2011 deductions, you can increase your home mortgage interest deduction by paying your January, 2012 payment **on or before December 31, 2011.** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December. **Planning Alert!** Make sure that you send in your January, 2012 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender will be sure to reflect that last payment on your 2011 Form 1098, and we can avoid a matching problem on your 2011 return. Here are some other planning strategies you should consider:

- **Look For Deductible "Points."** Points paid in connection with the purchase or improvement of your principal residence are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include "loan-processing fees," "loan premium charges," or "loan origination fees" so long as they don't represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys' fees, credit checks, property taxes, or mortgage insurance premiums). **Tax Tip.** If 2011 marks at least the second time that you refinanced your home, and you are not refinancing with the same lender, you may deduct in 2011 the unamortized points from the previous refinancing.

- **Remember To Deduct Seller-Paid Points.** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

- **Pay Off Personal Loans First.** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Time Payment Of State And Local Taxes To Your Benefit. If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2011) and any property taxes for 2011 **prior to January 1, 2012** if your tax rate for 2011 is higher than or the same as your projected 2012 tax rate. This will provide a deduction for 2011 (a year early) and possibly against income taxed at a higher rate. **Planning Alert!** State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, "overpayment" of your 2011 state and local income taxes is generally not advisable particularly if a refund in 2012 from a 2011 overpayment will be taxed at a higher rate than the 2011 deduction rate. **Please consult us before you overpay state or local income taxes!**

YEAR-END TAX PLANNING FOR INVESTORS

Planning With Capital Gains And Losses. Generally, the current maximum long-term capital gains rate of 15% **is scheduled to continue through 2012.** Also **through 2012,** lower-income taxpayers who have long-term capital gains that would otherwise be included in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate. **Tax Tip.** Timing your year-end sales of stocks, bonds, or other securities may save you taxes. ***After fully evaluating the economic factors,*** the following are time-tested, year-end tax planning ideas for sales of capital assets. **Planning Alert!** Always consider the economics of a sale or exchange **first!**

- **Planning With *Temporary* Zero Percent Capital Gains Tax Rate.** Long-term capital gains and qualified dividends that would otherwise be included in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate through 2012. **Planning Alert!** For 2011, all ordinary income (e.g., W-2, interest income) up to $69,000 for joint returns ($34,500 if single) is taxed at the 15% rate, or below. Thus, taxpayers filing jointly can benefit from the zero percent capital gains rate if (and to the extent) they have 2011 ordinary taxable income under $69,000 ($34,500 if single). **Tax Tip.** Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2011, may temporarily have income low enough to take advantage of the zero percent capital gains rate for 2011. If you are experiencing any of these situations, please call our firm and we will help you plan to take advantage of these low capital gains rates. **Planning Alert!** Gains that currently qualify for the zero percent rate will be taxed at 10% **starting in 2013,** unless Congress extends the zero percent rate beyond 2012.

- **Timing Your Capital Gains And Losses.** If you have already recognized capital gains in 2011, you should consider selling securities that have declined in value **prior to January 1, 2012.** These losses will be deductible on your 2011 return to the extent of your recognized capital gains, plus $3,000. **Tax Tip.** These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: $2,500 American Opportunity Tuition Tax Credit, $1,000 child credit, $13,360 adoption credit, etc. **Planning Alert!** If within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the "wash sale" rules (although the disallowed loss will increase the basis of the acquired stock). **Tax Tip.** If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Making The Most Of Capital Losses.** Many investors still have substantial loss carry forwards coming into 2011. If your stock sales to date have created a *net* capital loss exceeding $3,000, consider selling enough appreciated securities **before the end of 2011** to decrease your net capital loss to $3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of $3,000) to offset your short-term capital gain, while preserving your favorable long-term capital gain treatment for later years. **Planning Alert!** Your *net* short-term capital gains can be used to free up a deduction for any "investment interest" you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest. **Tax Tip.** If you are considering selling "loss" investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine which strategy will maximize your tax savings.

- **Year-End Mutual Fund Purchases.** If you are thinking about buying mutual fund shares near year-end, watch out for a common tax trap. Mutual funds typically distribute income, including capital gains, near the end of each year. If you invest in the fund near the end of the year, but on or before the record date for this payout, you generally will be taxed on a year-end distribution as if you had held the fund all year. This, in essence, treats a return of your investment as a taxable distribution. **Tax Tip.** Before investing, determine the amount and timing of any year-end payout.

Stock "Traders" Should Consider The "Mark-to-Market" Election. If you are a "trader" (instead of an "investor") in stocks, the "mark-to-market" election could possibly save you taxes. Generally, you may qualify as a "trader" if you have frequent purchases and sales of stock, you hold the stock for short-term gain (rather than long-term appreciation and dividends), and you have a high volume of stock transactions throughout the year. As a trader, you can elect (for tax purposes) to mark your stock down or up to market at year end. This election will convert what would generally be short-term capital gains and losses, into "ordinary" gains and losses. **Tax Tip.** This election could save taxes if at some point you incur significant losses. If you qualify as a "trader," making a timely "mark-to-market" election allows you to deduct those losses as "ordinary losses," instead of being limited by the $3,000 ceiling on net capital losses. Also, making this election **will not** subject your mark-to-market stock gains to Social Security or Medicare taxes. **Planning Alert!** Unless you made the election for a prior year, the mark-to-market election, unfortunately, must be made by the due date (without regard to extensions) of your **prior year's tax return.** Even though it is too late to make the election for 2011, you may wish to make the election by April 16, 2012, for 2012 and future years. Please call us if you think this election might save you taxes and we will be glad to fill you in on the details.

Exercising Incentive Stock Options (ISOs) Could Trigger AMT. Exercising an incentive stock option (ISO) in 2011 can generate a 2011 alternative minimum tax (AMT) if the difference between the stock's value and the exercise price is substantial. **Tax Tip.** If you exercised an ISO **in 2011** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2011 AMT tax liability if you sell the stock **on or before December 31, 2011.** Please check with us if you have exercised incentive stock options during 2011 and the price of the stock has fallen since the date of exercise.

PLANNING WITH EDUCATION COSTS

To encourage higher education, Congress has provided a host of deductions and credits that can save significant taxes, including: the "American Opportunity Credit" the Lifetime Learning credit, the student loan interest deduction, and others. If your income is down for 2011, this may be a particularly good time to take advantage of these tax breaks since their benefits are reduced at higher income levels. As you develop your 2011 tax year-end planning strategies, the following should help you plan for these interrelated (and sometimes overlapping) education tax incentives:

- **"American Opportunity Education Tax Credit" (Formerly "Hope Credit").** Before 2009, individuals were allowed a HOPE tuition tax credit (HOPE Credit) for qualifying tuition costs generally for the first two years of college (e.g., freshman and sophomore years). **For 2009 through 2012,** Congress changed the name of the HOPE credit to the ***"American Opportunity Tax Credit"*** and: **1)** increased the maximum credit from $1,800 to $2,500 (100% of the 1st $2,000 of qualifying education expenses plus 25% of the next $2,000 of qualifying expenses); **2)** increased the total number of years that a student may qualify for the credit from *two* years to *four* years (i.e., generally, freshman through senior years); **3)** increased the income phase-out levels (for 2011 the credit is phased out as your modified adjusted gross income increases **from $160,000 to $180,000 for those filing joint returns** and from **$80,000 to $90,000 for single filers**); **4)** made 40% of the credit refundable *(unless the person claiming the credit* is subject to the so-called *kiddie tax rules*); and **5)** added *course materials* to the expenses (in addition to tuition and fees) that qualify for the credit. **Planning Alert!** To get the full $2,500 credit for 2011, you must pay qualifying expenses of at least $4,000 for the student **by December 31, 2011.** For example, if you paid tuition and books of $2,500 for the fall, 2011 semester for a college freshman, you would need to pay tuition of at least $1,500 for the spring, 2012 semester by **December 31, 2011,** to get the full credit of $2,500 for 2011.

- **The Lifetime Learning Credit.** The *Lifetime Learning tax credit* equals 20% of the first $10,000 of qualified higher education tuition and fees. The credit phases out ratably as your modified adjusted gross income increases from **$102,000 to $122,000** on a joint return (**$51,000 to $61,000** on a single return). The Lifetime Learning credit is for an unlimited number of years and can be used for graduate or professional degrees (as well as undergraduate education). However, the Lifetime Learning credit **limitation of $2,000 is per tax return, not per student. Planning Alert!** If your income **is more than $122,000 ($61,000 on a single return),** you do not qualify for the Lifetime Learning credit. However, the IRS says the student (e.g., your child) may claim the credit on his or her return, provided you elect not to claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). Since the Lifetime Learning credit is a *non-refundable* credit, your child must have sufficient income tax liability to utilize the credit on his or her return.

- **Student Loan Interest.** For **2011,** you may deduct (whether or not you itemized deductions) up to $2,500 of interest on qualified student loans. Your deduction phases out as your adjusted gross income increases from **$120,000 to $150,000 on a joint return (from $60,000 to $75,000 on a single return).** The IRS says that if a family member pays your interest, the payment will be treated as a gift to you, and you will then be treated as paying the interest yourself.

- **Using IRA Funds For Education Expenses.** If you have an IRA, you can withdraw funds for qualified higher education expenses without having to pay the normal 10% early distribution penalty. The distribution is, however, still taxable. **Tax Tip.** The taxes on the distribution for higher education expenses, may be offset by an American Opportunity Tax credit or a Lifetime Learning credit resulting from the payment of the qualifying education expenses. Also, this exception from the early distribution penalty for qualifying education expenses ***only*** applies to *distributions from IRAs*. Therefore, if you receive a distribution from your *employer's retirement plan* and you do not meet any other exception to the 10% penalty, you will generally pay the 10% penalty tax even if you pay qualifying education expenses equal to or greater than the distribution during the same tax year. Consequently, a distribution from your employer's retirement plan **should be first rolled to an IRA** within the 60-day rollover period, and then distributed from the IRA to avoid the 10% penalty. **Planning Alert!** You must withdraw the IRA funds *in the same tax year* that you pay the qualified education expenses to avoid the 10% early distribution penalty. Therefore, if you have paid qualifying education expenses in 2011 and want a penalty-free reimbursement from your IRA for those expenses, you must **make the distribution no later than December 31, 2011.**

PLANNING WITH RETIREMENT PLANS

Consider Contributing The Maximum Amount To Your Retirement Plan. As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

- **IRA Contributions.** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to $10,000 ($12,000 if you're both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than $5,000 ($6,000 if you're at least age 50) may be contributed to either your or your spouse's separate IRA for 2011. If you are an active participant in your employer's retirement plan during 2011, your IRA deduction is phased out ratably as your adjusted gross income increases from **$90,000 to $110,000** on a joint return (**$56,000 to $66,000** on a single return). However, if your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your ability to contribute the full amount to an IRA phases out only as the adjusted gross income on your joint return goes from **$169,000 to $179,000.** **Planning Alert!** Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2011, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **$169,000 to $179,000** on a joint return or from **$107,000 to $122,000** if you are single.

- **Workers At Least Age 70½.** If you are age 70½ or older, you **cannot** make a contribution to a traditional IRA. **Tax Tip.** If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½.

- **Consider Contributing To Your Company's 401(k) Plan.** If you are covered by your company's 401(k) plan, you should consider putting as much of your compensation into the plan as allowable. The maximum contribution you may make (employee portion) for 2011 is $16,500 ($22,000 if you're at least age 50 by the end of 2011). This is particularly appealing if your employer offers to match your contributions.

- **Seek Advice Before Dipping Into Your Qualified Retirement Accounts Or IRAs!** If you are experiencing financial distress which is tempting you to tap your retirement plan funds, **be extremely careful!** There are specific ways to withdraw funds without paying a 10% penalty (although you generally must include the withdrawal in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** you have reached age 59½, **2)** you have been medically determined to be disabled, **3)** you are using the funds for qualified education expenses, **4)** you are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** you take substantially equal payments over your life expectancy. **Planning Alert!** These rules are exceedingly technical and if not properly followed, can result in a 10% penalty. Please call our firm if you need to access your retirement funds and we will help you determine if you qualify for one of these exceptions to the penalty.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Maximize Tax-Favored Medical Benefits For Children Under Age 27. Effective March 30, 2010, an employer-provided health plan may provide tax-free reimbursements to an employee's child **who is under age 27** *at the end of the tax year*. This exclusion applies even if the employee cannot claim the child as a dependent for tax purposes. Previously, an employer could only reimburse "tax free" the medical expenses of an employee, the employee's spouse, and the employee's dependents. **Tax Tip.** If your employer's health insurance plan is currently covering your child who will turn age 27 in 2012, accelerating discretionary medical expenses for that child from **2012 to 2011** will allow your employer's 2011 reimbursements to be tax-free.

In addition, if you are self-employed, you may take an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums that you pay for your child who is **under age 27** at the **end of the year,** even if the child is not your "dependent" for tax purposes.

Don't Forget That Over-The-Counter Drugs Are No Longer Tax Favored. Before the *Health Care Act*, taxpayers were allowed tax-free reimbursements for most *nonprescription* drugs and medicines from a health savings account (HSA), health flexible spending arrangement (FSA), health reimbursement arrangement (HRA), or other qualified employer health plans. The Health Care Act provides that after 2010, reimbursements for drugs and medicines are tax free *only for* a *"prescribed"* drug or *insulin*. **Tax Tip.** If you have been using one of these tax-favored arrangements to reimburse over-the-counter medications, you now must get a physician's prescription for that medication to receive tax-free reimbursements except for insulin. **Planning Alert!** The IRS says that over-the-counter drugs and medications can be reimbursed tax-free as long as you have a valid prescription for the drugs or medications.

<u>30% Credit For Qualified *Residential* Solar Water Heaters, Geothermal Heat Pumps, Etc.</u> If you install a qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property in or on your residential property located in the U.S., you may qualify for a credit equal to 30% of the equipment's cost (including onsite labor costs). The residence does ***not*** have to be your **"principal residence,"** so installations in your second residence or vacation home may qualify. **<u>Tax Tip.</u>** Unlike many other tax breaks, this credit is not reduced or eliminated as your AGI increases. Also, the IRS says on its website that this credit is available to the extent that the purchase price of a new home can be reasonably allocated to the qualifying energy-efficient equipment. Therefore, if you purchased a new home in 2011, be sure to ask the builder to provide you a cost breakdown of any solar electric panels, solar water heaters, etc. **<u>Planning Alert!</u>** Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify. Also, to take the credit for 2011, the property must *actually be installed* **no later than December 31, 2011. Please note** that this credit is not currently scheduled to expire until **after 2016.**

<u>Planning With The "Kiddie Tax."</u> A child who *is not filing a joint return with a spouse* will have his or her unearned income (e.g., interest, dividends, and capital gains) in excess of the *threshold amount* ($1,900 for 2011), taxed at the *parents' tax rate* if: **1)**The child **has not attained age 18** by the *close of the tax year*; **OR 2)** The child **is age 18** by the *close of the tax year* AND the child's **earned income does not exceed one-half the child's support; OR 3)** The child is **age 19 through 23** by the *close of the tax year* AND the child is a full-time student AND the child's earned income does not exceed one-half the child's support. **<u>Planning Alert!</u>** College students who are subject to this so-called *kiddie tax* will not be able *to* sell their appreciated capital gain property (for example to cover tuition), and pay tax at their lower tax rates to the extent their interest, dividends and capital gains exceed $1,900. **<u>Tax Tip.</u>** Since a child's *earned income* is not taxed at the parents' tax rates, parents may save taxes by employing a child in the parent's business and paying the child *reasonable* compensation. The child's earnings won't be subject to tax at the parent's rates under the kiddie tax rules and the earnings should be deductible by the business. Also, if the child is over age 17 and the earnings exceed one-half of his or her support, the child would also avoid the kiddie tax exposure for any unearned income.

<u>Consider Utilizing The $13,000 Annual Gift Tax Exclusion.</u> For individuals dying in **2011 or 2012,** there is generally a **35%** estate tax to the extent the estate's value plus any taxable gifts made during the decedent's life exceeds **$5 million** (the "estate and gift unified exclusion amount"). This current $5 million *exclusion amount* is scheduled to **drop to $1 million** for gifts made and for estates of individuals dying **after 2012,** and the top estate and gift tax rate is scheduled to **increase to 55%. <u>Tax Tip.</u>** You can reduce your estate without using any of the unified exclusion amount and without making taxable gifts by making annual gifts up to the annual gift tax exclusion amount of $13,000 per donee. Your spouse can do the same, bringing the total gifts that can be made free of gift tax and without using any of the unified exclusion amount to $26,000 per donee. **<u>Planning Alert!</u>** If you make your 2011 gift by check, the IRS says that the donee must actually "deposit" the check **by December 31, 2011** in order to utilize the 2011 $13,000 annual gift tax exclusion. Therefore if gifts are made near the end of the year, you should consider making the gifts using a cashier's check which should constitute a gift when the check is delivered.

<u>FINAL COMMENTS</u>

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this letter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of these provisions may apply to a specific situation.

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