Lally & Co.
CPAs and Business Advisors

The Evergreen

Quarterly Journal for Clients & Friends

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This Issue:

- **2012 Year-End Tax Planning for Individuals**
- **Tax Savings Strategies for Investing**
- **FAQ: Should I be paying estimated tax or having more withheld instead?**
- **AICPA 125th Anniversary**

The Evergreen. Always Growing.

Why a leaf-bearing tree? For *The Evergreen* we've chosen the image of a live oak tree to represent the strength, stability, and resourcefulness of our clients. Remaining green throughout the year in most climates, the live oak has been a living symbol of strength and durability for centuries.

At Lally & Co., we strive to offer solid solutions that ensure our clients' financial strength and protection. We are always looking for ways to better serve you.

Contact our office or visit our website for more information.

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Dear Clients and Friends,

With the National elections and the "fiscal cliff" just weeks and months away, many clients are asking what they can do to best position their tax liabilities for 2012 and beyond. Expectations are high that the current tax rules for 2012 and 2013 will change. Our dilemma is that we cannot predict the scope or magnitude of these changes when it looks like both political parties will share control of congressional legislation.

As mentioned in our Summer 2012 Newsletter, we have devoted this edition to identifying short and long term strategies for a rising income tax rate environment. Some may think that September / October is too early to be discussing year-end tax planning; why not wait until after the election. However, the uncertainty over the Bush-era tax cuts, the new taxes starting in 2013 and 2014, and possible retroactive legislation in 2013 all point towards specific, individual planning and proactive strategies that span several years.

As you read through *The Evergreen*, please do not hesitate to contact us at any time. We would be happy to hear from you and welcome the opportunity to provide clarity and simplification complex tax and business issues. This and past issues of *The Evergreen* are available on our website at http://lallycpas.com/newsletters/.

2012 Year-End Tax Planning for Individuals

2012 began with great uncertainty over federal tax policy and now, with the end of the year approaching, that uncertainty appears to be far from any long-term resolution. A host of reduced tax rates, credits, deductions, and other incentives (collectively called the "Bush-era" tax cuts) are scheduled to expire after December 31, 2012. To further complicate planning, over 50 tax extenders are up for renewal, either having expired at the end of 2011 or scheduled to expire after 2012. At the same time, the federal government will be under sequestration, which imposes across-the-board spending cuts after 2012. The combination of all these events has many referring to 2013 as "taxmeggedon".

Expiring incentives
Effective January 1, 2013, the individual income tax rates, without further Congressional action, are scheduled to increase across-the-board, with the highest rate jumping from 35 percent to 39.6 percent. The current 10 percent rate will expire and marriage penalty relief will sunset. Additionally, the current tax-favorable capital gains and dividends tax rates (15 percent for taxpayers in the 25 percent bracket rate and above and zero percent for all other taxpayers) are scheduled to expire. Higher

(continued on page 2)

Did you know?

- Lally & Co. consists of 34 individuals: 20 CPAs, 8 non-CPA professionals, and 6 administrative staff. The professional staff holds 7 advanced degrees and includes 1 attorney.
- You can find helpful financial tools on our website www.lallycpas.com/financial-calculator/
- This and past issues of *The Evergreen* are available on our website. www.lallycpas.com/newsletter

Firm Announcements

Ralph Burchell received an Excellence in Teaching Certificate from the University Of Pittsburgh Katz Graduate School of Business in August 2012

Leigh Ann Sobzack was promoted to the position of Manager in the Accounting and Auditing Department in August 2012

Tristin Simmons was married to Justin Wark on August 11, 2012

Important Dates:

October 15, 2012 -
2011 Extended Individual Tax Returns Due

November 15, 2012 -
2011 Extended Foundation Tax

income taxpayers will also be subject to revived limitations on itemized deductions and their personal exemptions. The child tax credit, one of the most popular incentives in the Tax Code, will be cut in half. Millions of taxpayers would be liable for the alternative minimum tax (AMT) because of expiration of the AMT "patch." Countless other incentives for individuals would either disappear or be substantially reduced after 2012. While a divided Congress may indeed act to prevent some or all of these tax increases, a year-end planning strategy that protects against "worst-case" situations may be especially wise to consider this year.

Year-end planning

Income tax withholding. Expiration of the reduced individual tax rates will have an immediate impact. Income tax withholding on payrolls will immediately reflect the increased rates. One strategy to avoid being surprised at April 15, 2014 is to adjust your income tax withholding early in 2013. Keep in mind that the current two percent payroll tax holiday is also scheduled to expire after 2012 so it is a good time to review if you are having too much or too little federal income tax withheld from your pay.

As mentioned, traditional year-end planning techniques should be considered along with some variations on those strategies. Instead of shifting income into a future year, taxpayers may want to recognize income in 2012, when lower tax rates are available, rather than shift income to 2013. Another valuable year-end strategy is to "run the numbers" for regular tax liability and AMT liability. Taxpayers may want to explore if certain deductions should be more evenly divided between 2012 and 2013, and which deductions may qualify, or will not be a valuable, for AMT purposes. Or, consider "bunching" deductions in a year so the combined amount exceeds the threshold.

Harvesting losses. Now is also a good time to consider tax loss harvesting strategies to offset current gains or to accumulate losses to offset future gains (which may be taxed at a higher rate). The first consideration is to identify whether an investment qualifies for either a short-term or long-term capital gains status, because you must first balance short-term gains with short-term losses and long-term gains ones with long-term losses. Remember also that the "wash sale rule" generally prohibits you from claiming a tax-deductible loss on a security if you repurchase the same or a substantially identical asset within 30 days of the sale.

Education expenses. Taxpayers with higher educational expenses may want to consider the scheduled expiration of the American Opportunity Tax Credit (AOTC) after 2012 in their plans. The AOTC (an enhanced version of the HOPE education credit) reaches the sum of 100 percent of the first $2,000 of qualified expenses and 25 percent of the next $2,000 of qualified expenses, subject to income limits. If possible, pre-paying 2013 educational expenses before year-end 2012 could make the expenses eligible for the AOTC before it expires. Another popular education tax incentive, the Lifetime Learning Credit, is not scheduled to expire after 2012.

Job search expenses. Some expenses related to a job search may be tax deductible. There is one important limitation: the expenses must be spent on a job search in your current occupation. You may not deduct expenses you incur while looking for a job in a new occupation. Examples of job search expenses are unreimbursed employment and outplacement agency fees you pay while looking for a job in your present occupation. Travel expenses to look for a new job may be deductible. The amount of job search expenses that you can claim on your

(continued on page 3)

tax return is limited. You can claim the amount of expenses only to the extent that they, together with other "miscellaneous" deductions exceed two percent of your adjusted gross income. Again, bunching of deductions in a year may cause the combined amount to exceed the threshold.

Gifts. Gift-giving as a year-end tax strategy should not be overlooked. The annual gift tax exclusion per recipient for which no gift tax is due is $13,000 for 2012. Married couples may make combined tax-free gifts of $26,000 to each recipient. Use of the lifetime gift tax exclusion amount ($5.12 million for 2012) should also be considered. Without Congressional action, the exclusion amount drops to $1 million in 2013.

Charitable giving. For many individuals, charitable giving is also a part of their year-end tax strategy. Under current law, the so-called "Pease limitation" (named for the member of Congress who sponsored the law) is scheduled to be revived after 2012. The Pease limitation generally requires higher income individuals to reduce their tax deductions by certain amounts, including their charitable deduction. This alone may suggest accelerating charitable giving into 2012, however, the expectations of higher tax rates in 2013 would support a deferral of charitable giving to 2013. A special rule for contributing IRA assets to a charity by individuals age 70½ and older expired after 2011 but could be renewed for 2012.

New Medicare taxes

In 2013, two new taxes kick-in. The Patient Protection and Affordable Care Act (PPACA) impose an additional 0.9 percent Medicare tax on wages and self-employment income and a 3.8 percent Medicare contribution tax. The 3.8 percent Medicare contribution tax will apply after 2012 to single individuals with a modified adjusted gross income (MAGI) in excess of $200,000 and married taxpayers with an MAGI in excess of $250,000. MAGI for purposes of the Medicare contribution tax includes wages, salaries, tips, and other compensation, dividend and interest income, business and farm income, realized capital gains, and income from a variety of other passive activities and certain foreign earned income. For individuals liable for the tax, the amount of tax owed will be equal to 3.8 percent multiplied by the lesser of (1) net investment income or (2) the amount by which their MAGI exceeds the $200,000 / $250,000 thresholds. Taxpayers with MAGIs below the $200,000 / $250,000 thresholds will not be subject to the 3.8 percent tax.

Looking a few months ahead

In July 2012, the House and Senate passed competing bills to extend many of the expiring incentives one more year. Both bills would extend the current income tax rates (10, 15, 25, 28, 33. and 35 percent) through 2013. The House bill would extend the current capital gains and individuals' treatment but the Senate bill would extend the tax favorable rates only for individuals with incomes below $200,000 (families with incomes below $250,000). For income in excess of $200,000 / $250,000, the tax rate on capital gains and individuals would be 20 percent. Both bills would extend the $1,000 child tax credit through 2013 and provide for an AMT patch for 2012 (the House bill also provides an AMT patch for 2013).

At this time, it is increasingly likely that the fate of all the expiring tax provisions will be decided by the lame-duck Congress after the November elections. Although the House and Senate bills passed in July differ, they have many points in common; the most important being that lawmakers could agree on a one-year extension of the Bush-era tax cuts. However, some observers anticipate no resolution until January 2013 or beyond with the possibility that changes would be retroactive to January 1, 2013.

More changes for 2013

Many employers with health flexible spending arrangements (health FSAs) limit salary reduction contributions to between $2,500 and $5,000. Effective 2013, the PPACA requires health FSAs under a cafeteria plan to limit contributions through salary reductions to $2,500. After 2013, the $2,500 limitation is scheduled to be adjusted for inflation. Individuals with unused health FSA dollars should consider spending them before year-end, or a 2½ month grace period if applicable, to avoid the "use it or lose it" rule. Keep in mind that health FSA dollars cannot be used for over-the-counter medications (except for insulin) after 2011.

Additionally, the threshold to claim an itemized deduction for unreimbursed medical expenses increases from 7.5 percent of adjusted gross income (AGI) to 10 percent of AGI after 2012. The PPACA provides a temporary exception for individuals (or their spouses) who are age 65 and older. This exception ends after 2017. While many medical expenses cannot be timed for tax-deduction purposes, bunching expenses into 2012, when the threshold is 7.5 percent, may make it more likely that the expenses will exceed that threshold.

Look out for 2014 Changes

The PPACA's individual mandate generally requires individuals to make a shared responsibility payment if they do not carry minimum essential health insurance for themselves and their dependents.

To understand who is covered by the individual mandate, it is easier to describe who is excluded. Generally, individuals who have employer-

(continued on page 4)

provided health insurance coverage are excluded, so long as that coverage is deemed minimum essential coverage and is affordable. If the coverage is treated as not affordable, the employee could qualify for a tax credit to help offset the cost of coverage. Individuals covered by Medicare and Medicaid also are excluded from the individual mandate. Additionally, undocumented aliens, incarcerated persons, individuals with a religious conscience exemption, and people who have short lapses of minimum essential coverage are excluded from the individual mandate.

This mandate will also bring a new shared responsibility payment for employers. Large employers (generally employers with 50 or more full-time employees but subject to certain limitations) will be liable for a penalty if they fail to offer employees the opportunity to enroll in minimum essential coverage. Large employers may also be subject to a penalty if they offer coverage but one or more employees receive a premium assistance tax credit.

Tax Saving Strategies for Investing

In the preceding article, we discussed the current and expected individual income tax rates that dividend and capital gains are subject. Although rates will always be subject to change, we have identified time-tested strategies to minimize taxes on your investment portfolio.

Retirement Planning
In a rising income tax rate environment, tax sheltered investments outperform investments in after-tax accounts. Tax sheltered investments include Traditional and Roth IRAs, Traditional 401k and Roth 401k, and other employer sponsored plans. Furthermore, studies have shown that most taxpayers, including those in the highest tax brackets, benefit most with Roth IRAs and Roth 401k accounts. In both instances, after-tax money is contributed to the plan, growth is tax free, and the money can be withdrawn tax free down the road when rates are presumably higher. There are two ways to contribute to a Roth IRA: a) contribute $5,000 per person (or $6,000 if over 50 years old) and b) convert your Traditional IRAs into Roth IRAs (you will need to pay an income tax when converted). Some employers with 401k plan have Roth 401k features that function like Roth IRAs.

If your employer does not have a Roth 401k feature, we recommend you do the math and maximize your 401k contributions and take full advantage of employer matches and incentives for participation.

Do you have a child or grandchild that has just joined the work force? Consider making a Roth IRA contribution in their name and getting them on the path of investing for the future. It is a great learning experience as they watch their investments grow. We suggest structuring your contribution as a gift.

Municipal Bonds
Municipal bonds are generally free from Federal taxes and from certain state income taxes. If tax rates are rising, this tax free status enhances the yield on muni bonds. This is a bid advantage for muni bonds over US Treasury bonds or corporate bonds, both of which are federally taxed.

529 College Savings Plans
Contributions are after tax and qualified withdrawals are tax free. These plans are especially beneficial with longer investment horizons, i.e. younger children and grand children.

Buy a Home
The price of homes have been reset over the past few years and show signs of beginning a rebound. Current mortgage rates are at historically lows and owning a home may be less expenses than renting, even before considering the tax benefits of the mortgage interest deduction. Then, if you sell your home for a gain, the first $250,000 is tax free ($500,000 if filing jointly). These are just a few reasons why we encourage home ownership and older generations helping younger generations fund the purchases.

In all instances, your tax and investment advisors should be consulted to determine which asset classes are best suited for tax sheltered and after-tax accounts.

FAQ: Should I be paying estimated tax or having more withheld instead?

Some individuals must pay estimated taxes or face a penalty in the form of interest on the amount underpaid. Self-employed persons, retirees, and nonworking individuals most often pay estimated taxes to avoid the penalty. An employee may need to pay them if the amount of tax withheld from wages is insufficient to cover the tax owed on other income. The potential tax owed on investment income also may increase the need for paying estimated tax, even among wage earners.

An individual should pay a sufficient amount of estimated tax to avoid a penalty but not to overpay. The IRS will refund the overpayment when you file your return, but it will not pay interest on it. In other words, by overpaying tax to the IRS, you are giving the government an interest-free loan rather than investing your money somewhere else and to make a profit.

(continued on page 5)

When do I make estimated tax payments?
Individual estimated tax payments are generally made in four installments accompanying a completed Form 1040-ES, Estimated Tax for Individuals. For the typical individual who uses a calendar tax year, payments are due on April 15, June 15, and September 15 of the tax year, and January 15 of the following year (or the following business day when it falls on a weekend or other holiday).

Am I required to make estimated tax payments?
Generally, you must pay estimated taxes in 2012 if (1) you expect to owe at least $1,000 in tax after subtracting tax withholding and (2) you expect your withholding and credits to be less than the smaller of 90 percent of your 2012 taxes or 100 percent of the tax on your 2011 return. There are special rules for higher income individuals.

Usually, there is no penalty if your estimated tax payments plus other tax payments, such as wage withholding, equal either 100 percent of your prior year's tax liability or 90 percent of your current year's tax liability.

However, if your prior year adjusted gross income exceeded $150,000, you must pay either 110 percent of the prior year tax or 90 percent of the current year tax to avoid the estimated tax penalty. For married filing separately, the higher payments apply at $75,000.

In figuring your installments, you must also take into account other taxes such as the alternative minimum tax, penalties for early withdrawals from an IRA or other retirement plan, and self-employment tax, which is the equivalent of Social Security taxes for the self-employed.

What if I realize I have miscalculated my tax before the year ends?
An employee may be able to avoid the penalty by getting the employer to increase withholding in an amount needed to cover the shortfall.
The IRS will treat the withheld tax as being paid proportionately over the course of the year, even though a greater amount was withheld at year-end. The proportionate treatment could prevent penalties on installments paid earlier in the year.

What else can I do?
If you receive income unevenly over the course of the year, you may benefit from using the annualized income installment method of paying estimated tax.

Under this method, your adjusted gross income, self-employment income and alternative minimum taxable income at the end of each quarterly tax payment period are projected forward for the entire year. Estimated tax is paid based on these annualized amounts if the payment is lower than the regular estimated payment.

AICPA 125th Anniversary

Our professional association, the American Institute of Certified Public Accountants (AICPA), was founded in 1887, marking 2012 its 125th year in the accounting profession.

There are very few professional organizations to reach this landmark birthday, and we believe it deserves some recognition.

Gregory J. Anton, CPA, chairman of the AICPA, announced several public interest initiatives being launched in honor of the anniversary. The first is Total Tax Insight™, a tool that gives individuals a clearer understanding of the number and types of taxes they pay each year. This tool is free to the public and can be found at www.totaltaxinsights.org. Another initiative is an educational video entitled What's At Stake. This video discusses how the government's financial statements can be used by lawmakers and citizens to better understand the fiscal health of the U.S. Government.

To commemorate this milestone the June 2012 edition of the *Journal of Accountancy* is dedicated to the anniversary. It includes a timeline highlighting notable people and significant events that took place in the development of the AICPA. There is also an article on the tools and machines that were used through the profession's 125 years. To access these articles, visit the publications section of the *Journal of Accountancy* at www.aicpa.org.

Chairman Anton concluded his announcement of this anniversary with the following comments:
"Of course, our profession and its many accomplishments simply reflect the high quality of our membership and CPAs' dedication to high standards. So it's fitting to close by congratulating my fellow CPAs for enabling our national organization to thrive for 125 years. I look forward to taking part with all of you in our profession's exciting future."

We take great pride in the accomplishments of our profession. Visit aicpa.org/anniversary to share some of the highlights of our association's distinguished past, as well as a glimpse of our exciting future.

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