



2011 “Stretch Drive” Tax Guide

Year-End Tax Moves to Consider

Provided by Jay Peroni, CFP®

866-594-9919

www.faithbasedinvestor.com

How would you like to save hundreds or even thousands on your 2011 federal tax return?

Some year-end moves might allow you to do just that.

The fourth quarter of 2011 is passing by quickly and taxpayers now find themselves in the “stretch drive”, with just a few weeks left to make those moves that could help them address tax issues this year and next.

Here is a list of some year-end tax moves to consider, and a few items you might want to review before 2011 ends.

Of course, you should consult a qualified tax or financial professional before taking any action.

Part 1 ... some ideas for everyone.

1 Think about estimating your 2011 taxes.

Have you ever tried to estimate the tax you will pay next April? It does take time, and very often it is time well spent. Estimating your taxes will give you some clues about where you can potentially save some tax dollars before 2011 ends.

If you know roughly how much you will owe or receive from the IRS for 2011, then you can act on that information. If hundreds or thousands of dollars might be coming your way, you can start thinking about the destiny of that money - how it might be invested or used to accomplish a goal. If you're going to be writing a check next April, you can make a payment before the end of 2011 or adjust your withholding to bring you tax bill down.

2 If you are married, compare your tax liability if you file separately rather than jointly.

This takes time to figure out, especially with regard to state tax consequences - but there are cases in which filing separately may save you some money. When two spouses are in markedly different tax brackets or one spouse wants to claim a whole bunch of itemized deductions, there may be a total tax savings from filing separately. Since phase-outs of itemized deductions and personal exemptions kick in depending on AGI, filing separately can help here as well.

3 If appropriate, adjust your withholding status.

This may seem pretty basic, but you'd be amazed how many taxpayers don't do it. If you find yourself saying "yes" to any of the following conditions, it may be time for a withholding adjustment:

- *You tend to pay a great deal of income tax annually.*
- *You tend to get a big refund each year from the IRS.* No doubt Uncle Sam enjoys getting interest-free loans from you, but if you would rather not give him another one, you could adjust your withholdings.
- *You married or divorced.*
- *A family member passed away.*
- *You started a new job at much greater salary.* If this is the case, it might be better to refrain from claiming as many exemptions as you had in the past (family size is a factor, of course).
- *You opened up your own business or started freelancing.* If you've started a business, adjusting your withholding amount upward might relieve you of having to file quarterly self-employment tax payments. If you earn the bulk of your income from freelance work, you may want to file self-employment tax payments quarterly.
- To help out, there is actually a withholding calculator over at irs.gov.

4 Consider maxing out 2011 contributions to your 401(k) or 403(b).

In 2011, you can contribute up to \$16,500 per year to these accounts with a \$5,500 catch-up contribution also allowed if you are age 50 or older.¹

5 Consider making a gift (or multiple gifts).

The annual gift tax exclusion is \$13,000 per donor in 2011 and 2012. A single taxpayer may gift up to \$13,000 this year to an unlimited number of individuals, and you might have a long way to go before reaching the lifetime exclusion of \$5 million.²

Since that \$13,000 limit is per individual taxpayer, a married couple can give away up to \$26,000 tax-free annually per recipient. IRC § 2513 says that even if one spouse makes the actual gift of between \$13,001-26,000, it is viewed as a gift from both spouses if both of them consent. So if your daughter is considering buying a house in 2012, you and your spouse could gift her \$26K toward the down payment before January 1 and \$26K toward the down payment after January 1.²

You may want to make a gift of appreciated securities if you are in the 25% tax bracket or higher. Once you are in that bracket, you can't realize the 0% tax rate on long-term capital gains now available to those in lower tax brackets. But you could gift appreciated securities you have held for more than one year to a family member who is in a lower tax bracket (children must be adults no longer subject to the "kiddie

tax”). This way, you can both avoid capital gains tax when these securities are eventually sold.³

In addition to the annual exclusion, an unlimited gift tax exclusion is allowed for direct payments made by a donee to a health care provider/practitioner or an educational organization for tuition.⁴

6 If you’re 70½ or older, you could make a charitable IRA gift.

IRA charitable rollovers lost some of their luster when the individual estate tax exemption was raised to \$5 million. Still, a tax-free donation of IRA proceeds (of up to \$100,000 per year) to a qualifying charity or nonprofit can be a boon to that charity in these economically challenging times and allow you to take credit for a Qualified Charitable Distribution on your 2011 federal return. (You can also make an IRA charitable rollover to a fund held by a community foundation, but not a donor-advised fund.)⁵

To be tax-free, the donor must be 70½ or older and the donation has to be a direct transfer (a rollover) from your IRA trustee to the qualifying charity, nonprofit foundation or nonprofit organization. (You cannot claim a charitable tax deduction as a result of this move.) There is no word yet on whether charitable IRA gifts will be permitted in 2012; the opportunity will sunset at the end of 2011 unless Congress decides to keep it around.⁵

7 If you can manage it, you can make an extra mortgage payment before the end of 2011 to boost your mortgage interest deduction.

If you can make a January mortgage payment before 2012 or put a lump sum toward your fixed-rate mortgage balance, you have another way to cut your 2011 taxes. If your mortgage interest statement doesn’t show your end-of-2011 payment, deduct the correct amount on your tax return and send a note to your mortgage lender detailing the how and why of the difference.⁶ Alternatively, make the January 2012 mortgage payment early enough so that the lender has processed the payment by December 31, 2011.

8 You could practice a little tax loss harvesting.

In shorthand, you sell some losers to counteract some winners - you take some capital losses to offset short-term capital gains. This can mean immediate tax savings and even aid in portfolio diversification.

Under current IRS rules, if your loss is more than your gain it can reduce earned income by up to \$3,000 per year (\$1,500 is the deduction limit for taxpayers married and filing separately). To clarify, up to \$3,000 of capital losses in excess of capital

gains can be deducted from ordinary income, and any remaining capital losses above that can be carried forward to offset capital gains in upcoming years.⁷

So by taking a bunch of losses this year and carrying over the excess losses into 2012, you can potentially shelter some (or maybe even all) of your long-term and short-term capital gains next year. Abide by the “wash sale” rules - if you sell securities at a loss and then buy “substantially identical” securities within 30 days before or after the sale, you don’t get to deduct that particular capital loss.⁷

9 You could delay stock option & year-end bonus income until 2012.

If you can defer this income until January, you can lower your 2011 taxable income.⁶

10 See if you can time deductible expenses.

Sometimes deductions are all in the timing. By paying certain deductible expenses (like state and local taxes) before 2011 ends, you might be able to lower your 2011 tax bill as a consequence of boosting your deductions. However, exercise caution if the alternative minimum tax (AMT) could be an issue for you. State and local taxes, as well as certain other itemized deductions are not allowed in computing the AMT.

Look particularly for above-the-line deductions, among them:

- Traditional IRA contributions
- Alimony payments
- Educator expenses
- College tuition
- HSA contributions
- Self-employment tax deduction
- Self-employed health coverage premiums
- Self-employed contributions to SEPs, SIMPLE IRAs & qualified retirement plans
- Early withdrawal penalties (savings)

Above-the-line deductions help you out in two ways: they lower your adjusted gross income, and as a consequence they can help you to preserve tax breaks you might lose due to income phase-outs or limits.

Potential deductions don’t end there, of course. Some other examples:

Mortgage points. In most cases, you can deduct 100% of the prepaid interest on a home loan paid to buy or build your primary home - or alternatively, you can elect to stretch such deductions over the duration of the mortgage.³

State & local sales tax. You can elect to deduct state and local sales tax instead of state income tax. This option could go away in 2012.³

Interest on qualified education loans. This is actually an above-the-line deduction. You may currently deduct up to \$2,500 of such interest annually, whether you itemize deductions or not. Phase-out ranges apply for joint filers with MAGI of \$120,000-150,000 and single filers with MAGI of \$60,000-75,000.³

Casualty/property losses. If you owned real property this year that was fully or partially destroyed as a result of a sudden, unexpected occurrence, then you may very well have the opportunity to take a casualty loss deduction.³

Job hunting expenses. Even if you didn't find a job in 2011, you can deduct certain job-seeking expenses if the itemized deductions are greater than 2% of your AGI. You have to have sought a job in your present career field. Expenses such as resume printing, miles traveled for job interviews and career counseling sessions typically fall into this category.³

Energy-efficient home improvements. If you installed energy-efficient doors or windows, insulation, air conditioning and heating units, furnaces or roofs at your primary residence, you may be eligible for a federal tax credit of up to \$500. If you put in a solar electric or hot water system, a geothermal heat pump or a fuel cell system or wind turbine, you may be eligible for another federal energy credit of 30%.³

Volunteer expenses. Did you do volunteer work this year for a qualified charity, i.e., a 501(c)(3) non-profit? For 2011, you can deduct 14¢ per mile driven as a result of such efforts, along with some other expenses (consult with your tax advisor as there are many potential deductions).³

Medical expenses. Myriad healthcare expenses can be itemized and deducted provided you have enough to total at least 7.5% of your 2011 AGI. Medical and dental bills, x-ray and lab test costs, psychiatric care, smoking cessation programs, surgeries, eyeglasses and contacts, hearing aids, breastfeeding supplies ... they can all potentially qualify, and there are many others.³

Volunteer expenses. Did you do volunteer work this year for a qualified charity, i.e., a 501(c)(3) non-profit? You can deduct 14¢ per mile driven as a result of such efforts, along with some other expenses (consult with your tax advisor as there are many potential deductions).³

Education funding expenses. Here are the summary details on three potentially big tax breaks:

- **Tuition & Fees Deduction:** Available if your MAGI is \$80,000 or less as a single filer, or \$160,000 or less for married joint filers. A deduction for graduate, undergraduate and career skills courses with a limit of \$4,000 (\$2,000 for some taxpayers). If you haven't hit the limit on this deduction, you could pay spring 2012 tuition before 2011 is over.³
- **Lifetime Learning Credit:** Available if your MAGI is \$61,000 or less as a single filer, or \$122,000 or less for married joint filers (phase-outs apply). A deduction for graduate, undergraduate and career skills courses with a limit of \$2,000 per federal tax return.³

- **American Opportunity Credit:** Available if your MAGI is \$90,000 or less as a single filer, or \$180,000 or less for married joint filers (phase-outs apply). A deduction for the first 4 years of undergraduate education with a limit of \$2,500 per student.³

There are rules preventing taxpayers from claiming more than one of these deductions for the same student in a given tax year.³

On the state tax level, contributions to 529 College Savings Plans are often deductible.⁶

A general reminder: there are deduction floors for itemized medical and itemized miscellaneous expenses. You can claim a deduction when your itemized medical expenses are at least 7.5% of your AGI and when your itemized miscellaneous expenses exceed 2% of your AGI.³

11 You could see if you qualify for the Child Tax Credit or the Child & Dependent Care Credit.

These credits are often confused with one another. A brief explanation of each:

- **Child Tax Credit:** This is a credit that may be worth up to \$1,000 per each dependent child (including stepchildren and eligible foster children) under age 17 at the end of 2011, depending on the amount of the income tax and/or AMT that you owe. The MAGI phase-outs begin at \$110,000 (married filing jointly), \$55,000 (married filing separately), and \$75,000 (single filers). If you find yourself able to claim a Child Tax Credit that exceeds the amount of income tax you owe, then it is possible that you can claim the IRS's Additional Child Tax Credit for further deductions.
 - The child has to be a U.S. citizen, U.S. national or U.S. resident alien that you claim as a dependent.
 - The child must be your son, daughter, stepchild, adopted or foster child, brother, sister, stepbrother, stepsister or a descendant of any of these individuals.
 - The child must have lived with you for at least half of 2011.
 - The child cannot have provided more than one-half of his or her financial support.⁸
- **Child & Dependent Care Credit:** Do you and your spouse both work? Did you pay child care expenses in 2011 out of necessity so that you could go to work? Did you pay expenses to a caregiver or someone providing at-home care for a disabled spouse or adult dependent while you were at work? Then you may be poised to claim this credit. If this credit is to apply to child care, the child has to be younger than 13. The credit can be as large as \$3,000 (\$6,000 if you have more than one child or adult dependents living with you).³

Part 2 ... some ideas & reminders for business owners

- **See if your company qualifies for the Section 179 deduction.** Per IRC Section 179, a small business can write off 100% of the expense of qualifying equipment or computer software made in 2011 with a \$500,000 limit. These capital expenditures can be on new or used equipment. Your company has to be profitable in order for you to take full advantage of the write-off, and you can't take complete advantage of it if you have spent more than \$2 million on qualifying capital in 2011.^{9,10}
- **Remember the 2011 100% first-year depreciation bonus.** Your business can claim 100% of the cost of new (not used) property ("qualified property"): tangible property with a depreciation period of not more than 20 years (machinery, equipment, other tangible personal property and non-building land improvements); most computer software; and certain building improvements purchased in 2011 as long as your business uses the property before 2012. This 100% depreciation also applies to qualified property bought after September 8, 2010.^{3,10}
- **Remember that you can take a deduction for start-up expenses.** The Small Business Jobs Act of 2010 raised this deduction to \$10,000, with phase-outs starting at \$60,000 worth of startup expenditures. Those expenses can include rent, attorney and CPA fees, licensing fees, travel costs, insurance and supplies.^{3,10}
- **You may be able to exploit some major health care tax credits.**
 - If you are a) self-employed, b) a partner in a business, or c) a 2% shareholder-employee in an S corporation, you have the ability to deduct 100% of your medical insurance premiums (for yourself, for your family) as an adjustment to gross income. The adjustment does not reduce net earnings, and it can't surpass the earned income from the business at which the health coverage was arranged. Also, you can't deduct premiums paid during any month in which you or your spouse were eligible for employer-paid health coverage.³
 - If a) you employ 25 or fewer Full Time Employees (FTE's), b) the majority of them earn less than \$50,000 annually, and c) you bear the cost of at least 50% their health insurance premiums ... you may be able to deduct up to 35% of the money you spend on those premiums for 2011. To get the full 35% credit, you must have 10 or fewer FTEs with annual wages averaging \$25,000 or less. Above that, phase-outs apply.³
- **If you work from home, you can probably qualify for the home office deduction.** You have to have a dedicated office space within your residence to take this deduction, by which a portion of utilities and certain expenses can be tax-deductible. For example, if you live in a 2,000-square-foot home and you run your business from a 160-square-foot home office, you can legitimately

deduct 8% of your utilities, internet expenses, or any expenses linked to maintaining that home office.¹¹

- **Think about purchasing supplies and delaying receipt of your receivables.** Buying supplies can lower your profit, and delaying receipt of your receivables will lower your taxable income level - thereby helping to reduce the amount of taxes you pay for 2011. Of course, if you'll be in a higher bracket or if you think taxes will soon increase, you may want to generate more income now with the goal of paying a lower tax rate on it. This can work whether you use the accrual method or the cash method of accounting: if you use the cash method, you can hold off on certain billing notices so that certain payments won't arrive until 2012, and if you go by the accrual method, you can elect to postpone certain shipments until 2012. (Year-end shipments can also be made FOB destination instead of FOB shipping point to delay title transfers.)³
- **If you have a C corp., you might want to consider trying to generate more corporate income this year if you think your C corp. will enter a higher tax bracket for 2012.** Weigh the opportunity cost and cash flow ramifications of such a choice first.³
- **Be sure that you put your corporation through a gross receipts test.** This can help you to determine whether the corporation could be hit with AMT.³
- You also might be able to get a deduction for **vacation pay** vested by the end of 2011 and **employee bonuses** you won't be paying out until early 2012. (There is much fine print linked to those possibilities, so talk further about them with your tax advisor.)³
- **If you are looking at a net operating loss for 2011, remember that you can carry it back up to 2 years and carry it forward up to 20 years.** If you carry it back, you might get yourself a refund of taxes paid; if you carry it forward, you could use the NOL to cancel out some future taxable income.³
- **If you are looking at an NOL and you view the effort as a for-profit business or investment activity rather than a hobby, be aware that the IRS could readily contest your claim.** The IRS definition of a for-profit activity is an activity that makes a profit in three of the last five years, including the currently applicable tax year (or at least two of the last seven years if you are breeding, showing, training or racing horses).¹²
- **Double-check to see if your compensation might be subject to self-employment taxes.** That might be true if you are a sole proprietor, a manager in an LLC or an active partner in an LLP. Any net earned income generated through the business entity may be fair game.
- **Finally, see if your company might be eligible for two oft-overlooked business credits.** Check if you can qualify for the domestic production activities deduction (which can be up to 9% of the lesser of either taxable income or income realized through qualified production activities) or the research and experimentation (R&D) credit.³

Part 3 ... a few tax cautions, concerns, and news items that you should know about.

1 Most Americans are looking at a tax hike next year.

The Social Security tax rate for employees will reset from 4.2% to 6.2% in 2012 unless Congress prolongs the current payroll tax holiday. In 2011, that 2% cut meant as much as \$2,136 in savings to a wage earner, as earnings up to \$106,800 were subject to payroll tax. In 2012, the maximum taxable earnings amount for Social Security increases to \$110,100 from \$106,800.¹³

The 2011 payroll tax holiday replaced the Making Work Pay credit, which is not available for your 2011 federal return.¹⁴

2 The IRS just announced that more than 2 million taxpayers erroneously claimed the American Opportunity Tax Credit on their 2010 returns.

It estimates that 52% of these returns were prepared by paid tax preparers. Around 2.1 million taxpayers may have received about \$3.2 billion in refunds by claiming the credit without proper supporting documentation or eligibility. The IRS expects the magnitude of this error to increase upon further analysis.¹⁵

3 Don't forget that the IRS defines your household help as employees.

If you have paid a maid, au pair, or other domestic employee more than \$1,700 in 2011, you are defined as an employer by the IRS and you are looking at the “nanny tax”. You are going to pay three taxes and maybe as many as five. You will owe FICA and FUTA taxes (Social Security, Medicare and federal unemployment taxes) and possibly state disability tax and state unemployment tax.

You must report federal employment taxes for household employees on Form 1040, Schedule H. You must also get an EIN (Employer ID Number) and give the household employee a W-2 form. IRS Publication 926 (the Household Employer's Tax Guide) spells things out in detail. SmartMoney.com has a useful “nanny tax” calculator: www.smartmoney.com/personal-finance/taxes/the-nanny-tax-9560/¹⁶

If your nanny, maid or domestic employee was actually your spouse or your parent, a child of yours younger than 21, or a minor whose principal occupation is not domestic employment, you aren't subject to such taxes even if you have paid that person more than \$1,700 for their services in 2011.¹⁶

4 Double-check that you won't be hit with a) AMT or b) taxes on Social Security income.

The 2011 AMT exemption amounts are:

- \$48,450 for single filers
- \$74,450 for married couples filing jointly
- \$37,225 for married couples filing separately

Of course, phase-outs apply for higher-income taxpayers. If you are subject to the AMT, the present AMT tax rates are 26% and 28%.³

As for taxes on your Social Security benefits, you want to try to avoid going over the provisional income limits for 2011. You can figure out if you might be subject to such taxes by using the Social Security Benefits Worksheet in the instruction booklets for IRS Form 1040 and Form 1040A or Worksheet 34-1 in IRS Publication 915.

For 2011, here are the limits (you'll still need to use the above worksheets to determine if you'll exceed them):

- *Single person:* up to 50% of your SSI can be taxed if your provisional income is greater than \$25,000, and up to 85% of your SSI can be taxed if your provisional income exceeds \$34,000.
- *Married/head of household:* up to 50% of your SSI can be taxed if your provisional income is greater than \$32,000, and up to 85% of your SSI can be taxed if your provisional income exceeds \$44,000.¹⁷

5 Finally, the onerous 1099 reporting requirement for small businesses for 2012 has been repealed.

It happened back in April, if you didn't hear about it. This means that small businesses, self-employed individuals and independent contractors will **NOT** have to file 1099 forms with the IRS next year on payments of \$600 or more made to service providers.¹⁸

Jay Peroni, CFP® may be reached at 866-595-9919 or jay@jayperoni.com
www.faithbasedinvestor.com

Disclaimer

This material was prepared with help by MarketingLibrary.Net Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is not a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such.

This Special Report is not intended as a guide for the preparation of tax returns. The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting or tax advice or opinion provided by «representativename» nor MarketingLibrary.net, Inc. to recipients. No information herein was intended or written to be used by readers for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions. Readers are cautioned that this material may not be applicable to, or suitable for, their specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. Readers are encouraged to consult with professional advisors for advice concerning specific matters before making any decision. «representativename» and MarketingLibrary.net, Inc. disclaim any responsibility for positions taken by taxpayers in their individual cases or for any misunderstanding on the part of readers. «representativename» and MarketingLibrary.net, Inc. assume no obligation to inform readers of any changes in tax laws or other factors that could affect the information contained herein.

Citations.

- 1 www.irs.gov/newsroom/article/0,,id=229975,00.html [10/28/10]
- 2 www.nolo.com/legal-encyclopedia/reduce-estate-tax-by-gifts-30095.html [11/8/11]
- 3 www.dentbaker.com/LinkClick.aspx?fileticket=5gZQwSHvjwQ%3d&tabid=36 [2011]
- 4 turbotax.intuit.com/tax-tools/tax-tips/Tax-Planning-and-Checklists/The-Gift-Tax/INF12036.html [1/27/11]
- 5 www.ctphilanthropy.org/s_ccp/bin.asp?CID=14889&DID=45124&DOC=FILE.PDF [12/17/10]
- 6 www.taxact.com/tax-information/articles/2011/cut-your-taxes-with-these-year-end-moves.asp [11/10/11]
- 7 money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/2011/11/08/time-for-tax-loss-harvesting.html [11/8/10]
- 8 www.irs.gov/newsroom/article/0,,id=106182,00.html [2/10/11]
- 9 money.cnn.com/2011/01/17/smallbusiness/small_business_new_tax_credits/ [1/17/11]
- 10 journalofaccountancy.com/Web/20113750.htm [1/14/11]
- 11 www.blackenterprise.com/2011/10/05/10-year-end-small-biz-tax-tips/ [10/5/11]
- 12 www.irs.gov/irs/article/0,,id=186056,00.html [6/08]
- 13 www.investmentnews.com/article/20111023/REG/310239992 [10/23/11]
- 14 www.walletpop.com/2011/01/19/dont-forget-about-the-making-work-pay-credit/ [1/19/11]
- 15 www.advisorone.com/2011/10/25/taxpayers-get-billions-in-erroneous-education-tax [10/25/11]
- 16 www.smartmoney.com/personal-finance/taxes/the-nanny-tax-9560/ [1/25/11]
- 17 house.leg.state.mn.us/hrd/issinfo/sstaxes.htm [2/11]
- 18 www.whitehouse.gov/blog/2011/04/14/repealing-1099-reporting-requirement-big-win-small-business [4/11/11]