COROMANDEL WEALTH MANAGEMENT

Year End Tax Report - 2012

George Gagliardi, CFP®, MBA

Year-End Tax Moves for 2012

One of our main goals is to help clients identify specific opportunities that coordinate tax reduction with their investment portfolios. In order to achieve this goal, we continually stay current about potential year-end tax strategies and keep abreast of future strategies that our clients might want to consider to help reduce their taxes.

As a comprehensive financial services firm, Coromandel Wealth Management is committed to helping our clients improve their long-term financial success. This special report covers the details of many year-end tax strategies for 2012. Of course, since every situation is different, not all strategies outlined will be appropriate for you. Please discuss all potential tax strategies with your tax preparer. Remember, this is not advice for preparing your taxes. Our goal is to identify ways to ***reduce*** your taxes.

We are available to provide you with updated information that can help with all of your financial planning needs. If you would like us to send a copy of this report to any of your friends or associates, please call George Gagliardi at (781) 728-9001. We also have a longer, more detailed version of this tax report which we are sending to our clients. If you schedule a free, no obligation "Financial Checkup" with us, we will provide you with a copy of the full tax report. Please contact George if you would like to pursue this option.

The Election Results are Official

On Tuesday, November, Americans voted to give President Barack Obama a second term as President of the United States. In a hard fought battle, he defeated Republican candidate, Governor Mitt Romney. The other significant result of election night was that Congress remained much the same; the Democrats hold a majority in the Senate, and the Republicans retain control of the House of Representatives.

So what happens now, and how do these results affect investors?

Even before President Obama gets to his second inaugural on January 20, he must address the threatened "fiscal cliff." A combination of an over $550 billion dollar package of automatic tax increases and steep across-the-board spending cuts are set to take effect in January if Washington doesn't quickly reach a budget deal. Experts have warned that the economy could fall back into recession without an agreement.

Our Goal

Our primary goal is to monitor this situation with extreme caution, and then to advise our clients based on how it affects their personal situations. We are pleased to share with you this tax report, Year-End Tax Moves for 2012, as a summary of the current tax law status.

Fiscal Cliff

The term "Fiscal Cliff" refers to the $550 billion in tax hikes and spending cuts that will take place automatically on January 1, 2013. Unless the President, the House, and the Senate can all agree on a compromise before the end of the year, January 1st will bring the largest increases in income taxes for individuals, corporations, and other entities that our country has seen in over 20 years.

There are two parts of this "fiscal cliff": tax increases and spending cuts. The current tax laws, also known as the "Bush-era tax cuts" and worth trillions of dollars, will expire on December 31, 2012 unless Congress takes action. These tax increases are currently scheduled and will be automatic.

The income tax rates are scheduled to revert to pre-2001 levels. The combination of the resurrected 39.6% tax rate along with the 3.8% Medicare contribution tax means that certain income will be taxed at 43.4%. The maximum tax on long-term capital gains will rise from 15% in 2012 to 23.8% in 2013. Stock dividends are affected even more. They currently have a maximum tax rate of 15% for 2012, but will be taxed as high as 43.4% starting January 1, 2013.

The second part of this fiscal cliff is the automatic spending cuts. The combination of spending cuts with higher taxes threatens to push the economy from its currently weak growth into a mild recession next year, and increase unemployment to over 9%. (Congressional Budget Office projection)

Given worries about the fiscal cliff, the stock markets could be very volatile for the remainder of this year.

Income Tax Rates

The chart on the right shows the marginal income tax rates for 2012 and the scheduled rates for 2013. Currently, we are scheduled to move from a range of 10% – 35% back to 15% – 39.6% in 2013 if Congress fails to act.

Marginal Income Tax Rates

2012	2013
10%	**15%**
15%	**15%**
25%	**28%**
28%	**31%**
33%	**36%**
35%	**39.6%**

Medicare Tax

There are two major changes to the Medicare tax. The first is an additional 0.9% Medicare surtax on wages exceeding certain thresholds. The other, more expansive change is a 3.8% Medicare contribution tax on net investment income for wealthy taxpayers. Both of these changes take effect on January 1, 2013.

The Medicare contribution tax is imposed only on "net investment income" and only to the extent that total "Modified Adjusted Gross Income" (MAGI) exceeds $200,000 for single individuals and $250,000 for taxpayers filing joint returns. One of the difficulties with the Medicare contribution tax is determining what constitutes net investment income that is subject to the tax.

There are several different planning tips that a taxpayer can use to help reduce their Medicare contribution tax. For more information on this subject please call us.

Retirement Plans

In 2012, the maximum 401(k) contribution is $17,000 (plus a $5,500 catch-up contribution for those 50 or older by the end of the year). If you are self-employed, you have other retirement savings options such as solo 401(k)s, SEP-IRAs, and defined benefit plans.

You can also contribute to an IRA for 2012 up through April 15, 2013. The maximum is $5,100 with a catch-up provision of $1,000.

Capital Gains and Losses

If your capital gains are larger than your losses, you might want to do some "loss harvesting." This means selling certain investments that will generate a loss—converting them from unrealized losses to realized losses. You can use an unlimited amount of capital losses to offset capital gains. However, you are limited to only $3,000 of net capital losses that can offset other income, such as interest, dividends and wages. Any remaining unused capital losses can be carried forward into future years indefinitely.

Please note that if you sell an investment with a loss and then buy it right back, the IRS disallows the deduction.

The "wash sale" rule says you have to wait at least 30 days before buying back the same security in order to be able to claim the original loss as a deduction. However, you can buy a *similar* security to immediately replace the one you sold—perhaps a stock in the same sector. This strategy allows you to maintain your general market position while utilizing a tax break.

Zero Percent Tax on Long-term Capital Gains

If you are in the 10% or 15% tax bracket, the tax rate for long-term capital gains in 2012 is zero percent. In order to qualify for this tax break, your 2012 taxable income cannot exceed $35,350 for singles and $70,700 for married joint filers. The 0% long-term capital gains rate is set to expire at the end of this year.

Taxation of Social Security Income

Social Security income may be taxable, depending on the amount of other income a taxpayer receives. If a taxpayer only receives Social Security income, the benefits are generally not taxable and it is possible that the taxpayer may not even need to file a federal income tax return.

If a taxpayer receives other income in addition to Social Security income, and one-half the Social Security benefits plus the other income exceeds a base amount, then up to 85% of the Social Security income can be taxable. The base amount is $25,000 for single filers, $32,000 for married taxpayers filing a joint return.

A complicated formula is necessary to determine the amount of Social Security income that is subject to income tax. IRS Publication 915 contains a worksheet that is helpful in making this determination.

Estate and Gift Tax Opportunities

For 2012, each taxpayer can pass $5,120,000 (minus past taxable gifts that he/she has made) to children or other beneficiaries without having to pay gift or estate taxes.

There is a 35% estate tax on gifts or estates of deceased persons exceeding the $5,120,000 amount. (This is the exemption amount for *federal estate* tax, not for *state inheritance* tax, which is different from the federal amount.)

This exemption is scheduled to drop down to $1 million on January 1, 2013, and the estate tax rate will increase from 35% to 55%.

Don't ignore annual gifts that qualify for the exclusion. You and your spouse can each give $13,000 per calendar year ($26,000 for couples) to as many individuals as you'd like without reducing your lifetime gift tax exemptions. Gifts to medical or educational providers are not included in the $13,000 limit. Please see us regarding this subject, as the most effective strategy will vary depending on your situation.

Miscellaneous Year-End Tax Reduction Strategies

Prepare a tax projection for 2012 and possibly 2013 to try to determine which tax bracket you are in. If you are itemizing your deductions in 2012, you may want to consider accelerating some of these deductions before the end of this year:

1. Make your January 2013 mortgage payment on your residence before the end of this year, which enables you to deduct the interest portion in 2012.
2. Maximize your payments of state or sales taxes. Taxpayers who itemize deductions can choose between writing off their state income taxes <u>or</u> their sales taxes in 2012. In most cases, income taxes will provide the bigger tax break. However, if you live in a state with no income tax, or if you buy a big ticket item such as a car or boat by December 31, 2012, you may be better off deducting sales tax instead.
3. Prepay the state income taxes in 2012 that are due in January 2013 as part of your estimated tax payments or the estimated amount of state income tax due on April 15, 2013.
4. Pay all of your property taxes in 2012 rather than deferring them to 2013.

Please note that some of these deductions, called "AMT adjustments and tax preference items," get added back in when computing the Alternative Minimum Tax (AMT). If you are subject to the AMT, it is often best to delay these payments and not use these strategies until 2013. It is always possible you might be able to use the deductions next year.

Roth IRA Conversions

The previous income cap on Roth IRA conversions expired on December 31, 2010. A conversion to a Roth IRA today does not have an income limitation cap. You should keep in mind that a conversion to a Roth IRA may place you into a higher tax bracket. In addition, converted IRAs distributed prior to five years or age 59 ½, whichever occurs first, may also be subject to a 10% excise federal income tax penalty. It is best to run the numbers to determine the most appropriate amount for your situation. If you are interested in exploring this option, please contact us.

Alternative Minimum Tax

Alternative Minimum Tax, better known by its acronym "AMT," imposes an alternative higher tax on certain taxpayers. Congress enacted the tax in 1969 to prevent wealthy taxpayers from paying little or no tax by utilizing tax loopholes. Unfortunately, the AMT exemptions are not indexed for inflation. Therefore, each year Congress has stepped in and applied what has become known as the "AMT patch", which lowers its impact on middle class taxpayers. This AMT patch has not been increased since 2011 and if Congress doesn't take action, it is estimated that approximately 26 million more taxpayers will be subject to the AMT in 2012. (Source: Journal of Financial Planning, August 2012)

Conclusion

Please note that many states do not follow the same rules and computations as the federal income tax rules. Make sure you check with your tax preparer to see what tax rates and rules apply for your particular state.

There are many other additional tax reduction strategies that will vary depending on your financial picture. We encourage you to come in so that we can review your particular situation and hopefully take advantage of those tax rules that apply to you. We look forward to seeing you soon.

P.S. Are you having trouble keeping up with changes in the tax laws? In April 2011, IRS commissioner Shaulmen reported that there have been about 3,500 tax law changes since 2000. Remember, it was Albert Einstein who said, "The hardest thing in the world to understand is the income tax."

George Gagliardi, CFP®, MBA, is a financial planner with Coromandel Wealth Management in Lexington, and helps clients develop and implement retirement, tax, and investment strategies. He is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor, and can be reached at (781) 728-9001 or george@CoromandelWM.com.

Complimentary Financial Check-up

If you are not currently a client of **Coromandel Wealth Management**, we would like to offer you a complimentary "Financial Checkup" at absolutely no cost or obligation to you. To schedule one, **please call George Gagliardi at (781) 728-9001.**

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