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Easing Tax, Financial & Realty Solutions

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Dear Valued Client:

America is on the verge of the largest tax increase in 19 years – an event commonly referred to as Taxmageddon or the fiscal cliff by the media. Unless Congress takes action, several major tax changes are set to take place at year-end, therefore, it is especially important to understand how these changes may affect you. By being informed and prepared to act as events unfold, we can help you plan to minimize your 2012 and 2013 tax liability. We will work more diligently than ever to minimize your tax bill to the maximum extent allowable by law. Below are some of the most important expected tax changes, as well as other tax laws to note:

Income Tax Rates: After 2012, the lowest individual income tax rate will jump up from 10% to 15%, and the highest tax rate will go up from 35% to 39.6%.

Alternative Minimum Tax: In 2012, the AMT exemption is reduced from $74,450 to $45,000 for joint filers; from $48,450 to $33,750 for single and head of household filers; and from $37,225 to $22,500 if married filing separate.

3.8% Medicare Surtax: In 2013, this new surtax will apply to certain passive investment income of high tax bracket individuals, trusts and estates.

Employee Social Security Tax: In 2012, 4.2% social security tax was withheld from employees' paychecks. In 2013, this goes up to 6.2%.

Medicare Hospital Insurance (HI) Tax: An additional 0.9% HI tax will apply to self-employed earnings or wages received in excess of $200,000 for single filers; $250,000 if filing joint; and $125,000 if married filing separate.

Capital Gains and Dividends: The existing lower capital gains rates will expire. Beginning 2013, the top capital gains rate will be 20% and dividends will be taxed as ordinary income.

Itemized Deductions: The state and local general sales taxes deduction will not be available starting tax year 2012. And in 2013, higher-income taxpayers' total itemized deductions will be subject to reduction. Further, the threshold for claiming medical expenses increases from 7.5% to 10% of the taxpayer's adjusted gross income (AGI).

Personal Exemption: The personal exemptions, currently at $3,800 per exemption, will be phased out when AGI exceeds certain thresholds, starting at $267,200 for joint filers and $178,150 for single filers.

Education Tax Credits: The *American Opportunity Tax Credit*, available for expenses in the first 4 years of post-secondary education, is scheduled to expire after 2012. Eligible taxpayers may want to front-load paying 2013 education expenses before 2012 ends.

Student Loan Interest Deduction: In 2013, this deduction applies only to interest paid during the first 60 months in which interest payments are required.

Child Tax credit: Effective 2013, the maximum credit will decrease from $1,000 to $500 per child.

Child and Dependent Care Tax Credit: In 2013, allowable care expenses will be reduced to a maximum of $2,400 for one child and $4,800 for two or more dependents. The credit will be between 20% and 30% of those amounts.

Mortgage Interest: Mortgage interest on a principal or second home is deductible only if the indebtedness does not exceed $1.1 million ($550,000 if married filing separate) and proceeds were used to buy, build or substantially improve said home(s). If the indebtedness exceeds these limits, phase-out calculations may apply.

Section 179 Deduction and Bonus Depreciation: The 50% bonus depreciation expires at the end of 2012. Also, for Section 179 assets, the maximum allowable expense will decrease from $139,000 to $25,000 and the investment ceiling will be down from $560,000 to $200,000. Business owners should consider acquiring in 2012 before these tax changes take effect.

Exclusion of Cancellation of Debt Income: Exclusion in connection with debt forgiveness due to foreclosure of a principal residence is set to expire at the end of 2012.

Foreign Accounts: For taxpayers with overseas financial accounts valued at more than US$10,000 at any time during the year, or a foreign business ownership, or any foreign income-generating property, special reporting requirements apply.

Small Business Health Care (Federal) Tax Credit: A nonrefundable credit is available to employers that provide health care coverage to employees beginning 2010. Credit is up to 35% (50% starting 2014) of qualified premium expenses.

Estate and Gift Tax: Effective 2013, estates worth more than $1 million will be taxed at 55%. That tax rate also applies to applicable gift taxes**. Tip:** You may gift up to $13,000 ($14,000 in 2013) to any individual, and to as many individuals as you wish, every year without any tax liability or tax filing requirement (exceptions may apply).

Required Minimum Distributions: If you turned 70½ this year and you expect to be subject to higher taxes in 2013, it may make sense to take your initial required minimum distribution by December 31 instead of waiting until April 2013.

Retirement Contributions: Maximize your *Traditional* or *Roth IRA* contributions. In 2012, the maximum contribution is the smaller of $5,000 ($6,000 if at least 50 years old) or the amount of your 2012 taxable compensation. Contributions must be made by the due date of your return, which for most taxpayers is April 15, 2013. *Employer-sponsored plans* such as SIMPLE IRA need to be setup by October 1 and funded by December 31, 2012 in order to be deductible for tax year 2012. Qualified plans such as 401(k) and profit sharing plans need to be set up by December 31, 2012. The maximum *401K* contribution for 2012 is $17,000 ($22,500 if at least 50 years old). A Keogh plan must be set up by December 31, while a SEP must be set up by the due date of filing the federal tax return, including extensions.

Roth IRA Conversions: Roth conversions provide future-year tax breaks. Unlike traditional IRAs, withdrawals from Roth accounts are not mandatory. When you do choose to take them, they are not subject to the new 3.8% Medicare surtax, nor are they included in figuring the taxable amount of your social security benefits. Talk to us before you convert. All conversions for 2012 must be completed by December 31, 2012.

If you expect to be subjected to higher tax rates in 2013, here are some specific steps that you should consider before the year ends.

1. Accelerate income into 2012. Common methods include: take bonuses before January 2013; sell outstanding installment contracts and appreciated assets; redeem U.S. Savings Bonds; declare special dividends; complete Roth IRA conversion; accelerate debt forgiveness income; maximize retirement distributions; accelerate billing and collections; avoid mandatory like-kind exchange treatment; and take corporate liquidation distributions in 2012.
2. Defer itemized deductions to 2013 if possible. For example, pay the last state estimated tax installment in 2013 and make charitable contributions in 2013.
3. As income tax rates are set to increase effective 2013, review your paycheck's tax withholding early next year to determine any underpayment. Timely detection will allow you to catch up on deficient withholdings and avoid interest and penalties.

4. Harvest capital *losses* in 2013 instead of 2012. If you have losing stocks, you may want to sell them after year-end and harvest the losses to offset investment gains, plus shield up to $3,000 of ordinary income from taxes. But do not buy stocks substantially identical to the ones you sold within 30 days before or after the sale to avoid the "wash sales" rules.
5. Harvest capital *gains* in 2012. A taxpayer can sell stocks in which there is a gain in 2012, lock in the lower capital gains rate and, if desired, repurchase the same stock immediately. There is no “wash sale rule” for gains. If you wait until 2013 to sell, higher capital gains rate will apply.
6. Reconsider how your business entity is structured. For example, an S corporation may be more tax efficient in some cases.
7. Consider investments such as depreciable real estate where the depreciation deduction may offset a portion of the rental income, or investments focused more on growth than current income.
8. Consider the use of a like-kind exchange to defer reporting of a gain on the sale of investment property.
9. If you need to withdraw from your IRAs and other qualified retirement plans, consider doing so in 2012 instead of 2013, so long as it will not be subject to the premature withdrawal penalties.

Please note that the information above is not meant, and should not be relied on, as advice for any person's specific tax situation. Each item above is a very condensed version of the rules, and details have been omitted for brevity. There are literally hundreds of other changes, extensions and deletions to be considered for tax planning.

Also, note that effective January 1, 2013, we will be operating under a corporate legal entity. Our new business name will be Emmanuel A Santos JD CPA, Incorporated. This change will not affect any of the services we provide.

If you have any questions regarding the above, please feel free to call or email me. Note that our office will be closed from December 25, 2012 through January 1, 2013. We wish you and your loved ones the best of the Holiday Season.

Sincerely,

Emmanuel (Noel) A. Santos, JD, CPA, EA, MST, PFS, Realtor
