

**IACOPI, LENZ AND COMPANY**  
**2011 Year End Tax Planning Opportunities**

The following tax saving ideas and the underlying reasons are based on the federal and state tax laws currently in effect, including provisions of the Patient Protection and Affordable Care (PPAC) Act, Health Care and Education Reconciliation Act (2010 Reconciliation Act), Small Business Jobs Act of 2010 (2010 Small Business Act), Hiring Incentives to Restore Employment (HIRE) Act and the Tax Relief, Unemployment Insurance, Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act).

**Highlights**

**Extension of Reduced Individual Tax Rates:** The current rate brackets (10, 15, 25, 28, 33 and 35 percent) remain unchanged for 2011 and 2012. The full repeal of the itemized deduction phase-out and the personal exemption phase-out has been extended through 2012. However, the 7.50 percent AGI medical deduction limit and the 2 percent AGI miscellaneous itemized deductions limit still apply

**AMT Relief:** Relief is provided to taxpayers facing the alternative minimum tax (AMT). The exemption amount for 2011 is \$74,450 for married filing jointly, \$37,225 for married filing separately and \$48,450 for single filers. The AMT relief for 2011 does not extend to 2012, thus it is important to plan strategically for the AMT.

**Extension of Reduced Capital Gains/Qualified Dividends Rates:** For 2011 and 2012, the maximum capital gains/qualified dividend tax rate is 15 percent. The rate is zero percent for individuals in the 10 and 15 percent tax brackets (taxable income less than \$34,500 for single, \$46,250 head of household and \$69,000 for married filing jointly taxpayers).

**Tax-Free IRA Distributions to Charity:** The exclusion for qualified charitable distributions of up to \$100,000 from IRAs is extended to distributions made in 2011. To be a qualified distribution it must be made after the IRA owner/beneficiary reaches 70½ and made directly to a qualified charity.

**Child Tax Credit:** The \$1,000 per child tax credit is extended to 2011 and 2012, and remains subject to income limits. In related developments, some enhancements to the earned income tax credit and the adoption credit are extended through 2012.

**Estate Tax:** Under the 2010 Tax Relief Act, the federal estate tax will again apply to the estates of decedents dying after December 31, 2009 and before January 1, 2013. The maximum estate tax rate is 35 percent with a \$5 million exclusion (\$10 million for married couples). Additionally, executors of estates of individuals who died in 2010 can elect out of the estate tax (Form 8939) and apply modified carryover basis rules, or can elect to have the estate tax apply. Form 8939 is due January 17, 2012, and cannot be extended. Besides the estate tax, there are provisions extending and modifying the federal gift tax and the federal generation skipping transfer (GST) tax. For gifts made in 2011 and 2012, the gift and GST lifetime exclusions are also \$5 million. The annual gift tax exclusion remains at \$13,000 for 2011 and 2012.

**Education:** A variety of tax incentives were extended through 2012 to help save for and finance education costs including: (1) American Opportunity Tax Credit; (2) higher education tuition deduction; (3) student loan interest deduction; (4) exclusion for employer-provided educational assistance; (5) enhancements to Coverdell education savings accounts; and (6) special rules for certain scholarships.

**Depreciation:** For 2011, the federal deduction limit for Section 179 property (generally nonresidential depreciable personal property used in a trade or business, but not luxury autos) placed into service during the year is \$500,000. Up to one-half of this amount may be expensed for qualified real property defined as (1) qualified leasehold improvements; (2) qualified restaurant property; and (3) qualified retail improvements. This maximum is currently scheduled to be reduced to \$139,000 in 2012 and \$25,000 in 2013 and subsequent years. The California limit remains at \$25,000.

Any new equipment or other new depreciable property with a life of 20 years or less, purchased and placed in service in 2011, qualifies for the federal 100 percent Bonus Depreciation write-off. For 2012 purchases, the rate will be reduced to 50 percent.

**More Incentives:** Other incentives extended include the state and local sales tax deduction and the \$250 expense deduction for classroom teachers. Not all of the expired temporary individual tax incentives were extended. Among the incentives not extended are the additional standard deduction for real property taxes, the \$2,400 exclusion for unemployment benefits, the first-time homebuyer tax credit, COBRA premium assistance and some others.

- The income limitation for Roth IRA conversions has been eliminated. Thus, all individual taxpayers will have the option to convert traditional, SEP and non-deductible IRA accounts to Roth IRAs but must pay income tax on the converted amounts in excess of basis. Under certain circumstances 401(k) funds may be converted to a Roth IRA. California has conformed to all of these provisions. The elimination of the income limits for Roth IRA conversions created a planning opportunity for taxpayers who do not qualify for direct Roth IRA contributions. If you are interested in funding annual Roth IRA contributions but do not qualify due to the income limits for direct contributions, contact us to discuss possible options related to non-deductible IRA contributions, including funding a non-deductible IRA for 2011 and converting it to a Roth IRA.
- The HIRE Act created two new tax benefits for employers hiring workers who were previously unemployed or only working part time. Employers who hired unemployed workers after February 3, 2010 and before January 1, 2011, may have qualified for a 6.2 percent payroll tax incentive in 2010. To be a qualified employee, the employee was required to submit Form W-11 certifying that he/she was not employed for more than 40 hours during the 60 days preceding the hire date. For each qualified worker retained for at least a year, businesses may claim an additional general business tax credit, up to \$1,000 per worker, when they file their 2011 income tax returns.
- California's New Jobs Credit provides a credit of \$3,000 for each new qualified full-time employee hired by a small business. For this purpose, a small business is one that had 20 or fewer employees on the last day of the prior year. The credit is claimed on a timely filed original income tax return by attaching Form 3527. State wages are not required to be reduced by this credit. No other state credit, such as the EZ Hiring Credit, may be claimed for the same qualifying full-time employee. There is a statewide cap on the credit and it is allocated as the returns are filed.
- If your business is located in an Enterprise Zone (EZ) or a Targeted Tax Area (TTA), you may be able to reduce your state income taxes by purchasing certain equipment for use in the EZ or TTA or by hiring new employees to work in the EZ or TTA. Portions of San Joaquin County, Modesto, Sacramento, Merced and Los Banos are located in EZ areas, and portions of Visalia and Tulare are located in Targeted Tax Areas. Check your location at [www.sjcez.org/](http://www.sjcez.org/) or contact our office for assistance.

- The California Employer Child Care Reimbursement Credit is available to sole proprietors who establish a childcare plan for the benefit of employees' children under age 12, including the sole-proprietor's children.
- Often overlooked is Section 199 Domestic Production Activities Deduction (DPAD). The deduction is targeted to U.S. taxpayers engaged in manufacturing activities but also applies to other production activities, construction and farming. Generally, the maximum Section 199 deduction is equal to a percentage of the lesser of either the taxpayer's Qualified Production Activities Income (QPAI) or taxable income. The maximum deduction for 2011 is 9 percent of qualified production income. The deduction is, however, limited to 50 percent of the W-2 wages actually paid to employees and reported by the employer. Consider increasing your wages paid before year end if it will increase your DPAD.

### Itemized Deductions

For 2011, the standard deduction for married-filing-jointly is \$11,600, head of household is \$8,500 and single is \$5,800. It will be advantageous to itemize your deductions if they will exceed the standard deduction amount.

For 2011, and 2012, your total itemized deductions will not be subject to a limitation based on your Adjusted Gross Income (AGI). However, the 7.50 percent AGI medical deduction limit and the 2 percent AGI miscellaneous itemized deductions limit still apply.

- **Mortgage Interest:** Pay your January 2012 deductible qualified personal residence mortgage loan payment(s) in December 2011 to accelerate your deduction for interest expense into the 2011 tax year. Your check for the January payment must be dated and mailed no later than December 31, 2011. Note: You must have sufficient funds in your checking account to cover the check at the time it is written and mailed. Consider mailing your payment early enough so the lender will be able to reflect it on your December 31, 2011 year end loan/mortgage statement.

Interest paid on loans secured by your principal residence or second home is deductible qualified interest for up to a maximum aggregate home acquisition debt and home equity debt of \$1.1 million. Of this maximum, home equity debt is limited to \$100,000. Acquisition debt is amounts borrowed to purchase or construct your primary or secondary residence.

Non deductible personal interest includes credit card finance charges and personal automobile loan interest expense, as well as interest on income tax deficiencies. Interest rates on home mortgages are currently low, and credit card rates have substantially increased, so you may be able to substantially reduce your interest payments while increasing the deductible amount if you qualify for a home equity loan, limited to \$100,000, that could be used to reduce the balances on any personal debt. Note: Interest on equity debt not used to purchase or construct your residence or second home is not deductible for Alternative Minimum Tax (AMT) and, thus, the benefits of a home equity loan may be reduced or eliminated.

- **Investment Interest:** Pay interest on your loans qualifying as investment-related indebtedness accruing through December 31, 2011 even if your interest is not payable until a later time. A phone call to your banker or broker will inform you of the amount of interest accruing on your open loan indebtedness, and this amount should be paid in December to obtain a 2011 tax deduction. Be aware that investment interest expense is only deductible to the extent of investment income.
- **Medical Expenses:** Since medical expenses are subject to AGI percentage limitations, consider bunching these expenses in years which you may be close to exceeding the limitation. Expenses which are either paid, or charged on your credit card, by December 31, 2011 will be deductible in 2011.

- **Charitable Contributions:** Pay all charitable contributions which you have pledged (or are contemplating) in December 2011. Cash contributions in excess of \$250 to the same organization must be substantiated by a contemporaneous written acknowledgement from the donee organization. For all contributions, regardless of amount, you must have a bank record or a written communication (receipt) from the donee showing the name of the organization, the date of the contribution and the amount of the contribution.

For non-cash donations, such as autos, clothing or furniture, your deductible contribution is limited to the lesser of your cost basis or the fair market value. Non-cash donations of clothing or household items must be in “good” used condition to be deductible. It may be helpful to take a picture of your donated items. For non-cash donations of \$500 - \$5,000, you must be able to provide all pertinent details of the donation, including how you arrived at the value of the items you donated to the charity. Also, if the value of the non-cash contribution exceeds \$5,000, the IRS requires you to obtain an appraisal of the item from a qualified appraiser. The appraisal requirement does not apply to gifts of publicly-traded stock.

If you have a car or other motor vehicle, a boat or aircraft you are contemplating donating to a charity, you must obtain Form 1098-C as a receipt from the charitable organization. Deductions for charitable contributions of these assets, if valued at more than \$500, are limited to the amount of proceeds received by the charity when the property is sold. This may be substantially less than the “Blue Book” value of the vehicle. Certain exceptions may apply.

In general, if you receive any benefits (goods or services) for a payment to a charity, you must reduce your deduction by the value of that benefit. You should save solicitation materials or receipts to properly compute your deduction. Out-of-pocket expenses incurred while providing services to a charitable organization must be supported with a letter or statement from the organization.

Be sure all donations, cash or non-cash, are made to qualified 501(c) (3) organizations.

Consider a transfer to a donor advised fund for last-minute charitable contributions. The full amount transferred to the fund is deductible in the year of transfer even though no specific charities are designated until subsequent years. This allows an accelerated tax deduction with flexibility to choose the timing of the actual transfer to a charity. Most financial institutions can set-up and administer these funds.

- **Taxes:** *For taxpayers that will not be subject to the Alternative Minimum Tax (AMT) in 2011,* consider paying both installments of your 2011-2012 real estate taxes on your principal residence and your other homes in December 2011. If your lender pays the property taxes from a tax impound account, make arrangements with your lender/trustee to disburse both installments from your impound account during December. Also, consider paying your fourth quarter state estimate in December.
- **Miscellaneous Itemized Deductions:** Certain itemized deductions are allowed only to the extent the aggregate exceeds 2 percent of your Adjusted Gross Income (AGI). These deductions include (1) unreimbursed employment-related expenses such as travel, entertainment, education, job search expenses, subscriptions to professional journals or trade magazines, uniforms and union dues; and (2) investment-related expenses such as investment fees and service charges, collection fees, appraisal fees, tax advice and tax preparation fees and some legal fees. Consider bunching these expenses in years which you may be close to exceeding the limitation.

## **Business Expenses and Credits**

- If you are operating your business as a cash basis sole-proprietorship and you have profits for 2011, you should pay all outstanding bills for expenses incurred in operating your business by December 31, 2011, including those you would normally pay in January. These would include such bills as utilities and office supplies, and must have been incurred during 2011, or prior, to be deductible. Note: You must have sufficient funds in your checking account to cover these year end expense disbursements.
- If you have business losses for 2011, contact our office to discuss ways to maximize your tax benefit from these losses.
- If you are operating your business on the accrual basis, you should review your ending inventory for damaged or obsolete items and make the appropriate adjustments. You should also review your accounts receivable and write off any uncollectible accounts or other uncollectible debts owed to you.
- Document the business use of your vehicles with a contemporaneous log or other recording. You may deduct either the actual costs of operating your business autos or elect to use the standard mileage rate. For 2011, the standard mileage rate is 51 cents per mile January-June and 55.5 cents per mile July-December. You may not claim the standard mileage rate for a vehicle that has been depreciated using an accelerated method in prior years.
- Document your travel and entertainment expenses related to your business with receipts and contemporaneous records indicating the date, amount and business purpose.
- Pay spousal wages if your spouse works in your business. As your employee, your spouse may be entitled to many benefits, including medical and dental coverage, childcare and pension benefits. Although spousal wages are subject to FICA withholding, you will be able to reduce your self-employment income by deductible wages, payroll taxes and benefits for your spouse, and reduce your overall tax liability.
- Pay wages to your children who help in your business. Wages paid reduce your income for income tax and social security tax, and sole-proprietors are not required to pay payroll taxes for their children under the age of 18. You must, however, include their wages on your payroll tax reports and issue them a W-2.
- Pay all outstanding business association dues, including dues to professional organizations, business leagues, trade associations, chambers of commerce, boards of trade, real estate boards and civic and public service organizations (such as Kiwanis, Rotary, Lions and Elks). Dues to social or recreational clubs are not deductible. Examples are athletic, luncheon, sporting, airline, and hotel clubs.
- As a reminder, there is a reporting requirement for businesses that hire independent contractors if the payments are subject to Form 1099 filing requirements or the contract exceeds \$600 during the year. Within 20 days of payment or entering into a contract, the name, social security number, date of contract and dollar amount must be reported to the EDD using Form DE-542. There is a similar requirement for reporting newly hired employees to the EDD New Hire Registry within 20 days of the start of work date using Form DE-34.
- If you have interstate business activities, you may have multi-state tax liabilities, including sales, payroll, income and other taxes owed to other states in addition to your home state taxes. To avoid interest and

penalties, you must timely file required forms and pay these out-of-state taxes. Contact our office if you need assistance with these filings.

- Eligible small employers may claim a tax credit for employee health insurance expenses (Section 45R). The credit is generally available to small employers that pay at least half the cost of qualified coverage. The maximum credit is 35 percent of premiums paid by eligible employers. The maximum credit goes to employers with 10 or fewer Full-Time Equivalent (FTE) employees paying average annual wages of \$25,000 or less per employee. Average annual wages are the total aggregate employer wages divided by the number of full-time equivalent employees. The credit is completely phased out for employers with more than 25 FTEs or with average annual wages of more than \$50,000. Health insurance expenses paid for relatives do not qualify for the credit.

### Depreciation

- **Section 179 Expense:** Review your business equipment needs. For 2011, the federal deduction limit for Section 179 property (generally nonresidential depreciable personal property used in a trade or business, but not luxury autos) placed into service during the year is \$500,000. Up to one-half of this amount may be expensed for qualified real property defined as (1) qualified leasehold improvements; (2) qualified restaurant property; and (3) qualified retail improvements. This maximum is currently scheduled to be reduced to \$139,000 in 2012 and \$25,000 in 2013 and subsequent years. The California limit remains at \$25,000. This provision is subject to limitations such as trade or business taxable income and the cost of qualifying property. For 2011, the federal Section 179 deduction begins to phase out for businesses that place into service more than \$2,000,000 of Section 179 qualified assets and is completely eliminated if more than \$2,500,000 of Section 179 assets are placed into service during the year. The state phase-out range is \$200,000 to \$225,000 of qualified assets.
- **Bonus Depreciation:** Any new equipment or other new depreciable property with a life of 20 years or less, purchased and placed in service in 2011, qualifies for the federal 100 percent Bonus Depreciation write-off. For 2012 purchases, the rate will be reduced to 50 percent.
- **Luxury Auto Limits:** The depreciation deduction, including Section 179 expense for all passenger vehicles, including light trucks, vans and SUVs, with a Gross Vehicle Weight Rating (GVWR) of 6,000 pounds or less, is limited to the luxury auto maximum depreciation amounts (\$3,060 for autos and \$3,260 for the light trucks, vans and SUVs placed in service in 2011).

This luxury auto limit generally does not apply to vehicles with unloaded gross vehicle weight greater than 6,000 pounds. However, SUVs and light trucks with a GVWR greater than 6,000 pounds, but not greater than 14,000 pounds, are limited to a \$25,000 Section 179 deduction for vehicles placed in service in 2011.

For new luxury autos placed into service in 2011, the bonus depreciation is \$8,000 for a total first year depreciation maximum of \$11,060 (\$11,260 for light trucks and vans).

- **Cost Segregation Analysis:** If you recently purchased or constructed a building for use in your business, you should consider a cost segregation analysis to allocate some of the cost to assets with shorter depreciable lives and/or accelerated cost recovery. This could substantially accelerate your depreciation deduction over the first few years.

## **Rental Property**

- Generally, cash basis taxpayers should pay all outstanding bills incurred for operating expenses on rental properties by December 31, 2011. These expenses would include utility bills, repairs, cleaning, insurance premiums and both installments of real estate taxes. You can still deduct up to \$25,000 of the rental losses for 2011, if your Adjusted Gross Income (AGI) is under \$100,000, or a reduced amount if your AGI is greater than \$100,000 but less than \$150,000.
- If you rent out your vacation home or main home for less than 15 days during the year, it is not considered rental property, and the rental income is tax free. On the other hand, if you have personal use of property for more than 14 days during the year and also rent out that property for more than 14 days, your rental deductions will be limited.
- For federal income tax purposes, if you are a Real Estate Professional, you may be able to fully deduct any losses from real estate rental activities against your other taxable income. Individuals who spend a substantial portion of their time in the real estate industry can potentially qualify to treat any rental real estate activities as non-passive on their federal return. To qualify under this provision, you must spend more than one-half of your personal services in the real estate industry in general and over 750 hours per year in one or more real estate trades or businesses in which you materially participate. Personal services as an employee do not count unless you have more than a 5 percent ownership interest in the employer. Thus, it is important to document your time as the year draws to a close. Sometimes putting in just a few more hours in an activity between now and year end could mean the difference between having to suspend a rental loss as a passive loss versus being able to deduct it against your other income.

## **California Business Use Tax Filing Requirements**

- California businesses with gross receipts over \$100,000 that do not hold a State Board of Equalization (SBOE) resale license are required to register with SBOE and file an annual sales and use tax return by April 15<sup>th</sup> of each year. The purpose of this form is to report and pay use tax on purchases made during the year which were not subject to California sales tax, such as out-of-state purchases. The form is required to be filed even if no sales or use tax is due, unless you have three consecutive years of reporting zero purchases subject to use tax. Smaller businesses and individuals are required to report and pay use tax on out-of-state purchases on their state income tax returns.

## **Pensions and IRAs**

The retirement savings plans listed below are not cumulative. In most cases, you are limited to only one plan, such as a SEP or a SIMPLE plan, but not both.

- If you are self-employed, you may establish an HR-10 (Keogh) plan with a financial institution under the terms and conditions of their master retirement plan before the end of 2011, with a minimum deposit of one hundred dollars (\$100). The balance of your 2011 Keogh plan contribution may be deposited into the account by the due date, including extensions, of your return, but must be paid before your return is filed.
- A Simplified Employee Plan (SEP) may be established after year end and funded by the due date of your return, including extensions.

- Your current plan(s) should be reviewed for amendments before December 31, 2011, to take advantage of new contribution limits and recent law changes, including the allowance of deductions for single-member 401(k) plans.
- If your employer offers a 401(k) plan or tax-sheltered annuity plan (403(b) or TSA), try to defer as much income as possible, up to the 2011 maximum of \$16,500 (\$22,000 for employees over 50). The tax-deferral benefits and any employer matching contributions make 401(k)s and TSAs outstanding tax shelters. As with an IRA, it is a long-term investment. A 10 percent penalty and regular income taxes generally will be owed on amounts withdrawn before age 59½ (unless properly rolled over to another qualifying plan or another exception applies).
- If your employer offers a 401(k) Roth IRA option, consider allocating some or all of your 401(k) elective deferral to the Roth IRA 401(k). Although the contributions do not reduce taxable income, the withdrawals (including earnings) are tax free as long as you hold the account at least 5 years and until you are at least 59½ years old.
- An IRA contribution need not be funded until April 17, 2012. The contribution limit is \$5,000 for 2011. If you are over 50 years old, you may qualify for an additional IRA catch-up payment of \$1,000. Generally, if you are covered by a qualified pension plan, you will not be able to make a deductible IRA contribution. However, you would be able to make a non-deductible IRA contribution and defer the income, or you may convert it to a Roth IRA.
- A Retirement Savings Contributions Credit (Section 25B) is available for contributions to an IRA, including a Roth IRA or 401(k) plan, made by taxpayers with 2011 income less than \$56,500 on a joint return, \$27,750 on a single return and \$42,375 on a head of household return. The maximum credit is \$1,000 per individual and cannot be claimed by dependents of another taxpayer.
- If you have taken a premature distribution from your IRA in 2011, consider paying all outstanding medical expenses for yourself and your dependents. Deductible medical expenses in excess of 7.5 percent of your AGI reduce the portion of your IRA withdrawal that is subject to the early withdrawal penalty. You may use this provision whether or not you are eligible to itemize your deductions.
- If your AGI will be less than \$179,000 for married taxpayers filing jointly, \$10,000 for married taxpayers filing separately or \$122,000 for single taxpayers and heads of household, you should consider a non-deductible Roth IRA contribution. All income and appreciation accrue tax free. Your 2011 Roth IRA contribution must be funded by April 17, 2012.
- Roth IRA Conversion: The income limitation no longer applies to Roth IRA conversions. If you have funds in a traditional IRA account, you should consider a Roth IRA conversion. You would pay tax, but generally not a penalty, on the value of the amounts transferred in excess of your basis, but the later income accrual and increase in value would be tax free. If you are not over 59½, or if no other exclusion applies at the time of conversion, you must transfer the entire distribution to your Roth IRA (you cannot have amounts withheld for taxes) to avoid the 10 percent penalty. California conforms to this treatment for Roth IRA conversions. If you made a Roth IRA conversion in a prior year and it has decreased in value, you may be able to close-down all of your Roth IRA accounts and deduct the losses as a miscellaneous itemized deduction. Penalties may apply if you are under 59½. Please call if you are considering this option.
- A federal deduction from AGI is allowed for contributions to a Health Savings Account (HSA) for anyone covered by a high-deductible medical insurance plan. The deductible must be at least \$1,200 for an

individual and \$2,400 for a family. The tax deduction is limited to \$3,050 for an individual and \$6,150 for a family. These amounts are increased by \$1,000 for participants over age 55 not yet eligible for Medicare. The high deductible medical plan must provide coverage for some part of 2011 to qualify for a 2011 tax deduction. Deductible contributions to the plan must be made by April 17, 2012. After December 31, 2010, the definition of “medical expenses” excludes over-the-counter drugs without a prescription. Accordingly, reimbursements are not allowed for payments of over-the-counter drugs without a prescription (except for insulin) from Flexible Spending Accounts (FSAs), Health Reimbursement Accounts (HRAs), Health Savings Accounts (HSAs) and Archer MSAs. An additional tax on HSA and MSA distributions not used for qualified medical expenses is increased from 10 percent to 20 percent of the amount includible in gross income.

### **Investments and Capital Gains**

- For 2011, net capital gains and qualified dividends are taxed at the 15 percent capital gain/qualified dividend rate or at a zero rate for certain lower income taxpayers (taxable income less than \$34,500 for single, \$46,250 head of household and \$69,000 for married filing jointly taxpayers). The 15 percent capital gain rate and qualified dividend tax rate have been extended through 2012.
- Beginning in 2013, an additional 3.8 percent federal tax applies to taxable dividends, interest, capital gains, rental income and other investment income for single taxpayers with AGI over \$200,000 and joint filers with AGI over \$250,000.
- Review your capital asset portfolio. Losses from the sale of capital assets can completely offset any capital gains you have this year and up to \$3,000 of ordinary income. Add up all gains and losses realized to date on stocks, bonds, securities and any other investment property and compare them with unrealized gains and losses you have in your portfolio. If you have a net capital loss, consider selling capital gain property with a net gain. If you have a net gain, consider selling loss property to offset gains. The “wash sale” rule defers the deduction for losses on securities if the same securities are purchased 30 days before or after the loss sale. To recognize the loss, be sure any repurchase of the same security is not within 30 days of the loss sale. Also, consider selling “worthless” securities to an independent party to ensure deductibility.
- Consider the effective capital gain rate when selling assets. The holding period for the 15 percent long-term capital gain rate is more than 12 months. The 15 percent rate is also used to determine the Alternative Minimum Tax (AMT). However, the phase-out of the AMT exemption and the graduated tax rates often combine to produce an effective AMT capital gain rate in excess of 15 percent.
- If you are planning to sell a highly appreciated asset, you should contact your accountant to discuss planning considerations including postponing the closing date until early 2012, using the installment method to postpone gain recognition for another year, or other options.
- Capital gain tax may be avoided on the appreciation of stocks, real estate and other capital assets contributed to charity, while providing a contribution deduction for the full Fair Market Value (FMV) of the asset contributed.
- If you originally acquired real property in a tax-deferred exchange and later converted it to your principal residence, you must hold the property for at least five years before selling it in order to take advantage of the \$250,000 (or \$500,000) gain exclusion for the sale of a principal residence.

- If you made a personal loan to a third party that you are now not able to collect, you may be able to claim a capital loss deduction for the uncollectible amount. In order to claim this type of personal bad debt deduction, it is important for you to document your efforts in attempting to collect the amount owed (use of legal counsel, for example).
- Be sure the tax identification number is correct on your investment accounts and any accounts held for a minor child are in the child's social security number. If you have a living trust, be sure all of your investment accounts are held in the name of your trust.
- Consider gifting appreciated assets, such as stocks or bonds, to children or grandchildren over age 18, or over age 24 if they are full-time students who are in a lower tax bracket. Even though the maximum long-term capital gain rate is 15 percent for most taxpayers in 2011, it is zero for lower income taxpayers. If you have assets that you are planning to sell, transferring them to a child and having the child recognize the income can provide an overall tax savings. However, because of the Kiddie Tax, unearned income in excess of \$1,900 for certain dependent children is generally taxed at the child's parents' tax rates. As such, shifting income producing assets to the child will not necessarily be beneficial unless the income is not recognized until after the child is over 18 and self-supporting. The federal Kiddie Tax applies to the unearned income of children under 18, and also applies to the unearned income of 18 year olds and full-time students 19 to 24 years old who do not provide over one-half of their own support from their wages or other earned income. The California Kiddie Tax conforms to the federal age requirements. Note: Once a gift is completed, the funds cannot revert back to the donor.
- Check the record date for dividends and distributions before buying or selling mutual funds near the end of the year. Most mutual funds recognize capital gains at year end and pass taxable gains to owners as of the record date. You can increase your after tax profits with proper timing of mutual fund sales or purchases. Also, consider making a charitable contribution of highly appreciated mutual funds immediately prior to the record date to reduce your capital gain and increase your tax deduction.
- Be sure to keep copies of all investment accounts, including buy and sell documents, for the entire year. Print copies of any investment information you maintain on your computer, particularly the cost basis of assets sold during the year.
- Beginning for tax year 2011, your broker or financial institution is required to report your basis of stock and securities sold during the year. You should contact your broker to confirm that your basis is correctly documented in your accounts. Your broker may also ask you to elect the method for determining the basis of your mutual funds. Please contact our office if you would like our assistance.

### **Education Incentives**

- You may qualify for educational incentives if you or your dependents attend college or other postsecondary schools. The Lifetime Learning Credit and the American Opportunity Tax Credit are available for current college or vocational students on amounts paid for tuition and related fees in 2011 and 2012. The Lifetime Learning Credit is the lesser of 20 percent of qualified tuition and related expenses paid each year, or \$2,000, and the American Opportunity Credit is 100 percent of the first \$2,000 and 25 percent of the next \$2,000 of tuition and related expenses for a maximum of \$2,500 per eligible student for the first four postsecondary years of education. The American Opportunity Credit phases out ratably for joint filers with an AGI in excess of \$160,000 and single filers with an AGI in excess of \$80,000. The Lifetime Learning Credit begins to phase out for single filers with an AGI in excess of \$51,000 and joint filers with an AGI in excess of \$102,000.

- A deduction is also allowed for up to \$2,500 paid for qualified education loan interest for single filers with an AGI under \$75,000 and joint filers with an AGI under \$150,000.
- The above-the-line tax deduction for qualified tuition has been extended through 2011. The maximum deduction is \$4,000 and is subject to phase-out based on AGI.
- Consider funding a Qualified College Tuition Program Account (529 Plan Account) for a child or grandchild. A contribution to the plan is not tax deductible, but future earnings accrue tax free, and qualified distributions from the account are tax free to the student/beneficiary.
- Consider funding a Coverdell Educational Savings Account (ESA) for your child or grandchild under the age of 18. The annual contribution limit is \$2,000 for 2011, and must be funded by December 31, 2011. This amount is not deductible. However, the income is tax-exempt and will not be considered unearned income for the Kiddie Tax. There are certain income limits applied to the contributor.

### Cancellation of Debt

- The cancellation of a nonrecourse home mortgage debt is treated as a sale of the residence. The principal residence exclusion (Section 121) would apply to any gain realized on the cancellation of principal residence debt. For recourse debt, individuals may exclude income from the discharge of qualified principal residence indebtedness of up to \$2 million on their 2011 federal returns. To qualify for the debt discharge exclusion, the debt must be secured by the taxpayer's principal residence, and only the amount used to buy, build or substantially improve that residence is qualified indebtedness subject to exclusion. The amount of the non-qualified debt, for example equity debt borrowed to pay credit cards, is considered to be discharged before the qualified debt, and is subject to tax at ordinary rates. The federal provision applies for tax years 2007-2012. California basically conformed but limits the qualified indebtedness to \$800,000 and the excludable cancellation amount to \$500,000.
- Debt discharge not excluded as principal residence debt is generally taxable as ordinary income unless the taxpayer is bankrupt or insolvent.
- If the foreclosed property was used for business or rental, the recourse debt cancellation in excess of the Fair Market Value (FMV) would be ordinary income, and the difference between the FMV and the adjusted basis would be a deductible business loss or a taxable business gain.

### Energy Incentives

- **Residential Energy Credits:** Home energy efficient improvements credits have been extended to 2011 at a reduced amount. Examples of improvements that may qualify are energy efficient windows, doors, heating or cooling systems, and other energy efficient items. The maximum credit for 2011 is \$500. The 30 percent residential energy efficiency credit for the cost of solar electric systems used for residential heating is not limited to a maximum amount and was extended through 2016.
- **Business Property Energy Credits:** An energy credit (Section 48) equal to 30 percent of the basis in qualified fuel cell property, certain solar energy property and qualified wind energy property, and 10 percent of the basis in other types of qualified energy property, is available for depreciable property placed in service during the taxable year and meeting performance standards promulgated by IRS.

- **Energy Efficient Buildings Deduction:** Owners of commercial buildings can earn write-offs for upgrading energy systems and constructing energy efficient buildings (Section 179D). The deduction is generally limited to \$1.80 per square foot of the building. The energy system must be certified as part of an overall plan designed to reduce total annual energy and power costs by 50 percent or more and meet other standards. Private architects, engineers, and contractors may be eligible to claim this deduction for work performed on public buildings.
- **Home Builders Credits:** Contractors that build energy efficient homes in 2011 may qualify for special tax credits.

### Other

- If you do not have a Will or have not updated your Will in the past several years, contact your attorney to review any action needed. You also may want to consider establishing a revocable living trust. As part of your estate plan, you should also check the beneficiary designation for all of your insurance policies and retirement accounts, particularly any rollover IRA accounts.
- Consider using the annual gift tax exclusion of \$13,000 for 2011, to gift appreciated stocks or other assets. This annual exclusion applies to each recipient or donee. If both spouses make gifts, or if they consent to have gifts by one treated as if made one-half by each, as much as \$26,000 for 2011 can be given to each donee each year, free of gift taxes. Over a period of years, the reduction in estate taxes can be considerable, and the earnings on the transferred property will be taxed to the donee (possibly at a lower tax rate). You may also make a direct payment of medical or tuition expenses in excess of the \$13,000 exclusion without gift tax consequences. For cash gifts, to avoid questions as to timing of the payments, allow time for the gift tax check to clear by December 31, 2011, or purchase cashier checks.
- **Cafeteria Plans:** Be sure to review your flexible spending account or reimbursement account at work. Generally, money left in these accounts at the end of the year will be forfeited. However, many plans have been amended to take advantage of the 2½ month grace period now allowed by the IRS. Consult with your employer regarding this provision.

You should consider participating in any employer maintained cafeteria plan available to you. Contributions to the plan will reduce your gross income if used to fund medical, child care or disability insurance expenses.

- Starting in 2010, those persons who received the homebuyer's federal tax credit on a home purchased after April 8, 2008 and before January 1, 2009, must commence repayment of the credit over the 15-year recapture period. The repayment amount is \$500 each year if the maximum \$7,500 credit was claimed, and is payable as an additional amount on the federal form 1040.

We are required by IRS Circular 230 to inform you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

**Please give us a call if we can be of assistance to you on these or other matters.**