The Individual Investor's Guide to Personal Tax Planning 2011

By AAII Staff

Article Highlights

- Most tax rates, deductions and credits are unchanged from 2010.
- Several tax items are unresolved for 2012, including the payroll tax cut, AMT exemptions and state sales tax deductions.
- Tax information and worksheets are included in this guide.

This year's tax guide brings both good news and bad news. The good news is that tax rates, deductions and exemptions are mostly unchanged from last year. The bad news is that some key items are uncertain for 2012.

As of press time, Congress has yet to pass legislation extending the payroll tax cut, the deduction for state sales taxes or higher alternative minimum tax exemptions into 2012. Social Security taxes for employees will revert back to 6.2% of salaries in 2012 from the reduced 4.2% rate charged this year. The deduction for state sales taxes is also slated to expire on December 31, 2011. Exemptions for the alternative minimum tax will revert back to pre-2011 levels next year without new legislation.

Potentially complicating matters more is the Congressional Super Committee. The bipartisan committee had a November 23 deadline for reaching an agreement on how to reduce the U.S. federal deficit. At press time (November 22), the committee has failed to reach a compromise agreement. It is likely that taxes will become a campaign issue, resulting in eventual changes to rates, deductions and exemptions.

This would be the case particularly for 2013. The Bush-era tax cuts are scheduled to expire on December 31, 2012. Though we report in Table 1 what the 2013 tax rates are currently projected to be, these numbers seem likely to change. To put things bluntly, long-range tax planning remains difficult.

Regardless of what changes Congress makes (or does not make) to the tax laws, one thing will be constant—you will still have to pay taxes. Furthermore, even a simplified tax code is still likely to be too complex; hence the need for tax guides. As has been the case in years past, our tax guide provides an overview of the tax rates and deductions likely to impact the majority of AAII members. Since there are many details, loopholes and pitfalls within the tax code, it is impossible for this guide to provide enough details to cover specific tax situations. Thus, if you have questions, please consult a tax professional. It is your tax return, and the IRS will hold you responsible for any errors made on it.

New Feature on AAII.com

You can now estimate your 2011 and 2012 tax liability on AAII.com. In response to a member's request, we adjusted our Tax Forecasting Worksheet to allow you to enter your data at our website. The fillable PDF document will calculate the results. Once you are finished, you can print a copy for your records. (Be sure to print the document if you want to preserve your work since the document cannot be saved to AAII.com. See the inside front cover of this issue, opposite the Table of Contents, for more details.)

What's New?

Based on existing tax law, the federal income tax rates will stay unchanged in 2011 and 2012 at 10%, 15%, 25%,

A special note of thanks goes out to Mark Luscombe, a principal analyst at tax authority CCH (www.cch.com) for answering detailed questions about the current and prospective rules. In addition, "J.K. Lasser's Your Income Tax 2012" (John Wiley & Sons, 2011) was extremely helpful in creating this year's guide.

Table 1. An Overview of Tax Changes in the Coming Years

	2011	2012	2013*
Long-Term Capital Gains Rate			
Tax Bracket Above 15%	15%	15%	20%
Tax Bracket 15% or Below	0%	0%	10%
Qualified Dividends Rate			
Tax Bracket Above 15%	15%	15%	taxed as income
Tax Bracket 15% or Below	0%	0%	taxed as income
Marginal Income Tax Rates			
Top Bracket	35%	35%	39.6%
Fifth Bracket	33%	33%	36%
Fourth Bracket	28%	28%	31%
Third Bracket	25%	25%	28%
Second Bracket	15%	15%	15%
First Bracket	10%	10%	–
Child Tax Credit	$1,000	$1,000	$500
Marriage Penalty Relief			
Standard Deduction (% of S.D. for singles)	200%	200%	na
15% Tax Bracket (% of bracket for singles)	200%	200%	na
Repeal (%) of Personal Exemptions Phase-outs	100%	100%	na
Repeal (%) of Limitation on Itemized Deductions	100%	100%	na
AMT Exemption			
Single	$48,450	$33,750*	$33,750
Married Filing Joint	$74,450	$45,000*	$45,000
Head of Household	$48,450	$33,750*	$33,750
Estate Tax			
Exemption	$5 million	$5.12 million	$1 million
Maximum Rate	35%	35%	55%

**Based on existing law and could be altered.*

28%, 33% and 35%.

Payroll taxes (for Social Security) paid by employees are reduced by two percentage points for 2011. This cut also applies to those who are self-employed. The reduction is limited to the first $106,800 in salary, capping the value of the cut at $2,136. Those who earn less than $106,800 can only keep an extra 2% of their salary. In other words, a worker earning $50,000 per year will receive an extra $1,000 this year. Taxpayers who are not employed will not be eligible to take advantage of this tax break.

The payroll tax cut is temporary and is set to expire on December 31, 2011. President Obama has proposed extending the tax cut into 2012 as part of a broader job creation package, but Congress has yet to pass legislation authorizing the extension.

A "fix" to the alternative minimum tax (AMT) that increased the size of exemptions for 2011 was included in last year's tax bills. The exemptions will be significantly lower for 2012 if Congress does not pass new legislation.

The repeal of the phase-out for the personal exemption is extended through 2012. Prior to 2010, the personal exemption was reduced after adjusted gross income exceeded certain levels (e.g., $250,200 for married couples filing joint returns). This penalty was rescinded for 2010 and 2011 now will continue to be so through 2012.

Families will continue to benefit from three tax breaks in 2011 and 2012. First, an adjustment for the so-called "marriage penalty" puts the standard deduction for married couples filing jointly at double the standard deduction for those filing single. Married couples can claim a standard deduction of $11,600 and single filers can claim a standard deduction of $5,800 on their 2011 tax returns. In 2012, those amounts will increase by $300 and $150, respectively.

The $1,000 maximum child tax credit is maintained in 2011 and 2012. The credit is phased out for married couples filing jointly with modified adjusted gross income (MAGI) above $110,000 in 2011 (stays the same in 2012). If the child tax credit exceeds the tax liability, the difference will be paid to the taxpayer subject to certain requirements.

The estate tax is reinstated with larger exclusions. Specifics are discussed on page 9.

Capital gains and dividend taxes are staying at 2010 levels in 2011 and 2012. Both long-term capital gains and qualified dividends are taxed at 15% if incurred for securities held within a taxable account. (There is no capital gains tax or dividend taxes for securities held within a retirement account, such as an IRA. See Robert Carlson's article, "Do's and Don'ts of IRA Investing," in the March 2010 *AAII Journal* for investments that can cause an unexpected tax problem.) Collectibles, which include gold coins and bars, will be taxed at a 28% rate.

New Reporting of Capital Gains

Two new changes affect how capital gains are reported: Brokers will now list the cost basis and taxpayers will use Form 8949.

First, as of the start of 2011, brokers are required to report both the cost basis of and the proceeds from stocks sold by investors. This rule applies specifically to stocks purchased after January 1, 2011; it does not apply to stocks purchased on December 31, 2010, or earlier. Mutual funds and exchange-traded funds (ETFs) will be covered by this new rule beginning on January 1, 2012, and options and bonds will be covered beginning on January 1, 2013.

This is a change from what brokers have historically reported. Previously, only proceeds were listed on Form 1099-B. As of January 1, 2011, brokers must now list the cost basis. In addition, brokers must also state whether the gain or loss was short-term or long-term. The rule applies to all brokers, including online and full-service brokers.

The change is the response to a 2008 law passed by Congress. The law is intended to limit the loss in revenues caused by investors who underestimate their capital gains on tax returns.

A default accounting methodology known as first-in, first-out (FIFO) will be used when the purchase of a stock involves more than one transaction. The FIFO method treats the first shares purchased ("first in") as also being the first shares sold ("first out"). Depending on how the stock has performed, this treatment can result in a larger tax bill (the shares appreciated in value) or a bigger capital loss (the shares fell in value).

You can, however, specify to your broker which shares are to be sold first. For instance, if you built a position in a stock over the course of three days (say, Monday, Tuesday and Wednesday), you can sell the shares you bought on the last day (Wednesday) first. In order to do this, you must provide written instructions to your broker detailing your intentions before the order is executed, not afterward.

Dustin Stamper at Grant Thorton's National Tax Office emphasized the importance of providing these instructions in writing. If you give your broker specific instructions and your broker reports a different methodology to the IRS, the only way you can dispute what is on Form 1099-B is to provide a dated copy of your instructions. Stamper said that investors will not be able to retroactively determine which shares were sold; they must provide written instructions at or before the time the shares are sold.

The second change is Form 8949. This new form has two parts: one for listing short-term sales (assets held less than one year) and one for listing long-term sales (assets held for longer than a year). The totals calculated on Form 8949 are entered on Schedule D.

Short-term capital gains will be taxed as ordinary income. If you are in the 10% or 15% tax bracket, long-term capital gains and qualified dividends are not taxed.

Estate Tax

There are two primary aspects to last year's revisions to the estate tax code. The first is a higher exclusion amount. The first $5 million of an estate is excluded from taxes. (The exemption will increase to $5.12 million in 2012.) This a per spouse exclusion and it is portable, meaning if one spouse passes away, the surviving spouse can claim the exclusion, resulting in a total effective exclusion of $10 million in 2011 ($10.24 million in 2012). The large figures will prevent most families from having to pay estate taxes.

The second aspect is the reinstatement of the step-up basis rule. Should an inherited asset be sold, the capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of inheritance.

Though heirs were able to chose between the old and the new estate tax laws in 2010, only the new law, which includes the step-up basis rule, applies to the estates of those who pass away in 2011 or 2012.

Change in Capital Gains Reporting

Effective January 1, 2011, brokers are required to report the cost basis for stocks sold by their clients and bought during 2011 or later. This is a change from 2010 and previous years, when brokers only reported the proceeds from the sale of the stock. In 2012, brokers will be required to report the cost basis for mutual fund and exchange-traded fund shares. Similar requirements for options and bonds go into effect in 2013. If you sold a capital asset in 2011, you will need to fill out the new Form 8949. See the special write-up in the "New Reporting of Capital Gains" box for details on the new rules.

Self-Employed Health Insurance

Medical insurance premiums for the self-employed are deductible and can be used to reduce adjusted gross income for 2011 and 2012 on Form 1040. This is a change from 2010, when health insurance premiums could be used as a business expense that reduced self-employment income.

Tax Software, Books and Guides

Although the tax rates, deductions and exemptions for 2011 are mostly known, if you use a software program (e.g., TurboTax), book (e.g., "J.K. Lasser's Your Income Tax 2012") or related aid, check for updates before filing. Doing so will ensure that you are using the most up-to-date information.

Be sure to check for updated information regarding 2012 as well, if you intend to plan for next year. Since some of the rates are currently unknown, the first versions of the aids will have incomplete or outdated information. Check with the provider of any software, book or guide to see if a download or a supplement is available.

Useful Tax Numbers

Here is a list of the tax rates, deductions, exemptions, credits and other related items that may apply to your 2011 taxes. These numbers are based on what has been published by the IRS as of the time of publication and assumptions based on the new tax law.

Standard Deduction

For 2011, the standard deduction is $11,600 for married couples filing a joint return, $5,800 for those who are single or those who are married filing separate returns, and $8,500 for heads of household.

For 2012, the standard deduction will be $11,900 for married filing a joint return, $5,950 for singles and married individuals filing separate returns, and $8,700 for heads of household.

Personal Exemptions

The 2011 personal exemption is $3,700. The exemption can be claimed for yourself, your spouse (if filing a joint return) and any qualifying dependents. There is no phase-out for the personal exemption—regardless of your income level, you can claim the full amount.

Last year's legislation extended the repeal of the phase-out through 2012. The personal exemption will be $3,800 in 2012.

Individual Retirement Accounts and 401(k) Plans

The maximum allowed IRA contribution is unchanged in 2011 at $5,000 ($6,000 for any individual who is age 50 or older). The contributions can be fully deducted for modified adjusted gross incomes (modified AGI) below $90,000 for joint returns and below $56,000 for single filers. In 2012, the maximum contribution amounts will remain the same. The maximum modified AGI levels will rise to $92,000 and $58,000 for married filing joint and single returns, respectively.

In 2011, the maximum annual contribution limit for 401(k)s is $16,500 ($22,000 if you are age 50 or over); in 2012, those amounts will rise to $17,000 and $22,500 respectively.

In 2011, the maximum annual contribution for SIMPLE plans is $11,500 (those age 50 or over can make a maximum catch-up contribution of $2,500); in 2012, those amounts will remain the same.

Qualified Plan Contributions

In 2011, the maximum annual contribution for qualified plans, including SEP and Keogh plans, is $49,000 or 25% of your compensation, whichever is less; in 2012, the maximum contribution will be $50,000 or 25% of your compensation, whichever is less.

Estate and Gift Tax Limits

The estate tax was revised in 2010. A $5 million exemption that is portable to the surviving spouse was created. This exclusion will increase to $5.12 million in 2012. See the previous section about the estate tax for information on calculating taxable gains from the sale of the inherited assets.

The annual gift tax exclusion is $13,000 in 2011 and $26,000 for consenting couples. (You will need to file Form 709). These limits will remain unchanged in 2012.

Required Minimum Distributions (RMDs)

Individuals age 70½ and older are required to take a distribution from their retirement accounts by December 31, 2011. These accounts include 401(k) plans, 403(b) plans, 457(b) plans, traditional IRAs, SEP IRAs, SARSEP IRAs, SIMPLE IRAs and Roth 401(k) plans. Roth IRA plans are exempt while the owner is alive.

You must also take a required minimum distribution (RMD) in 2012 if you are 70½ or older during the calendar year.

If you turned 70½ in 2011, you have until March 30, 2012, to take your first RMD. You will need to take a second RMD during 2012 to satisfy that year's distribution requirement.

According to the IRS, "Generally, a RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that IRS publishes in Tables in Publication 590, Individual Retirement Arrangements (IRAs)."

Child Tax Credit

In 2011, the maximum child tax credit for dependent children younger than 17 is $1,000. The amount remains the same for 2012.

Kiddie Tax

In 2011, the "kiddie tax" applies to children up to age 18 and could apply to children up to age 23—depending on how much earned income they have and whether or not they are full-time students.

Under the kiddie tax rules, children with investment income above a certain amount may have part or all of their investment income taxed at their parents' income tax rate.

For 2011, the kiddie tax applies if the child is 17 or under by the end of the year and the child's total investment income for the year was more than $1,900. It is projected that this amount will remain the same for 2012.

In addition, the kiddie tax can apply to older children, depending on how much earned income they have and whether or not they are full-time students:

- Starting in the year that your child turns 18, the kiddie tax will apply if your child's earned income (including salaries and wages, commissions, professional fees and tips) is

- less than half of the child's overall support.
- Starting in the year your child turns 19, the kiddie tax will apply if your child is a full-time student.
- The kiddie tax will stop applying in the year your child turns 24.
- The kiddie tax will also not apply if your child is married filing jointly.

Charitable Donations

Donations of clothing and other personal items must be in "good condition" or better in order to be deducted. Form 8283 must be filled out if your total deduction for all noncash contributions exceeds $500.

In addition, charitable contributions of cash (regardless of the amount) to any qualified charity must be supported by a dated bank record (such as a cancelled check) or a dated receipt from the charity that must include the name of the charity and the date and amount of the contribution.

Congress also extended through 2011 the provision allowing tax-free distributions from IRAs to qualified charities for individuals over age 70½. The maximum contribution limit remains at $100,000. A qualifying transfer, or qualified charitable distribution, counts toward the IRA's required minimum distribution. You cannot claim a deduction for a qualified charitable distribution excluded from income, however.

When Congress voted to extend the provision until December 31, 2011, it allowed taxpayers to make a qualified charitable distribution in January 2011 and have it be characterized as a 2010 contribution. Contributions characterized in this manner do not count against the 2011 limit of $100,000 on qualified charitable distributions.

As of press time, it is uncertain as to whether Congress will extend the qualified charitable distribution provision into the 2012 tax year.

Medicare

Taxpayers who itemize deductions can deduct (as a medical expense) the premiums they pay for Medicare Part B supplemental insurance and Medicare Part D prescription drug insurance. Premiums for voluntary coverage under Medicare Part A are only deductible by those over the age of 65 and not covered by Social Security. Medical expenses must exceed 7.5% of adjusted gross income to qualify for deductions.

Itemized Deduction Phase-Outs

The phase-out of itemized deductions for taxpayers with adjusted gross income above a certain amount was fully repealed in 2010. This repeal remains in place for both 2011 and 2012, allowing the full benefit of itemized deductions to be applied.

Planning Considerations: Married taxpayers filing jointly will need to calculate whether taking the increased standard deduction or itemizing deductions will generate the most tax savings overall. When doing so, make sure to consider whether state law restricts the ability to itemize to only those who itemize for federal purposes. The higher deductions may also require more couples to pay alternative minimum tax.

Sales Tax Deduction

As stated previously, the provision allowing taxpayers who itemize deductions the option of choosing between a deduction of sales taxes or income taxes when claiming a state and local tax deduction was extended into 2011. This deduction will expire at the end of 2011, unless Congress moves to extend the state sales tax deduction into the 2012 tax year.

Tax-Exempt Interest Reporting

State and local governments are required to report interest paid on tax-exempt state and local bonds on Form 1099-INT, Interest Income. This amount must be shown on your tax return and is for information only.

For a complete tax guide to the buying and selling of your personal investments, go to our Personal Investments 2011 Tax Guide in the online version of this article.

Health Savings Accounts

You may be able to take a deduction if you contributed to a Health Savings Account (HSA). To qualify, you must be covered by a "high-deductible health plan."

More information on this can be found at AAII.com in the online version of this article.

Education Savings

The 2009 stimulus bill expanded the Hope education credit into the American Opportunity education credit. The maximum credit is $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books). However, the credit phases out for higher income taxpayers. This credit was extended for both 2011 and 2012.

The Lifetime Learning credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phase-outs.

You can make non-deductible contributions to qualified tuition plans, also known as section 529 plans. (However, the contributions may be deductible from your state income tax, depending on where you live.) These accounts, offered by states or their designees, are maintained solely for the qualified higher education expenses of a beneficiary. Distributions are tax-free, provided that the distributions are used to pay qualified expenses. Though the definition of "qualified education expense" has included computers, computer technology and Internet service, this is no longer the case in 2011.

For both 2011 and 2012, the contribution limit to a Coverdell Education Savings Account was kept at $2,000 per beneficiary, as part of the 2010 tax law. The contributions are not deductible, but they grow tax-free in the IRA. Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers.

Investment Strategies: 2012 and Beyond

Given the nature of the changing tax rates in the past few years, and the likelihood that changes will be made in the near future, tax planning opportunities are difficult to assess.

Listed below are traditional tax planning strategies that can help keep your tax bill down under various tax scenarios. It is important, however, to keep in mind that your goals and risk tolerance, not just the income tax impact of an investment, should drive your investment decisions.

Consider Roth IRA Conversion Opportunities

You have the option of converting all or part of your traditional IRA into a Roth IRA, regardless of your adjusted gross income. Roth IRAs can provide certain advantages: The converted assets can be withdrawn tax-free at any time, future earnings are also tax-free (with some limitations), and Roth IRA owners are not required to take any minimum distributions in retirement. The downside, however, is that the conversion amount is taxable in the year it occurred.

An exception existed in 2010 that allowed the taxes from the conversion to be paid in equal amounts in 2011 and 2012. If you opted for two-year deferral in 2010, you must report one-half of the taxable conversion on your 2011 tax return, and the other half on your 2012 tax return.

Conversions made in 2011 must be reported in full on your 2011 tax return. The same rule applies for conversions made in 2012—they must be reported on your 2012 tax return. You cannot defer taxes on conversions made in either in 2011 or 2012.

While the benefits of a Roth IRA conversion could be considerable, taxpayers must carefully weigh the up-front tax costs against the long-term tax advantages. For more on this, see "Retirement Plans: Evaluating the New Roth IRA Conversion Opportunity" by Christine Fahlund in the November 2009 *AAII Journal* and "New Rules for Converting to a Roth IRA" by William Reichenstein, Alicia Waltenberger and Douglas Rothermich in the January 2010 *AAII Journal*. Though the articles discuss the 2010 option for delaying the

Be Careful With Fund Distributions

Investment returns generated by a mutual fund or an exchange-traded fund (ETF) can take the form of dividends, interest or capital gains and losses. Funds are required to distribute dividends, interest and net realized gains to you each year. (However, both mutual fund and ETF managers can use strategies to limit distributions and offset realized capital gains; therefore, it is possible for a fund not to distribute a realized gain for a given year.)

Distributions are taxable whether you take them in cash or reinvest them in fund shares, unless they are income dividends from tax-exempt municipal bond funds, or if they are within a tax-sheltered account such as an IRA or other retirement account (where they are tax-sheltered until withdrawn).

The status of any capital gain or dividend distributed to you by a fund depends on how long the fund owned the securities that produced the gain or dividend—not on how long you owned shares in the fund. The information you will need to determine how your distributions are taxed will be on your fund's Form 1099.

What about losses?

A fund's capital losses are never distributed to shareholders, but are used to offset capital gains realized by the fund during the year. Any additional losses are carried forward by the fund to apply against gains realized in the future. The only losses you can claim are those you may have incurred when you redeemed your own shares of a fund.

Because fund distributions are taxed even if they are reinvested, it is important to remember that you should add reinvested income, dividends and capital gains (from both taxable and tax-free funds) to your original cost basis when it comes time to figure gains or losses on any fund shares that are sold. If you do not, you will, in effect, be paying taxes twice on those distributions. (Beginning on January 1, 2012, mutual funds and brokers will be required to report the cost basis for mutual fund shares and ETFs bought and sold after that date.)

In addition, consider delaying an investment in a fund if you are investing close to the fund's ex-dividend date. When a distribution is made, it is subject to tax, even if you reinvest it in that fund (although the reinvested amount increases your tax basis in the fund).

Most funds commonly make distributions toward the end of the year. Investors must be wary of this distribution date. Generally, you should not invest in a fund shortly before its distribution date, because a portion of your investment will be immediately returned to you with an accompanying tax liability. Most mutual fund and ETF providers should be able to give you a good idea of when their year-end distributions will take place, so calling the fund company prior to investing can be a wise move.

AAII's "Individual Investor's Guide to the Top Mutual Funds" and "Individual Investor's Guide to the Top Exchange-Traded Funds" list tax-cost ratios for all covered funds. The February 2012 *AAII Journal* will include the latest mutual fund guide; the ETF guide was published in the August 2011 *AAII Journal*.

taxes from the conversion, their suggestions regarding whether to convert or not continues to be applicable. You may also want to consult a tax advisor for the best strategy.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. However, currently qualified dividends and long-term capital gains are taxed at the same rate—and the rates are at a rock bottom 0% for taxpayers in the 15% or below marginal tax brackets. The 2010 tax law extended these rates until the end of 2012, at which time Congress will have to act to prevent them from resetting to a higher level, if it does not act sooner.

Sell Low-Basis Stock

The current tax environment continues to present the opportunity to sell low-basis stock held for more than one year, because long-term capital gains rates may eventually be reset higher from the maximum rate of 15% (0% for the two lowest income brackets). Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider using the proceeds from selling the stock to diversify your portfolio. This is particularly the case if a large portion of your wealth is concentrated in just a few securities.

Use Losses Carefully

While tax considerations should not drive your investment decision, you can take advantage of losses in holdings that you would prefer to either sell or reduce from an investment standpoint.

Capital losses first reduce capital gains: long-term losses reduce long-term gains first, and short-term losses reduce short-term gains first. Any long-term losses left over reduce short-term gains, and vice versa. If you still have losses remaining after offsetting capital gains, you can reduce your "ordinary" income by up to $3,000. Losses not used this year can be carried forward to future years until they are used up. For more information, see "Capital Pains: Rules for Capital Losses" by Julian Block in the September 2010 *AAII Journal*.

When planning, make sure you don't run afoul of the wash-sale rules. If you sell an investment at a loss and then acquire substantially identical securities during the 30-day period before or 30-day period after the sale, the loss will be disallowed. If your loss is disallowed by the wash sale rule, you can reduce the cost basis of the new stock by the amount of the disallowed loss. The holding period for the new stock is also adjusted to include the holding period of the stock sold at the disallowed loss. You cannot adjust the cost basis or holding period, if you acquire the investment in a IRA or Roth IRA, however.

How Much of Your Social Security Is Taxed?

Income Level	Percent of SS Benefits Taxed
Below $25,000 Single & Head of Household Below $32,000 Married Filing Jointly	0%
$25,000 to $34,000 Single & Head of Household $32,000 to $44,000 Married Filing Jointly	up to 50%
Above $34,000 Single & Head of Household Above $44,000 Married Filing Jointly	up to 85% of benefits + other income

Consider the Impact of Taxes on Mutual Fund Investments

Selecting tax-aware managers of mutual funds may be important to maximizing your aftertax rate of return in your taxable investment portfolio.

You may choose when to sell shares of the fund and may, therefore, create long-term versus short-term capital gains. But you don't control the investments within the fund. Should an equity manager fail to extend the holding period on a stock, it could cost you 20% of your gain (35% ordinary rate for short-term capital gains versus 15% long-term capital gains rate).

Some mutual fund dividends will qualify for the 15% rate, while others will not. Dividends paid by stocks held by the fund and passed through to the shareholder will qualify for the dividend tax rate. However, capital distributions and bond interest will not. These payments are reported on Form 1099, which specifies the type of distribution.

For more on mutual fund distributions, see the box on page 12.

Reconsider Taxable Versus Tax-Free Bonds

Interest from tax-free municipal bonds is generally exempt from federal income taxes, unlike the interest from taxable bonds, which is taxed as income. Like any bond, credit quality matters as you want to ensure that the issuer will not default. Changing yields can also alter the aftertax yield advantage, making municipal bonds more or less attractive to taxable bonds.

Additionally, private-activity bonds (a type of tax-free bond) could increase your exposure to the alternative minimum tax since their interest income is taxable for purposes of the alternative minimum tax. There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds, and Gulf Opportunity Zone bonds. Furthermore, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer for the bond's tax status.

You should review your bond and money market accounts to make sure that you are earning the highest aftertax return. But don't forget to consider the state tax implications of switching from tax-free to taxable bonds before making any final portfolio decisions.

Consider Increasing Retirement Savings

Increasing retirement savings makes sense from a financial planning standpoint and, depending on your adjusted income, may reduce your tax bill. You have until April 17, 2012, to make an IRA contribution for the 2011 tax year.

At press time, it is uncertain whether Congress will extend this year's payroll tax cut into 2012. Social Security taxes for workers were reduced by two percentage points, to 4.2%, in 2011, but the cut is slated to end on December 31, 2011.

Review the Tax Implications of Taxable Versus Tax-Deferred Accounts

The spread between capital gains and ordinary income rates has important implications with respect to your asset allocation between taxable and tax-deferred (retirement) accounts. For example, from a tax perspective, holding individual stocks in tax-deferred accounts and bonds in taxable accounts could be expensive, because the long-term gains resulting from stocks held in tax-deferred plans such as IRAs or 401(k) plans will be taxed at ordinary rates when taken as a distribution. By reversing that structure, taxable bonds and other tax-inefficient assets will be shielded from taxation in the deferred accounts, while equities will enjoy the reduced rates for dividends and capital gains in personal accounts. Tax-free municipal bonds should, of course, remain outside of retirement accounts. Individuals should also consider the cost of commissions and taxes, as well as current cash flow needs, before making any investment moves between taxable and tax-deferred accounts.

Protect Social Security Benefits

If you are receiving Social Security benefits, you may have to pay taxes on them if your modified adjusted gross income (primarily your taxable income plus any tax-exempt interest income plus half of your Social Security benefits) exceeds certain levels. To protect your benefits, watch the amount of interest you receive from municipal bonds, since this amount is included in your modified adjusted gross income when determining the Social Security benefit taxability. In addition, you may want to delay taxable distributions from a retirement plan or IRA.

Conclusion

It is important to remember that taxes are not the key to investment planning. And the temporary duration of the current tax law provisions should motivate individuals to reconsider existing strategies in the coming years. However, one thing is certain: There will be more tax changes coming, and everyone should consider how the changes directly affect their overall tax and investment strategies.

Tax Planning Strategies

All Taxpayers: Determine Where You Are at the End of the Year

At the end of each year, you should take the time to assess your tax situation. Doing so will give you the opportunity to shift certain items around, should that be beneficial in terms of your tax liability. Taking a few initial steps now and using year-end planning strategies can result in significant tax savings.

How can you effectively plan?

Here are the basic steps you should take to help start your personal tax planning:

- Estimate your income, deductions, credits and exemptions for 2011 and 2012 using the Tax Forecasting Worksheet (page 20 and on AAII.com in a fillable PDF);
- Identify items that you can shift from 2011 into 2012 and beyond (or vice versa);
- Determine your marginal tax rate—the rate at which your next dollar of income will be taxed—for 2011 and 2012;
- Determine how much tax you owe and when you must pay it to avoid underpayment penalties;
- Determine whether you are subject to the alternative minimum tax (AMT);
- Consult with your tax professional, and then take the actions needed to make the best of your tax situation.

To minimize your taxes, consider both short-term and long-term tax planning issues and strategies. Starting early will give you extra time to obtain additional information about items that concern you and to investigate additional ideas for tax savings or deferral. The Tax Forecasting Worksheet on page 20 (and fillable PDF on AAII.com) will provide a starting point for evaluating the tax effects of various strategies.

Avoiding Tax Underpayment Penalties

Make sure you determine your 2012 tax liability as early as possible, as well as the due dates for paying those taxes (including the self-employment tax and the alternative minimum tax), so that you avoid underpayment penalties.

Federal tax law requires the payment of income taxes throughout the year as you earn your income. This obligation may be met through withholding, quarterly estimated tax payments, or both. If you do not meet this obligation, you may be assessed an underpayment penalty.

If your total tax due minus the amount you had withheld is less than 10% of your total tax due, you will not be assessed an underpayment penalty. The disadvantage of overpaying throughout the year, though, is that you are in effect making an interest-free loan to the government. However, the underpayment penalty can be high, and it is calculated as interest on the underpaid balance until it is paid, or until the regular filing date for the final tax return, whichever is earlier.

You can avoid underpayment tax penalties by adopting one of the safe harbor rules. The basic rule is to pay the required amount by the end of the year through withholding and quarterly estimated payments. The required amount will be one of the following, depending on your individual situation:

- 90% of the current year's tax liability;
- 100% of the prior year's tax liability (increases to 110% for taxpayers who had adjusted gross income in excess of $150,000 or $75,000 for those married filing separately for 2011 and 2012); or
- 90% of the tax liability based on a quarterly annualization of current year-to-date income (See IRS Form 505 and IRS Publication 505 for worksheets).

Penalties are based on any underpayment, which is the difference between the lowest amount required to be paid by each quarterly payment date and the amount actually paid by that date. The annual required amount, based on either of the first two alternatives, is paid in equal installments. In the case of the third method, which is based on annualized income, the amount due each quarter is based on actual income received for each installment period. The third method is typically more beneficial if you do not earn income evenly throughout the year (e.g., you operate a seasonal business) or had an unexpected increase in income, because it allows for lower required payments in the early quarters.

Income tax payments made through withholding from your paycheck (or from your pension or other payments) are given special treatment. The IRS treats income tax that is withheld as having been paid equally throughout the year (unless you prefer to use actual payment dates). This lets you make up for underpaid amounts retroactively, because amounts withheld late in the year may be used to increase the amounts paid in earlier quarters.

State and Local Rules: Be aware that many states have underpayment rules that vary from the federal requirements.

Timing: Income & Deductions for Taxpayers Not Subject to AMT

You have opportunities to reduce your taxes if you can control the timing of either your income or expenses. However, it is important to make sure you understand whether you may be subject to the alternative minimum tax (AMT) before adopting these strategies. (See the online version of this article for more information.)

Income

Your income is generally taxed in the year of receipt, so having the ability to control when you receive it affords a strategic tax planning opportunity. Deferring income until a later year will, in most cases, delay the payment of tax. You cannot defer taxation by merely delaying receipt of the income if the funds are available to you and the time of payment is subject to your unrestricted discretion. Any decision to defer income must be weighed with the lost time-value of the money and other risks that could alter or forfeit your right to the income.

The timing of bonuses, recognition of capital gains from the sale of stocks, and the exercise of non-qualified stock options are all events that can easily be delayed into a subsequent year. You should also consider the deferral of compensation through the use of various retirement plans and deferred-compensation arrangements. If you operate a business or collect rental income and report that income on the cash receipts and disbursements method, you have an opportunity to delay or accelerate the billing to your customers or tenants and determine the timing of the related income.

Deductions

You can reduce taxes by controlling the payment of deductible expenses. If paid by December 31, you may deduct certain expenses that are due the following year on your current year tax return. This strategy helps when you have a higher tax liability in the current year than you expect to have in the coming year. Again, you must balance this decision with the time-value of money and other inherent risks.

For example, if you paid a deductible expense in December 2011 instead of April 2012, you reduced your 2011 tax instead of your 2012 tax, but you also lost the use of your money for three-and-one-half months. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a very high return in that three-and-one-half-month period. You must decide whether the cash used to pay the expense early should be used for something more urgent or more valuable than the accelerated tax benefit.

For those who will pay 2012 estimated taxes based on their 2011 tax liability, reducing your 2011 taxes has another advantage: Your 2012 estimated tax payments may be smaller.

State Taxes

If accelerating deductions makes sense for you and you choose to claim a deduction on your state and local income taxes, you may want to prepay the balance on your estimated state tax liability in December, rather than waiting until 2012. This secures that deduction on your 2011 tax return, even though the payment might not be required by the state until January 17, 2012, or April 17, 2012.

Charitable Contributions

If you are planning on making a gift to a charity in 2012, consider making the gift in 2011 to accelerate the tax benefit of the contribution. However, it is important to note that certain limitations exist with respect to deductions for charitable contributions.

You should also consider the benefits of gifting appreciated stock to a charity. If you donate long-term appreciated stock directly to the charity, you get a deduction for the full fair market value of the stock; whereas, if you sell the stock first and donate cash, you only get a deduction for the aftertax cash donated. (If you have an unrealized loss in the stock, however, it might be more beneficial from a tax standpoint to sell the stock and then donate the cash proceeds. Doing so would give you deductions for both the capital loss and the charitable donation.)

When making a gift to charity, you must have an appropriate record

Where's My Money? Tracking Your Refund 24/7

If you are expecting a refund on your 2011 income tax, you can check on its status if it has been at least three to four weeks since the date you filed your return by mail, or 72 hours if you filed electronically. You will need to supply the following information: your Social Security number or IRS Individual Taxpayer Identification number, your filing status, and the exact whole-dollar refund amount as it is shown on your return.

You can check the status of your refund in two ways:

- On the Internet, go to www.irs.gov and click on "Individuals" and then "Where's My Refund."
- By telephone (for automated information), call 800-829-4477.

If you are unable to get information on your refund through either of these two automated services, you can call the IRS for assistance at 800-829-1040.

The IRS website also allows you to start a trace for lost or missing refund checks, or to notify the IRS of an address change when refund checks go undelivered. Taxpayers can avoid undelivered refund checks by having refunds deposited directly into a personal checking or savings account. This option is available for both paper and electronically filed returns.

of the gift in order to properly support the deduction. In addition, cash contributions of any amount must be supported by a written record, either in the form of a bank record (for example, a cancelled check) or a written receipt from the charity. The record must include the name of the charity, the date, and the amount of the contribution.

Prepaid Interest

A cash basis taxpayer may not deduct prepaid interest before the tax year to which the interest relates. However, there is some flexibility to prepay year-end interest that is due early in the following year. For example, if a mortgage payment is due on January 10, a taxpayer can accelerate the deduction of the portion of the interest relating to the period up to January 1 by mailing the check in December.

The most significant interest deductions currently available are for home mortgage interest and for investment interest expense to the extent of current-year investment income. Interest paid in relation to investments that earn a tax-free return is not deductible.

Medical Expenses

If the timing of certain medical and dental expenditures is flexible and your overall medical expenses are high in the current year, you may want to accelerate the timing of these expenses. Because unreimbursed medical expenses are only deductible to the extent that they exceed 7.5% of adjusted gross income, it is best from a tax standpoint to incur expenses—such as replacement eyeglasses or contact lenses, elective surgery, dental work, and routine physical examinations—in a year in which you have already gone over (or the added expenses would take you over) the 7.5% threshold.

Miscellaneous Itemized Deductions

Miscellaneous itemized deductions are only deductible to the extent that they exceed 2% of adjusted gross income. This category is large but includes:

- Tax preparation fees such as tax preparation software, tax publications and any fee paid for electronic filing; and
- Investment fees, custodial fees, trust administration fees, and other expenses paid for managing your investments that produce taxable income.

Accelerating miscellaneous itemized deductions only benefits taxpayers who accumulate expenses sufficient enough to exceed the 2% threshold. If possible, it may be advantageous to pay these types of expenses in one year if, because of the 2% floor, you would not receive a benefit of the deduction in each of the two consecutive years.

Timing Caution for Taxpayers Subject to AMT

The alternative minimum tax (AMT) was originally designed to ensure that everyone would pay his or her fair share of income taxes. In 1987, only 140,000 taxpayers were subject to the AMT. Since then, however, it has evolved into a separate tax regime that could affect millions of unsuspecting taxpayers at some time in the future.

The wisdom of conventional tax planning advice to defer income and accelerate certain types of deductions may not hold true if an individual expects to be subject to the AMT. Accordingly, during the tax planning process, it is critical that you determine whether you are subject to the AMT in both the current year and the following year. This analysis is even more complicated because the AMT exemption level must be "fixed" on nearly an annual basis. (Last year's tax bill provided AMT exemptions for only 2010 and 2011; Congress will have to act on the 2012 exemptions to prevent a large number of taxpayers from being hit by the AMT.)

If you are continuously subject to the AMT, avoid investing in private-activity (municipal) bonds. Income from these bonds is taxable for AMT purposes. (There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds, and Gulf Opportunity Zone bonds. Also, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer for the bond's

(continued on page 25)

2011 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,500	10%	$0
8,500	34,500	$850.00 + 15%	$8,500
34,500	83,600	$4,750.00 + 25%	$34,500
83,600	174,400	$17,025.00 + 28%	$83,600
174,400	379,150	$42,449.00 + 33%	$174,400
379,150	—	$110,016.50 + 35%	$379,150

For Married Taxpayers Filing Joint Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	17,000	10%	$0
17,000	69,000	$1,700.00 + 15%	$17,000
69,000	139,350	$9,500.00 + 25%	$69,000
139,350	212,300	$27,087.50 + 28%	$139,350
212,300	379,150	$47,513.50 + 33%	$212,300
379,150	—	$102,574.00 + 35%	$379,150

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,500	10%	$0
8,500	34,500	$850.00 + 15%	$8,500
34,500	69,675	$4,750.00 + 25%	$34,500
69,675	106,150	$13,543.75 + 28%	$69,675
106,150	189,575	$23,756.75 + 33%	$106,150
189,575	—	$51,287.00 + 35%	$189,575

For Individuals Filing as Head of Household

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	12,150	10%	$0
12,150	46,250	$1,215.00 + 15%	$12,150
46,250	119,400	$6,330.00 + 25%	$46,250
119,400	193,350	$24,617.50 + 28%	$119,400
193,350	379,150	$45,323.50 + 33%	$193,350
379,150	—	$106,637.50 + 35%	$379,150

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers Above the 15% Bracket (%)
Short-Term Capital Gains	taxed as income	taxed as income
Long-Term Capital Gains*	0	15
Qualified Dividends	0	15
Collectibles**	28 maximum	28 maximum
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum

**For investments held longer than one year.*
***Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $950	0%
Next $950	10%
Over $1,900	parent's rate

2011 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$11,600
Single	$5,800
Married, Filing Separate	$5,800
Head of Household	$8,500

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,150
Single	$1,450

Additional—Blind	
Married (or Qualifying Widow)	$1,150
Single	$1,450

Personal Exemption

$3,700

Maximum Child Tax Credit

$1,000 per child under 17 years

Standard Mileage Deductions

	1/1 – 6/30	7/1 – 12/31
Business Standard Mileage Rate (cents)	51.0	55.5
Medical Standard Mileage Rate (cents)	19.0	23.5
Moving Standard Mileage Rate (cents)	19.0	23.5
Charitable Serv Standard Mile Rate (cents)	14.0	14.0

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,000
If 50 or older	$6,000

Maximum 401(k) Employee Contribution

If younger than 50	$16,500
If 50 or older	$22,000

Self-Employed Medical Insurance Premium Deduction

100%*

Annual Gift Tax Exclusion (per person)

$13,000

Estate Tax Exclusion

$5 million

**Unlike 2010, premiums do not reduce self-employment income.*

2011 Other Tax Items

2011 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	4.20%*	10.40%	$106,800
Medicare	1.45%	2.90%	no limit
Total	5.65%	13.30%	

**Applies only to employees for the 2011 calendar year.*

2011 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 7.5% of AGI
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize state and local income taxes only or state and local sales taxes only, but not both

2011 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2011 AMT Exemption Amount

Single	$48,450
Married, Filing Joint	$74,450
Married, Filing Separate	$37,225
Head of Household	$48,450

2011 Tax Benefit Phase-Out Levels

Personal Exemption

	AGI Phase-Out Level
Married, Filing Joint	no limitations
Single	no limitations
Married, Filing Separate	no limitations
Head of Household	no limitations

Itemized Deduction

	AGI Phase-Out Level
Married, Filing Joint	no limitations
Single	no limitations
Married, Filing Separate	no limitations
Head of Household	no limitations

IRA Deductibility

For those covered by employer retirement plan [$5,000 maximum contribution per taxpayer; if 50 or older, maximum is $6,000]

	Modified AGI* Phase-Out Level
Married, Filing Joint	$90,000
Single	$56,000
Married, Filing Separate	$0**
Head of Household	$56,000
Married, Filing Joint not covered by pension plan, but spouse is	$169,000

Roth IRA Eligibility

Maximum $5,000 non-deductible contribution; if 50 or older, maximum is $6,000

	Modified AGI* Phase-Out Level
Married, Filing Joint	$169,000
Single	$107,000
Married, Filing Separate	$0
Head of Household	$107,000

Coverdell Education Account

$2,000 maximum non-deductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phase-Out Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$56,000 if strict criteria are met.*

Tax Forecasting Worksheet

This worksheet is designed for estimation purposes only and does not cover all the possible adjustments that may be required to arrive at actual taxable income (for example, Social Security benefits may be taxable in some circumstances) or to compute final income tax liability (for example, lump-sum distribution tax on retirement distributions). It should be adequate for most purposes and is a good starting point for discussions with your tax advisor, who can assist you in making exact calculations.

The online version of this worksheet calculates much of the math for you; go to: www.aaii.com/files/PDF/Tax Guide 2011/page20.pdf.

	2011	2012
Income		
1. Salaries per Form W-2	________	________
2. Non-qualified dividends and interest income	________	________
3. Net business income (losses)	________	________
4. Net capital gains and qualified dividend income[a]	________	________
5. Other gains (losses)	________	________
6. Passive income (losses) (subject to limitations)	________	________
7. Other income, including 85% of Social Security benefits, if applicable	________	________
8. Total income (sum of lines 1 – 7)	$ ________	$ ________
Adjustments		
9. Alimony paid	________	________
10. Keogh contributions	________	________
11. Deductible IRA contributions	________	________
12. Moving expenses (job-related, subject to limitations)	________	________
13. Other ________	________	________
14. Adjusted gross income (AGI) (subtract lines 9 – 13 from line 8)	$ ________	$ ________
Deductions		
15. Medical and dental expenses (excess over 7.5% of line 14) or self-employed health insurance	________	________
16. State and local income taxes (or sales taxes in 2011)	________	________
17. Real estate and property taxes (non-business property)	________	________
18. Home mortgage interest	________	________
19. Investment interest (limited to investment income)	________	________
20. Charitable contributions	________	________
21. Casualty or theft losses (excess over $100 plus 10% of line 14)	________	________
22. Miscellaneous expenses (excess over 2% of line 14)	________	________
23. Total deductions (sum of lines 15 – 22 or the standard deduction if greater)[b]	$ ________	$ ________
24. Personal exemptions ($3,700 in 2011; $3,800 in 2012)[b]	________	________
25. Regular taxable income (subtract lines 23 and 24 from line 14)	$ ________	$ ________
26. Regular tax (see tax rate tables)[a]	________	________
27. Tax credits	________	________
28. Regular tax (net) (subtract line 27 from line 26)	________	________
29. Alternative minimum tax[c]	________	________
30. Other taxes (self-employment tax, household help, and so forth)	________	________
31. Total tax (sum of lines 28, 29, and 30)	________	________
32. Total withholding and estimated tax payments	$ ________	$ ________
33. Balance due (refund) (subtract line 32 from line 31)	$ ________	$ ________

a. If your taxable income includes net capital gain and qualified dividend income, you may be eligible for a tax rate on that income that is lower than the tax rate that applies to your other income. Refer to IRS Form 1040, Schedule D.

b. The standard deduction and personal exemptions are not allowed when calculating the alternative minimum tax.

c. Use IRS Form 6251 as a worksheet and review the discussion on AMT on page 15 and further notes in the online version of this article.

2012 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,700	10%	$0
8,700	35,350	$870.00 + 15%	$8,700
35,350	85,650	$4,867.50 + 25%	$35,350
85,650	178,650	$17,442.50 + 28%	$85,650
178,650	388,350	$43,482.50 + 33%	$178,650
388,350	—	$112,683.50 + 35%	$388,350

For Married Taxpayers Filing Joint Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	17,400	10%	$0
17,400	70,700	$1,740.00 + 15%	$17,400
70,700	142,700	$9,735.00 + 25%	$70,700
142,700	217,450	$27,735.00 + 28%	$142,700
217,450	388,350	$48,665.00 + 33%	$217,450
388,350	—	$105,062.00 + 35%	$388,350

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,700	10%	$0
8,700	35,350	$870.00 + 15%	$8,700
35,350	71,350	$4,867.50 + 25%	$35,350
71,350	108,725	$13,867.50 + 28%	$71,350
108,725	194,175	$24,332.50 + 33%	$108,725
194,175	—	$52,531.00 + 35%	$194,175

For Individuals Filing as Head of Household

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	12,400	10%	$0
12,400	47,350	$1,240.00 + 15%	$12,400
47,350	122,300	$6,482.50 + 25%	$47,350
122,300	198,050	$25,220.00 + 28%	$122,300
198,050	388,350	$46,430.00 + 33%	$198,050
388,350	—	$109,229.00 + 35%	$388,350

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers Above the 15% Bracket (%)
Short-Term Capital Gains	taxed as income	taxed as income
Long-Term Capital Gains*	0	15
Qualified Dividends	0	15
Collectibles**	28 maximum	28 maximum
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum

**For investments held longer than one year.*
***Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $950	0%
Next $950	10%
Over $1,900	parent's rate

2012 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$11,900
Single	$5,950
Married, Filing Separate	$5,950
Head of Household	$8,700

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,150
Single	$1,450

Additional—Blind	
Married (or Qualifying Widow)	$1,150
Single	$1,450

Personal Exemption

$3,800

Maximum Child Tax Credit

$1,000 per child under 17 years

Standard Mileage Deductions

Business Standard Mileage Rate	55.5 cents
Medical Standard Mileage Rate	23.0 cents
Moving Standard Mileage Rate	23.0 cents
Charitable Serv Standard Mile Rate	14.0 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,000
If 50 or older	$6,000

Maximum 401(k) Employee Contribution

If younger than 50	$17,000
If 50 or older	$22,500

Self-Employed Medical Insurance Premium Deduction

100%*

Annual Gift Tax Exclusion (per person)

$13,000

Estate Tax Exclusion

$5.12 million

**Unlike 2010, premiums do not reduce self-employed income.*

2012 Other Tax Items

2012 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%*	12.40%*	$110,100
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

**Congress has yet to extend the 2% reduction for employees from 2011.*

2012 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 7.5% of AGI
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize state and local income taxes only; state and local sales taxes are no longer itemizable unless Congress extends the deduction

2012 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)
- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)
- 110% of prior year tax or
- 90% of current year tax liability

2012 AMT Exemption Amount*

Single	$33,750
Married, Filing Joint	$45,000
Married, Filing Separate	$22,500
Head of Household	$33,750

**Congress has yet to extend higher exemptions from 2011.*

2012 Tax Benefit Phase-Out Levels

Personal Exemption

	AGI Phase-Out Level
Married, Filing Joint	no limitations
Single	no limitations
Married, Filing Separate	no limitations
Head of Household	no limitations

Itemized Deduction

	AGI Phase-Out Level
Married, Filing Joint	no limitations
Single	no limitations
Married, Filing Separate	no limitations
Head of Household	no limitations

IRA Deductibility

For those covered by employer retirement plan [$5,000 maximum contribution per taxpayer; if 50 or older, maximum is $6,000]

	Modified AGI* Phase-Out Level
Married, Filing Joint	$92,000
Single	$58,000
Married, Filing Separate	$0**
Head of Household	$58,000
Married, Filing Joint not covered by pension plan, but spouse is	$173,000

Roth IRA Eligibility

Maximum $5,000 non-deductible contribution; if 50 or older, maximum is $6,000

	Modified AGI* Phase-Out Level
Married, Filing Joint	$173,000
Single	$110,000
Married, Filing Separate	$0
Head of Household	$110,000

Coverdell Education Account

$2,000 maximum non-deductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phase-Out Levels
Married, Filing Joint	190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$56,000 if strict criteria are met.*

2012 Tax Planning Calendar

Tax and financial planning are activities best pursued year-round. Although the timing of some activities is critical, you should review all tax considerations from the perspective of your specific needs and establish an individualized planning calendar.

If the last day for filing a return, paying tax, or performing other activities falls on a Saturday, Sunday, or legal holiday (in the District of Columbia), you have until the next day that is not a Saturday, Sunday, or legal holiday to perform that act. Use the following list to remind yourself of important activities and dates:

First Quarter

General

- Complete Form W-4, Employee's Withholding Allowance Certificate, and adjust withholding, if needed.
- Evaluate before-tax and voluntary aftertax contributions to retirement plans.
- Apply for a Social Security number for any child who does not have one.

January 17

- Pay fourth-quarter 2011 estimated tax voucher if you did not pay your income tax for the year through withholding, or if you did not pay enough through withholding. You do not have to make this payment if you file your 2011 return and pay any tax due by January 31, 2012.
- Make quarterly defined-benefit Keogh contribution for preceding year.

January 31

- File your income tax return (Form 1040) for 2011 if you did not pay your last installment of estimated tax by January 18. Filing your return and paying any tax due by January 31 prevents any penalty for late payment of last installment.
- Make sure you have recieved a Form W-2 from each employer you worked for in 2011.

Second Quarter

March 30

- Comply with required minimum distribution (RMD) rules for qualified retirement plans if you attained age 70½ in the previous year.

April 17

- File individual and gift tax returns (or apply for an extension). If you want an automatic six-month extension of time to file the return, file Form 4868; or, you can get an extension (until October 15) by phone or over the Internet if you pay part or all of your estimate of income tax due with a credit card.
- File Schedule H (Form 1040) with your tax return if you paid cash wages of $1,700 or more in 2011 to a household employee.
- Report federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2010 or 2011 to household employees.
- Pay first-quarter estimated tax if you are not paying your 2012 income tax through withholding or you will not pay enough that way.
- Make prior-year IRA and Coverdell Education Savings Account contributions.
- Make prior-year Keogh or SEP plan contribution (unless you applied for an extension of time to file your return).
- Make quarterly defined-benefit Keogh contribution for the current year.

June 15

- Pay second-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Third Quarter

July 16

- Make quarterly defined-benefit Keogh contribution for the current year.

September 17

- Pay third-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Fourth Quarter

General

Begin your year-end tax planning:

- Project your current year and next year tax liabilities.
- Evaluate the applicability of the AMT and other taxes.
- Adjust withholding, if necessary.
- Evaluate year-end capital transactions.
- Establish a separate Keogh plan for self-employment income.
- Comply with minimum distribution rules for qualified plans.

October 15

- If you extended your individual tax return, file your 2011 income tax return and pay any tax, interest and penalties due.
- Make quarterly defined-benefit Keogh contribution for the current year.

December 31

- Comply with required minimum distribution (RMD) rules for qualified retirement plans. Can delay if obtained age 70½ during 2012.

Throughout the Year

- Re-evaluate your long-term strategies.
- Evaluate your tax and financial strategy for receiving discretionary and mandatory retirement plan distributions.
- Rebalance investment portfolio and re-evaluate your uses of debt.
- Consider making gifts up to the annual gift tax exclusion.
- Evaluate passive loss exposure and potential investment shifts.
- If you have excess cash flow, consider how to invest those funds.
- Optimize mix of interest expense items.
- Consider making charitable contributions of property.
- Consider ways to fund your children's education.
- Evaluate your mix of portfolio and passive income.

2012 Federal Legal Holidays (in the District of Columbia)

January 2—New Year's Day
January 16—Birthday of Martin Luther King Jr.
February 20—Washington's Birthday
April 16—District of Columbia Emancipation Day
May 28—Memorial Day
July 4—Independence Day
September 3—Labor Day
October 8—Columbus Day
November 12—Veterans Day
November 22—Thanksgiving Day
December 25—Christmas Day

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tax status.) Furthermore, you should be aware that unusual combinations of income and deductions might require AMT planning that runs contrary to conventional tax-planning advice.

Although the exercise of an incentive stock option (ISO) does not give rise to regular taxable income for the employee, the difference between the exercise price and the market price of a stock must be recognized for AMT purposes for the year in which the option is exercised. Accordingly, the exercise of incentive stock options with a large bargain element often causes a tax liability under the alternative minimum tax regime.

The AMT arena is extremely complex, so generalizations are difficult to make. If you think you may be subject to the alternative minimum tax you should consult with a tax professional to determine how to minimize your exposure.

Year-End Estate and Gift Tax Planning

Year-end planning from an estate planning perspective typically involves ensuring that "annual exclusion" gifts are completed by the end of a calendar year.

Under the federal gift tax system, each donor is permitted to make non-taxable gifts of a certain amount each year to any donee. These gifts are called "annual exclusion" gifts and do not count against the donor's lifetime gifts exemption. The annual gift tax exclusion level is $13,000 for both 2011 and 2012. To the extent not used, the annual exclusion evaporates at the end of each calendar year.

Annual transfers that take advantage of this exclusion can both diminish the donor's estate tax liability and improve the lives of the recipients. These gifts can take many forms (cash, stocks, real estate, partnership interests) and can be given outright through Uniform Transfers to Minors accounts, and even through a trust—provided it contains special provisions designed to allow the gift to qualify for the annual exclusion. ▲