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TAX AND BUSINESS Alert™

November 2012

Individual Year-end Tax Planning

The current federal income tax environment remains favorable through December 31st. Here are some tax planning ideas to consider as we approach year-end.

Leverage Standard Deduction by Bunching Deductible Expenditures. Are your 2012 itemized deductions likely to be just under or just over the standard deduction amount? If so, consider bunching expenditures for itemized deduction items every other year, while claiming the standard deduction in the intervening years. The 2012 standard deduction for married joint filers is $11,900; $5,950 for single and married filing separate filers; and $8,700 for heads of households.

For example, say you're a joint filer whose only itemized deductions are $4,000 of annual property taxes and $8,000 of home mortgage interest. If you prepay your 2013 property taxes by December 31st, you could claim $16,000 of itemized deductions on your 2012 return ($4,000 of 2012 property taxes, plus another $4,000 for the 2013 property tax bill, plus the $8,000 of mortgage interest). Next year, you would only have the $8,000 of interest, but you could claim the standard deduction. Following this strategy will cut your taxable income by a meaningful amount over the two-year period (this year and next). You can repeat the drill again in future years. Finally, check for any negative AMT implications before implementing this strategy.

Examples of other deductible items that can be bunched together every other year to lower your taxes include charitable donations and state income tax payments.

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Caution: If you think you'll be in a higher tax bracket next year, you may want to claim the standard deduction this year and bunch your itemized deductions into 2013 when they can offset the higher taxed income. This will boost your overall tax savings for the two years combined.

Take Advantage of the 0% Rate on Investment Income. For 2012, the federal income tax rate on long-term capital gains and qualified dividends is 0% when they fall within the 10% or 15% federal income tax rate brackets. This will be the case to the extent your taxable income

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(including long-term capital gains and qualified dividends) does not exceed $70,700 if you are married and file jointly ($35,350 if you are single). While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in one of the bottom two brackets. If so, consider giving them some appreciated stock or mutual fund shares that they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

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Giving away stocks that pay dividends is another tax-smart idea. As long as the dividends fall within the gift recipient's 10% or 15% rate bracket, they will be federal-income-tax-free.

Caution: The Kiddie Tax rules could cause capital gains and dividends to be taxed at the parent's tax rate. Also, the gift tax exclusion is $13,000 in 2012.

Time Investment Gains and Losses. As you evaluate investments held in your taxable accounts, consider the impact of selling appreciated securities this year. The maximum federal income tax rate on long-term capital gains in 2012 is 15%. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling. On the other hand, now may be a good time to cash in some long-term winners to benefit from today's historically low capital gains tax rates.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can also be a good idea. The resulting capital losses will offset capital gains from other sales this year, including short-term gains from securities owned for one year or less that would otherwise be taxed at ordinary income tax rates. The bottom line is that you don't have to worry about paying a higher tax rate on short-term gains if you have enough capital losses to shelter those short-term gains.

If capital losses for this year exceed capital gains, you will have a net capital loss for 2012. You can use that loss to shelter up to $3,000 of this year's ordinary income from salaries, bonuses, self-employment, and so forth ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

For the Charitably Inclined. Say you want to make some gifts to favorite relatives (who may be hurting financially) and/or favorite charities. You can make gifts in conjunction with an overall revamping of your stock and equity mutual fund portfolio. Here's how to get the best tax results from your generosity:

Gifts to Relatives (nondeductible). Do not give away loser shares. Instead sell the shares, and take advantage of the resulting capital losses. Then give the cash sales proceeds to the relative. Do give away winner shares to relatives. Most likely, they will pay less tax than you would pay if you sold the same shares. In fact, relatives who are in the 10% or 15% federal income tax brackets will generally pay a 0% federal tax rate on long-term gains from shares that were held for over a year before being sold in 2012. (For purposes of meeting the more-than-one-year rule for gifted shares, you get to count your ownership period plus the recipient relative's ownership period, however brief.) Even if the shares are held for one year or less before being sold, your relative will probably pay a lower tax rate than you would (typically only 10% or 15%). However, be aware that gains recognized by a relative who is under age 24 may be taxed at his or her parents' higher rates under the so-called Kiddie Tax rules.

Gifts to Charities (deductible). The strategies for gifts to relatives work equally well for gifts to IRS-approved charities. Sell loser shares and claim the resulting tax-saving capital loss on your return. Then, give the sales proceeds to the charity and claim the resulting charitable write-off (assuming you itemize deductions). This strategy results in a double tax benefit (tax-saving capital loss plus tax-saving charitable

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Recent Graduates' Job Search and Moving Expenses

With many college and high school graduates still looking for jobs, we thought it would be a good time for a refresher on which expenses are and are not deductible in connection with landing that first post-graduation job.

Job Search Expenses

Expenses incurred by taxpayers when searching for new employment *in the same trade or business are deductible* as a miscellaneous itemized deduction. Therefore, they are deductible for regular tax purposes and only to the extent they and other miscellaneous itemized deductions exceed 2% of adjusted gross income (AGI). Examples of deductible job search expenses include employment agency fees, resume preparation expenses, and travel and transportation expenses. Additional expenses that may be deductible include employment counseling fees, postage, typing and printing, and advertising.

However, the costs of finding first-time employment *are not deductible*, since first-time employment by definition cannot be in the taxpayer's same trade or business. Therefore, recent college and high school graduates seeking first-time employment cannot deduct any of their job search expenses.

Moving Expenses

While the costs of finding first-time employment are not deductible, moving expenses associated with first-time employment are deductible if the time and distance tests are met (see below). Moving expenses (for both foreign and domestic moves) are generally deductible above the line in computing AGI. These expenses include the cost of transporting household goods and personal effects from the former residence to the new residence. This includes the cost to pack and crate, store, and insure household goods and personal effects within any period of 30 days in a row after they were moved from the taxpayer's old home and before they were delivered to the new home.

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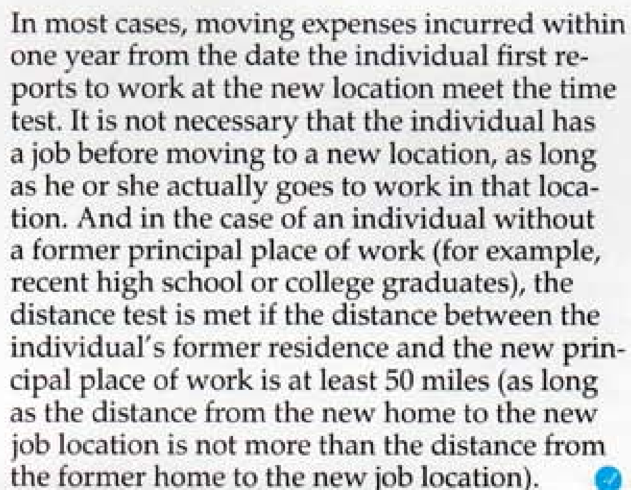

Moving costs also include the cost of traveling from the former residence to the new residence. (Traveling expenses include lodging, but not meals.) Automobile expenses can be calculated per mile in lieu of actual expenses. For 2012, the standard mileage rate is 23 cents per mile.

In most cases, moving expenses incurred within one year from the date the individual first reports to work at the new location meet the time test. It is not necessary that the individual has a job before moving to a new location, as long as he or she actually goes to work in that location. And in the case of an individual without a former principal place of work (for example, recent high school or college graduates), the distance test is met if the distance between the individual's former residence and the new principal place of work is at least 50 miles (as long as the distance from the new home to the new job location is not more than the distance from the former home to the new job location).

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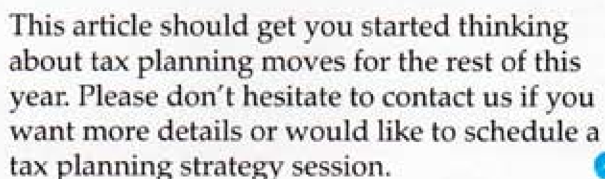
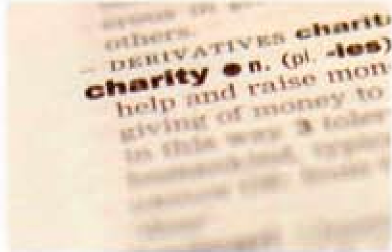
contribution deduction). Give away winner shares to charity instead of giving cash. Here's why. For publicly traded shares that you've owned over a year, your charitable deduction equals the full current market value at the time of the gift. Plus, when you give winner shares away, you walk away from the related capital gains tax. This idea is another double tax-saver (you avoid capital gains tax on the winner shares, and you get a tax-saving charitable contribution write-off). Because the charitable organization is tax-exempt, it can sell your donated shares without owing anything to the IRS.



This article should get you started thinking about tax planning moves for the rest of this year. Please don't hesitate to contact us if you want more details or would like to schedule a tax planning strategy session.

Substantiating Charitable Contributions

One of the most popular tax deductions for individuals is the one allowed for donations to charitable organizations—from the local church or synagogue to the Red Cross and various other national organizations. Unfortunately, this deduction has also been among the most abused. Thus, perhaps it is not surprising that Congress has responded to the problem by regularly enacting more rules around documenting donations.



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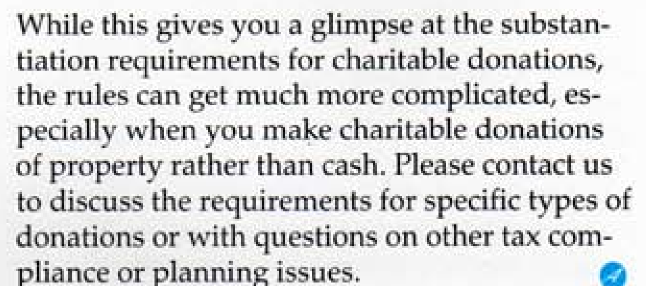
What we're left with is a confusing array of rules that you must comply with in order to claim a deduction. For example, donors must obtain a written acknowledgment from the charity if the value of the contribution (cash or other property) is $250 or more—a canceled check is not sufficient proof. A recent court case illustrates how easy it is to run afoul of the documentation requirements.

In the case, the taxpayers donated $22,517 to their church during the tax year. Several individual donations were made by check, each of which was in excess of $250. Although the donations were made by check and the taxpayer provided canceled checks to document the gift, the IRS disallowed the deduction because the taxpayers failed to obtain a timely receipt from their church to support the donations. Such receipt (or receipts) must be received by the time you file your return for the year of the donation (or, if earlier, by when the return is due). In addition, it must include all of the following:

1. The name and address of the charity.
2. The date of the contribution.
3. The amount of cash or a description (but not an estimate of value) of any property contributed.
4. A list of any significant goods or services received in return for the donation (other than intangible religious benefits) or a specific statement that the donor received no goods or services from the charity.

In the case at hand, the taxpayers had a receipt from their church, but it did not contain the required statement regarding whether goods or services were provided. They tried to correct this omission by getting a new receipt from their church after the IRS challenged the deduction. By then, of course, it was too late.



While this gives you a glimpse at the substantiation requirements for charitable donations, the rules can get much more complicated, especially when you make charitable donations of property rather than cash. Please contact us to discuss the requirements for specific types of donations or with questions on other tax compliance or planning issues.

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