

The Individual Investor's Guide to Personal Tax Planning 2012—Updated

By AAI Staff

Article Highlights

- Updated to reflect changes included in the American Taxpayer Relief Act of 2012.
- Covers information on 2012 and 2013 taxes, including rates, exemptions and deductions.
- The new 0.9% additional Medicare tax and the 3.8% Net Investment Income Tax will go into effect this year.

New tax legislation was signed into law at the start of the New Year, approximately 2½ weeks after we sent our 2012 tax guide to the printer. The new law permanently extends some provisions of the prior tax law that had expired at the end of 2012 and establishes new rules for high income earners. Here, we update our tax guide to incorporate changes made in the American Taxpayer Relief Act of 2012.

The biggest change the new law brings is the ending of sunset provisions for many parts of the tax code. Originally scheduled to sunset at the end of 2010, legislation passed in 2010 extended these rules for two more years. The new act makes many, but not all, of the laws permanent, providing greater long-term clarity for taxpayers.

Income tax rates for most taxpayers will be unchanged going forward. The 10%, 15%, 25%, 28%, 33% and 35% rates would have increased if new legislation had not been passed; instead they are now permanent. A new top bracket of 39.6% has been introduced for single filers with adjusted gross income (AGI) above \$400,000 and married couples filing jointly with AGI above \$450,000.

The payroll tax cut (for Social Security) expired at the end of 2012, as was expected. Workers will pay 6.2% of earnings, up to \$113,700, in 2013. Those who are self-employed will pay payroll taxes of 12.4% on wages up to \$113,700 in 2013. This is a two percentage-point increase from the discounted rates paid in 2011 and 2012.

A patch to the alternative minimum tax (AMT) was



instated retroactively for the 2012 tax year. Starting in 2013, the patch has been made permanent, resolving a long-standing necessity for Congress to pass new legislation to prevent a greater number of taxpayers from being ensnared by the tax. The exemptions for 2012 are \$50,600 for single filers and \$78,750 for married joint filers. The exemptions rise to \$51,900 and \$80,800, respectively, in 2013. Starting in 2014, the exemptions will be indexed to inflation.

There are other changes made by the new legislation, such as a new estate tax and a return of the “Pease” limitation on itemized deductions for high income earners. This update includes all of the applicable revisions made by the new law. A summary of these changes will also be included in the March *AAII Journal*. If you have questions about how the new changes impact you, contact a tax professional.

Keep in mind that further changes could occur as a result of the ongoing negotiations to reduce the debt or if an earnest effort to revise and simplify the tax code begins. Regardless of what changes Congress makes (or does not

A special note of thanks goes out to Mark Luscombe, a principal federal tax analyst at tax authority CCH (www.CCHGroup.com), a Wolters Kluwer business, for answering detailed questions about the current and prospective rules. “J.K. Lasser’s Your Income Tax 2013” (John Wiley & Sons, 2012) was extremely helpful in creating this year’s guide, and we wish to thank J.K. Lasser contributing editor Barbara Weltman for her assistance in answering questions.

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

	2012	2013	2014
Long-Term Capital Gains Rate			
Tax Bracket Equals 39.6%*	na	20%	20%
Tax Brackets 25%-35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Qualified Dividends Rate			
Tax Bracket Equals 39.6%*	na	20%	20%
Tax Brackets 25%-35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Marginal Income Tax Rates			
Top Bracket	na	39.6%	39.6%
Sixth Bracket	35%	35%	35%
Fifth Bracket	33%	33%	33%
Fourth Bracket	28%	28%	28%
Third Bracket	25%	25%	25%
Second Bracket	15%	15%	15%
First Bracket	10%	10%	10%
Child Tax Credit	\$1,000	\$1,000	\$1,000
Marriage Penalty Relief			
Standard Deduction (% of S.D. for singles)	200%	200%	200%
15% Tax Bracket (% of bracket for singles)	200%	200%	200%
Personal Exemption Phase-outs	repealed	\$300,000	\$300,000**
Limitation on Itemized Deductions	repealed	\$300,000	\$300,000**
AMT Exemption			
Single	\$50,600	\$51,900	\$51,900**
Married Filing Joint	\$78,750	\$80,800	\$80,800**
Head of Household	\$50,600	\$51,900	\$51,900**
Estate Tax			
Exemption	\$5.12 million	\$5.25 million	\$5.25million**
Maximum Rate	35%	40%	40%

na = not available or applicable.

*Additional 3.8% Net Investment Income Tax (NIIT) applies when AGI is above \$250,000/\$200,000.

**To be indexed for inflation.

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 AAIL 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.

Estimate Your Taxes on AAIL.com

We are carrying over a new feature from last year: the ability to estimate your 2012 and 2013 tax liability on AAIL.com. Our Tax Forecasting Worksheet allows you to enter your data on 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 AAIL.com. See the inside front cover of this issue, opposite the Table of Contents, for more details.) We updated the document to account for any applicable changes resulting from new legislation.

What's New?

The federal income tax rates stay unchanged in 2012 at 10%, 15%, 25%, 28%, 33% and 35%. The new 2013 legislation maintains these rates for most taxpayers, but adds a new upper bracket for higher income earners. A 39.6% bracket will apply to taxable income above \$400,000 for single filers and \$450,000 for married couples filing joint returns.

Payroll taxes (for Social Security) paid by employees are reduced by two percentage points for 2012. This cut also applied to those who are self-employed. The reduction is limited to the first \$110,100 in salary, capping the value of the cut at \$2,202. Those who earned less than \$110,100 can only keep an extra 2% of their salary. In other words, a worker who earned \$50,000 per year was eligible to receive an extra \$1,000. Taxpayers who were not employed were not eligible to take advantage of this tax break.

The payroll tax cut expired at the end of 2012. Effective January 1, 2013,

Cost Basis Now Reported for Stocks, Bonds, Funds and Options

The cost basis and the proceeds from mutual fund, exchange-traded fund (ETF) and dividend reinvestment plan (DRP) shares purchased after January 1, 2012, will be reported by your mutual fund family or broker. Brokers are also required to track and report the cost basis for all options and bonds purchased after January 1, 2013. Brokers have previously been required to report cost basis for stocks purchased after January 1, 2011. The rule does not apply to securities and funds purchased before those dates.

This is a change from what brokers had historically reported. Previously, only proceeds were listed on Form 1099-B. On January 1, 2011, a three-year rolling period began for brokers to also list the cost basis and state whether the gain or loss is short term or long term. The rule applies to all brokers, including online and full-service brokers.

The change was 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) is used when the purchase of securities (other than a mutual fund or DRP shares) 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).

For mutual funds and DRP stocks, the adjusted basis

must be reported in accordance with the broker’s default method, unless you specify otherwise. You can specify average cost basis instead of FIFO. As the name implies, the average purchase price for your shares, regardless of when they are acquired, is used to determine the cost basis. Another option is specific identification. The specific identification method allows you to choose the specific shares that are sold. This treatment can also result in a larger or a smaller tax bill depending on how the fund has performed relative to the purchase price of the selected shares. You may be able to use other methods such as highest-in, first-out (HIFO) or last-in, first-out (LIFO). Contact your broker, fund family or DRP program to determine what their default methodology is and what choices you have for selecting methodologies.

If you want your broker or fund family to use a specific methodology other than their default methodology (e.g., FIFO for stocks or average cost for mutual funds), you must notify them. 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 Thornton’s National Tax Office emphasized the importance of providing these instructions in writing. If you give your broker or fund family specific instructions and they report 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 payroll tax has reverted to its full rate of 6.2% of employee wages.

A permanent patch to the alternative minimum tax (AMT) has been written into law. The 2012 exemptions were raised to \$50,600 for single filers and \$78,750 for married couples filing jointly. In 2013, these amounts rise to \$51,900 for single filers and \$80,800 for married couples filing jointly. The exemptions are indexed to the rate of inflation and will be raised accordingly in the future. This automatic increase is important because previously the AMT exemption was not indexed to inflation. New legislation had to be passed to prevent the AMT from ensnaring an ever larger number of taxpayers.

The repeal of the phase-out for the personal exemption was extended through 2012. The phase-out returns in 2013, but at higher levels than in the past. The personal exemption phases out at income levels of \$250,000 for single filers and \$300,000 for married couples filing jointly. According to tax authority CCH, the total amount of exemptions that can be claimed by a taxpayer is reduced by 2% for each \$2,500 or portion thereof by which adjusted gross income exceeds the threshold level. Married couples filing separate returns will see their exemptions reduced by 2% for each \$1,250 of adjusted gross income.

Families benefited from three tax breaks in 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 \$11,900 and single filers can claim a standard deduction of \$5,950 on their 2012 tax returns. In 2013, those amounts will increase by \$300 and \$150, respectively.

The \$1,000 maximum child tax credit was maintained in 2012 and has been extended. The credit was phased out for married couples filing jointly with modified adjusted gross income (MAGI) above \$110,000 in 2012 (www.irs.gov/uac/The-Child-Tax-Credit-11-Key-Points). If the child tax credit

Health Care Reform's Impact on Taxes

Tax code changes included in the 2010 Patient Protection and Affordable Care Act went into effect on January 1, 2013. These changes include two new taxes, the amount of medical expenses that can be deducted and how much can be contributed to a flexible savings account.

The first of the new taxes is the 0.9% Additional Medicare Tax. This levy will apply to wages, compensation and self-employment income above \$250,000 for married persons filing jointly and qualifying widows(ers), \$200,000 for single persons and head of households and \$125,000 for those who are married but filing separately. The tax applies to wages that are subject to the Medicare Tax and does not depend on adjusted gross income. Should the additional tax not be withheld from wages (a situation that could occur for dual-income couples or individuals working more than one job), the tax could be subject to a penalty if not paid with estimated taxes or through additional withholdings (you can request that your employer increase the income tax withholding on your W-4). More information about the Additional Medicare Tax can be found on the IRS' website at www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax.

The second new tax is the 3.8% Net Investment Income Tax (NIIT) on net investment income. This applies to the lesser of net investment income or modified

adjusted gross income exceeding \$250,000 for married persons filing jointly and qualifying widows(ers), \$200,000 for single persons and head of households and \$125,000 for those who are married but filing separately. (These thresholds are not indexed for inflation.) Investment income subject to the tax includes, but is not limited to, taxable interest, dividends, non-qualified annuities, rents and royalties, capital gains and passive income from partnerships. Capital gains from the sale of one's primary residence is subject to the tax to the extent the income exceeds the applicable home sale exclusion (\$500,000 for joint filers and \$250,000 for single filers). Excluded from the new tax are tax-exempt interest (e.g., municipal bond interest payments), distributions from individual retirement accounts (IRAs) and distributions from qualified retirement plans (e.g. 401(k) plans). The IRS has answers to common NIIT questions at www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs.

Uninsured medical expenses must exceed 10% of adjusted gross income before they can be claimed as a deduction in 2013. This is an increase from the 7.5% floor that existed in 2012. Individuals age 65 and older continue to qualify for the lower 7.5% floor, however.

Flexible savings arrangement contributions are now limited to \$2,500 annually. This limit will be adjusted for inflation starting in 2014. Previously, the maximum contribution was set by employers.

exceeds the tax liability, the difference will be paid to the taxpayer subject to certain requirements.

The estate tax exemption is now indexed to inflation. The exemption rose to \$5.12 million in 2012 and will rise to \$5.25 million in 2013. Effective in 2013, a new, higher tax rate of 40% goes into effect.

Capital gains and dividend taxes stay at 2010 levels in 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; the article is available at AAII.com.) Collectibles,

which include gold coins and bars, are taxed at a 28% rate. Short-term capital gains are taxed as ordinary income. If you are in the 10% or 15% tax bracket, long-term capital gains and qualified dividends are not taxed. In 2013 and beyond, capital gains and dividend tax rates will stay unchanged for most taxpayers. Single filers with incomes above \$400,000 and married couples filing jointly with incomes above \$450,000 will pay a 20% tax on long-term capital gains and dividends. Single filers with net investment income or modified adjusted gross incomes above \$200,000 and married couples filing joint returns with net investment income or modified adjusted gross incomes above \$250,000 will also pay a new, additional 3.8% tax on capital gains and dividends. Collectibles, which include gold coins and bars, are taxed at a 28% rate, but are eligible for the new

3.8% additional tax as well.

New Health Care Reform Taxes

Two new taxes stemming from health care reform went into effect on January 1, 2013. The first is a 0.9% Medicare tax on wages, compensation and self-employment income above \$250,000 for married persons filing jointly and \$200,000 for single persons. The second is a 3.8% levy on net investment income that applies to married couples filing jointly and single filers with net investment income or modified adjusted gross income exceeding \$250,000 and \$200,000, respectively. More information about the new taxes can be found in the box on this page.

Estate Tax

The first \$5.12 million of an estate is excluded from taxes for those who

passed in 2012. This is 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 \$10.24 million in 2012. The large figures will prevent most families from having to pay estate taxes.

The step-up basis rule remains in effect for 2012 and beyond. If an inherited asset was 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.

As previously stated, the estate tax exemption will rise to \$5.25 million and the tax rate will rise from 35% to 40% in 2013. The step-up basis remains in effect.

Change in Capital Gains Reporting

Effective January 1, 2012, brokers and mutual fund companies were required to report the cost basis for mutual fund, exchange-traded fund (ETF) and dividend reinvestment program (DRP) shares bought and sold by their clients after January 1, 2012. This is a change from previous years, when brokers and mutual fund companies only reported the proceeds from a sale. This was the second part of a rule that went into effect in 2011 and required brokers to report the cost basis for stocks sold by their clients and bought during 2011 or later. Similar requirements for options and bonds just went into effect on January 1, 2013, for options and bonds purchased after January 1, 2013.

If you sold a capital asset in 2012, you will need to fill out Form 8949. See the special write-up in the “Cost Basis” box on page 6 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 2012 and 2013 on Form 1040.

Tax Software, Books and Guides

Although the tax rates, deductions and exemptions for 2012 are mostly

known, if you use a software program (e.g., TurboTax), book (e.g., “J.K. Lasser’s Your Income Tax 2013”) or a 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 2013 as well, if you intend to plan for this year. Since the new legislation was not passed until the start of January 2013, the first versions of the aids will likely 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 2012 and 2013 taxes. These numbers have been updated to include changes made by the American Taxpayer Relief Act of 2012. (This new law was passed after this guide’s original publication.)

Standard Deduction

For 2012, the standard deduction is \$11,900 for married couples filing a joint return, \$5,950 for those who are single or those who are married filing separate returns and \$8,700 for heads of household.

For 2013, the standard deduction will be \$12,200 for married individuals filing a joint return, \$6,100 for singles and married individuals filing separate returns, and \$8,950 for heads of household.

Personal Exemptions

The 2012 personal exemption is \$3,800. 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.

The personal exemption will rise

For a complete tax guide to the buying and selling of your personal investments, go to our Personal Investments 2012 Tax Guide in the online version of this article.

to \$3,900 in 2013. The exemption will start to phase out at \$300,000 for married couples filing jointly and \$250,000 for single filers.

Individual Retirement Accounts and 401(k) Plans

The maximum allowed IRA contribution is unchanged in 2012 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 \$92,000 for joint returns and below \$58,000 for single filers. In 2013, the maximum contribution amounts will increase by \$500 to \$5,500 (\$6,500 for those age 50 or older). The maximum modified AGI levels will rise to \$95,000 and \$59,000 for married filing joint and single returns, respectively.

In 2012, the maximum annual contribution limit for 401(k)s is \$17,000 (\$22,500 if you are age 50 or over); in 2013, those amounts will rise to \$17,500 and \$23,000 respectively.

In 2012, 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 2013, the maximum contribution will rise to \$12,000.

Qualified Plan Contributions

In 2012, the maximum annual contribution for qualified plans, including SEP and Keogh plans, is \$50,000 or 25% of your compensation, whichever is less; in 2013, the maximum contribution will be \$51,000 or 25% of your compensation, whichever is less.

Estate and Gift Tax Limits

The 2010 revisions to the estate tax law established a \$5.12 million exemption in 2012. This exemption was portable. The exemption is indexed to inflation and will rise to \$5.25 million in 2013. 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 2012 and \$26,000 for consenting couples. (You will need to file Form 709.) The exclusions rise to \$14,000 and \$28,000 in 2013.

Required Minimum Distributions (RMDs)

Individuals age 70½ and older were required to take a distribution from their retirement accounts by December 31, 2012. These accounts included 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 were also required to take a required minimum distribution (RMD) in 2012 if you were 70½ or older during the calendar year.

If you turned 70½ in 2012, you have until April 1, 2013, to take your first RMD. You will need to take a second RMD during 2013 to satisfy that year's distribution requirement.

According to the IRS, "Generally, an 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 2012 and 2013, the maximum child tax credit for dependent children younger than 17 is \$1,000.

Kiddie Tax

In 2012, the "kiddie tax" applied 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 2012, the kiddie tax applies if the child is age 17 or younger by the end of the year and the child's total investment income for the year is more than \$1,900. In 2013, the kiddie tax will apply if the child's total investment income exceeds \$2,000.

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.

The American Taxpayer Relief Act of 2012 extends a provision that allows those age 70½ or older to distribute up to \$100,000 from their traditional individual retirement account (IRA) tax-free to qualified charities for both the 2012 and 2013 tax years. (You have until January 31, 2013, to make a charitable distribution from your IRA for 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. In 2013, a new, higher 10% floor for deducting medical expenses has been instituted for those under the age of 65. Those age 65 and older can still deduct uninsured medical expenses above 7.5% of their adjusted gross income.

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 2012, allowing the full benefit of itemized deductions to be applied. The phase-out returns in 2013 for both single and married filing jointly taxpayers with incomes of \$250,000 and \$300,000, respectively, or higher.

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 (AMT).

Sales Tax Deduction

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 both 2012 and 2013.

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.

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 maximum American Opportunity education credit was \$2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books). This credit has been extended and can be claimed in both 2012 and 2013.

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.

For 2012 and beyond, the contribution limit to a Coverdell Education Savings Account stays at \$2,000 per beneficiary. 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: 2013 and Beyond

The fiscal cliff was just the latest event to make long-term tax planning difficult. It was merely two years ago that a temporary, last-minute deal was

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

required to extend the Bush-era tax cuts. With a long-term debt reduction plan needed and an economy that is still growing at a slow pace, it is likely that more tax law changes will be made.

Though we cannot predict what the politicians in Washington will do, or when they will do it, there are strategies that make sense regardless of the legislative environment. Listed below are traditional tax planning strategies that can help keep your tax bill down. 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.

While the benefits of a Roth IRA conversion could be considerable, taxpayers must carefully weigh the upfront 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* (both available at AAII.com). Though the articles discuss the one-time, 2010 option for delaying the taxes from the conversion, their suggestions regarding whether to convert or not continue to be applicable. You may also want to consult a tax adviser for the best strategy. (Note that if you converted to a Roth IRA in 2010 and chose to spread the tax payments over two years, the second-half of the liability is due with your 2012 taxes.)

You cannot convert required minimum distributions (RMDs) from your traditional IRA for a particular year (including the calendar year in which you reach age 70½) to a Roth IRA. IRS publication 590 explains the rules for RMDs and Roth IRA conversions.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gain tax rates of 0% or 15%. For single filers with income above \$400,000 and married couples filing jointly with income above \$450,000, long-term capital gains rates rise to 20% in 2013. Short-term capital gains, in contrast are taxed at ordinary income tax rates, which run as high as 39.6% in 2013. The new 3.8% Net Investment Income Tax (NIIT), which went into effect on January 1,

2013, applies to taxpayers with income above the \$200,000/\$250,000 threshold in 2013. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, non-qualified annuities, rents and royalties, and passive income from partnerships.

Similar rules apply to qualified dividends. For single filers with income above \$400,000 and married couples filing jointly with income above \$450,000, dividends will be taxed at 20% in 2013.

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 whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use 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* (available at AAIL.com).

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 an IRA or Roth IRA, however.

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, as long as you notify the fund family or your broker in writing with specific instructions. 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 19.6% of your gain (39.6% ordinary rate for short-term capital gains versus the 20% long-term capital gains rate).

Some mutual fund dividends can be treated as qualified dividends and eligible for the reduced tax rate (if legislation to extend it is passed), while others will not qualify. Dividends paid by stocks held by the fund and passed through to the shareholder are eligible for the qualified dividend tax treatment. However, capital distributions and bond interest are not. These payments are reported on Form 1099, which specifies the type of distribution.

More on mutual fund distributions can be found at AAIL.com in the online version of this article.

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 to find out 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 15, 2013, to make an IRA contribution for the 2012 tax year.

The payroll tax cut was not extended into 2013. Workers will resume paying a 6.2% Social Security levy on earnings. This tax will apply to earnings up to \$113,700.

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 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, current cash flow needs, and the new 0.9% Additional Medicare Tax and 3.8% NIIT 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. 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 2012

and 2013 using the Tax Forecasting Worksheet (page 17 and on AAIL.com in a fillable PDF; the worksheets have been updated to reflect the new tax law);

- Identify items that you can shift from 2013 into 2014 and beyond (or vice versa);
- Determine your marginal tax rate—the rate at which your next dollar of income will be taxed—for 2013 and 2014;
- 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 17 (and fillable PDF on AAIL.com) will provide a starting point for evaluating the tax effects of various strategies.

Avoiding Tax Underpayment Penalties

Make sure you determine your 2013 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 gov-

ernment. 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 2012 and 2013); 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

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

If you are expecting a refund on your 2012 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 "Refunds" 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.

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. 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 pay a deductible expense in December 2013 instead of April 2014, you reduce your 2013 tax instead of your 2014 tax, but you also lose 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 2014 estimated taxes based on their 2013 tax liability, reducing your 2013 taxes has another advantage: Your 2014 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 2013, rather than waiting until 2014. This secures that deduction on your 2013 tax return, even though the payment might not be required by the state until January 15, 2014, or April 15, 2014.

Charitable Contributions

If you are planning on making a gift to a charity in 2014, consider making the gift in 2013 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

(continued on page 22)

2012 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income		The Tax Is	
Over (\$)	But Not Over (\$)		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		The Tax Is	
Over (\$)	But Not Over (\$)		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		The Tax Is	
Over (\$)	But Not Over (\$)		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		The Tax Is	
Over (\$)	But Not Over (\$)		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 age 17 at the end of the year

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

*IRA contributions cannot exceed earned income.

2012 Other Tax Items

2012 Social Security Tax Rates

	Employers & Employees	Self- Employed	Wage Limits
Social Security	4.20% *	10.40%	\$110,100
Medicare	1.45%	2.90%	no limit
Total	5.65%	13.30%	

*Applies only to employees for the 2012 calendar year. Employers pay a 6.20% tax.

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 casualties or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

2012 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through withholding 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	\$50,600
Married, Filing Joint	\$78,750
Married, Filing Separate	\$39,375
Head of Household	\$50,600

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.

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.

Go to [www.aaii.com/files/PDF/Tax Guide 2012/page17.pdf](http://www.aaii.com/files/PDF/Tax%20Guide%202012/page17.pdf) for an online worksheet that calculates the math for you.

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)

2012**2013**

_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
\$ _____	\$ _____

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; 10% in 2013, unless age 65 or older) or self-employed health insurance
16. State and local income taxes (or sales taxes)^b
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)^c
- 24. Personal exemptions** (\$3,800 in 2012; \$3,900 in 2013)^c
- 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^d
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 option to deduct state and local sales taxes will expire at the end of 2013, without new legislation to extend it.
- c. The standard deduction and personal exemptions are not allowed when calculating the alternative minimum tax.
- d. Use IRS Form 6251 as a worksheet and review the discussion on AMT on page 12.

2013 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income		The Tax Is	
Over (\$)	But Not Over (\$)		Of the Amount Over
0	8,925	\$0 + 10%	\$0
8,925	36,250	\$892.50 + 15%	\$8,925
36,250	87,850	\$4,991.25 + 25%	\$36,250
87,850	183,250	\$17,891.25 + 28%	\$87,850
183,250	398,350	\$44,603.25 + 33%	\$183,250
398,350	400,000	\$115,586.25 + 35%	\$398,350
400,000	—	\$116,163.75 + 39.6%	\$400,000

For Married Taxpayers Filing Joint Returns

Taxable Income		The Tax Is	
Over (\$)	But Not Over (\$)		Of the Amount Over
0	17,850	0 + 10%	\$0
17,850	72,500	\$1,785 + 15%	\$17,850
72,500	146,400	\$9,982.50 + 25%	\$72,500
146,400	223,050	\$28,457.50 + 28%	\$146,400
223,050	398,350	\$49,919.50 + 33%	\$223,050
398,350	450,000	\$107,768.50 + 35%	\$398,350
450,000	—	\$125,846.00 + 39.6%	\$450,000

For Married Taxpayers Filing Separate Returns

Taxable Income		The Tax Is	
Over (\$)	But Not Over (\$)		Of the Amount Over
0	8,925	0 + 10%	\$0
8,925	36,250	\$892.50 + 15%	\$8,925
36,250	73,200	\$4,991.25 + 25%	\$36,250
73,200	111,525	\$14,228.75 + 28%	\$73,200
111,525	199,175	\$24,959.75 + 33%	\$111,525
199,175	225,000	\$53,884.25 + 35%	\$199,175
225,000	—	\$62,923.00 + 39.6%	\$225,000

For Individuals Filing as Head of Household

Taxable Income		The Tax Is	
Over (\$)	But Not Over (\$)		Of the Amount Over
0	12,750	0 + 10%	\$0
12,750	48,600	1,275 + 15%	\$12,750
48,600	125,450	\$6,652.50 + 25%	\$48,600
125,450	203,150	\$25,865.00 + 28%	\$125,450
203,150	398,350	\$47,621.00 + 33%	\$203,150
398,350	425,000	\$112,037.00 + 35%	\$398,350
425,000	—	\$121,364.50 + 39.6%	\$425,000

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers in the 25% to 35% Brackets*	Taxpayers in the 39.6% Bracket*
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0	15	20
Qualified Dividends	0	15	20
Collectibles***	28 maximum	28 maximum	28
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum	25 maximum

*May also be subject to the 3.8% Net Investment Income Tax (NIIT).

**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 \$1,000	0%
Next \$1,000	child's rate
Over \$2,000	parent's rate

2013 Allowable Tax Benefits

Standard Deduction

Under Age 65

Married, Filing Joint	\$12,200
Single	\$6,100
Married, Filing Separate	\$6,100
Head of Household	\$8,950

Additional—Age 65 or Older

Married (or Qualifying Widow)	\$1,200
Single	\$1,500

Additional—Blind

Married (or Qualifying Widow)	\$1,200
Single	\$1,500

Personal Exemption

\$3,900

Maximum Child Tax Credit

\$1,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	56.5 cents
Medical Standard Mileage Rate	24.0 cents
Moving Standard Mileage Rate	24.0 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	\$5,500
If 50 or older	\$6,500

Maximum 401(k) Employee Contribution

If younger than 50	\$17,500
If 50 or older	\$23,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

\$14,000

Estate Tax Exclusion

\$5.25 million

2013 Other Tax Items

2013 Social Security Tax Rates

	Employers & Employees	Self- Employed	Wage Limits
Social Security	6.20%	12.40%	\$113,700
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2013 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (7.5% if age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualties or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

2013 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through withholding 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

2013 AMT Exemption Amount

Single	\$51,900
Married, Filing Joint	\$80,800
Married, Filing Separate	\$40,400
Head of Household	\$51,900

2013 Tax Benefit Phase-Out Levels

Personal Exemption

	AGI Phase-Out Level
Married, Filing Joint	\$300,000
Single	\$250,000
Married, Filing Separate	\$150,000
Head of Household	\$275,000

Itemized Deduction ("Pease" Limitation)

	AGI Phase-Out Level
Married, Filing Joint	\$300,000
Single	\$250,000
Married, Filing Separate	\$150,000
Head of Household	\$275,000

IRA Deductibility

For those covered by employer retirement plan [\$5,500 maximum contribution per taxpayer; if 50 or older, maximum is \$6,500]

	Modified AGI* Phase-Out Level
Married, Filing Joint	\$95,000
Single	\$59,000
Married, Filing Separate	\$0**
Head of Household	\$59,000
Married, Filing Joint not covered by pension plan, but spouse is	\$178,000

Roth IRA Eligibility

Maximum \$5,500 non-deductible contribution; if 50 or older, maximum is \$6,500

	Modified AGI* Phase-Out Level
Married, Filing Joint	\$178,000
Single	\$112,000
Married, Filing Separate	\$0
Head of Household	\$112,000

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.

**\$59,000 if strict criteria are met.

2013 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 15

- Pay fourth-quarter 2012 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 2012 return and pay any tax due by January 31, 2013.
- Make quarterly defined-benefit Keogh contribution for preceding year.

January 31

- File your income tax return (Form 1040) for 2012 if you did not pay your last installment of estimated tax by January 15. Filing your return and paying any tax due by January 31 prevents any penalty for late payment of last installment.
- Make sure you have received a Form W-2 from each employer you worked for in 2012.

Second Quarter

April 1

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

April 15

- 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 \$1,800 or more in 2012 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 2011 or 2012 to household employees.
- Pay first-quarter estimated tax if you are not paying your 2013 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 17

- 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 15

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

September 16

- 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 2012 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 2013.

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.

2013 Federal Legal Holidays (in the District of Columbia)

January 1—New Year's Day

January 21—Birthday of Martin Luther King Jr. and
Inauguration Day

February 18—Washington's Birthday

May 27—Memorial Day

July 4—Independence Day

September 2—Labor Day

October 14—Columbus Day

November 11—Veterans Day

November 28—Thanksgiving Day

December 25—Christmas Day

(continued from page 13)

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 of the gift in order to properly sup-

port 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 10% of adjusted gross income starting in 2013 (7.5% for those age 65 and older), 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 10% 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.

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 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 was \$13,000 for 2012 and is \$14,000 for 2013. 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. ▲