Shannon & Associates LLP
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Special Alert!

2012 MIDYEAR TAX PLANNING

Midyear may not seem like "tax season," but now is an ideal time to assess your tax situation and to identify and implement appropriate planning strategies. Current federal tax law provides many opportunities for certain taxpayers to reduce their tax bills for 2012. However, a number of favorable measures are scheduled to expire at year-end, so careful planning for the balance of the year is prudent.

Start planning now

In light of certain potentially expiring tax provisions, planning ahead can be especially important if you expect to earn more income this year than last year. Furthermore, there may be certain income that you choose to accelerate into 2012 -- as opposed to postponing to 2013 when tax rates may be significantly higher. It's smart to prepare a taxable income projection for the year, including the income you expect to receive through the remainder of 2012 and the tax deductions that you may be entitled to claim. Once your taxable income for 2012 is projected, an estimate of your 2012 tax bill can be calculated using the current tax rate schedule. You can then compare that to an alternate scenario should certain taxable income be included in 2013, as opposed to 2012.

Consider potentially expiring provisions

Many current favorable federal tax provisions will expire at the end of 2012, absent further legislative actions. Changing provisions that may have an adverse impact on your 2013 tax liability include the following:

Individual Tax Rates
Current ordinary rates of 10%, 15%, 25%, 28%, 33%, and 35% may be increased to 15%, 28%, 31%, 36%, and 39.6% beginning in 2013.

Long-Term Capital Gains Rates
In 2012, the maximum long-term capital gains rate is 15%. The maximum capital gains rate is scheduled to increase to 20% in 2013.

Qualified Dividend Rates
While qualified dividends are taxed at 15% in 2012, dividends are scheduled to be taxed as ordinary income beginning in 2013.

Payroll Taxes
For the balance of 2012 only, employees pay a 4.2% Social Security tax rate on wages up to $110,100 (the 2012 Social Security Wage Base), as opposed to the normal 6.2% rate. Similarly, current law reduces the tax rate for the Social Security portion of self-employment tax on self-employment net earnings up to $110,100.
Accordingly, the maximum savings for employees and self-employed individuals in 2012 will be $2,202 (i.e., 2% of $110,100). For spouses who both earn at least as much as the Social Security Wage Base in 2012, the maximum savings will be $4,404.
The above Social Security/self-employment tax rates are scheduled to return to the full 6.2% in 2013. The resulting increased Social Security tax liability should be factored into your overall planning.

Personal Exemptions and Itemized Deductions Phaseouts
For 2012, no income-based phaseouts of these thresholds apply. Next year, prior law income limits will be restored, resulting in a lower amount of exemptions and itemized deductions that may be claimed by higher income individuals.
These potentially expiring provisions (and this is only a partial list; many other scheduled 2013 tax law changes may affect your overall tax liability) -- and the likely resulting consequences -- should be considered as tax planning steps are taken during the balance of 2012.

Avoid estimated payment penalties

At this time of the year, it is also prudent for you to check your income-tax withholding payments. Failure to satisfy the withholding rules can result in a tax penalty when you file your return.
Note that, if you receive significant income from sources other than your job, or if you are self-employed, you may be required to make quarterly estimated tax payments directly to the government.
Your total payments in tax withholding from your paycheck and estimated tax payments you send to the IRS over the course of the year should typically be at least 90% of your 2012 federal tax liability. Or, you can base your payments on the taxes you paid for 2011.

- If your adjusted gross income (AGI) in 2011 was $150,000 or less ($75,000 AGI or less for married persons filing separate returns), this alternative requires a 2012 payment of 100% of your 2011 tax liability.
- If your AGI was over $150,000 ($75,000), this alternative requires a payment for 2012 of 110% of your 2011 tax.

If you fail to meet these payment rules, the IRS may charge you a penalty, unless the final tax payment owed on your return is less than $1,000.
Example: Assume you will incur 2012 federal income taxes of $50,000. For 2011, assume your taxes were $40,000. To avoid a penalty, you must pay 2012 withholding and/or estimated taxes of: (1) 90% of your 2012 tax (or $45,000); or (2) if your AGI in 2011 was $150,000 or less ($75,000 or less if you were a married-separate filer), 100% of 2011's tax (or $40,000); or (3) if your 2011 AGI was more than $150,000 ($75,000 as a married-separate filer), 110% of your 2011 tax (or $44,000).

Itemized deductions

If you expect to itemize your deductions on your 2012 return, you will need to consider whether to pay optional expenses before the end of the year to lower your 2012 taxes or wait to pay them in 2013. Remember to factor in the scheduled higher rates for 2013 (and the potentially higher benefit you would get from deductions in a higher-rate environment) as opposed to the potential phaseout of certain deductions in 2013.
If you believe accelerating deductions into 2012 is your best course of action, consider the following:

Deductible Interest
Consider making your January 2013 mortgage payment (which includes December's interest) in late December 2012, so the interest will be deductible on your 2012 return.

Medical and Miscellaneous Itemized Expenses
Your deductions are limited to the amounts that exceed 7.5% of AGI for medical expenses and 2% of AGI for miscellaneous expenses. Bunching two years of you or your family's unreimbursed medical or miscellaneous itemized expenses (such as certain job-related expenses and investment expenses). Bear in mind that the floor limit relating to medical-expense deductions will generally increase to 10% of AGI in 2013, absent further legislation.

Charitable contributions
Contributions charged on your credit card in 2012 count as 2012 deductions, even if you don't receive or pay the credit card bill until 2013.

Taxes
If you pay quarterly estimated state income taxes, consider paying your last 2012 estimate before December 31, so that it will be deductible on this year's tax return. Employees who have state income taxes withheld from their pay may wish to increase the amount withheld from their remaining 2012 paychecks to cover any projected underpayment.

Retirement savings plan

If you are contributing to a retirement plan at work, such as a 401(k) plan or a 403(b) tax sheltered annuity, try to take full advantage of the tax benefits offered. The money you contribute in 2012 is not included in your taxable income for the year, so not only does contributing to your plan let you accumulate savings on a tax-deferred basis, but it will also allow you to reduce the income tax you currently pay. In any event, try to make enough of a contribution to secure the maximum employer matching contribution.
If you have a traditional IRA or Roth IRA, you have until the tax filing date in 2013 to make a contribution for 2012 of up to $5,000 to your account, or $6,000 if you're age 50 or older. Check with us for eligibility requirements and other important tax considerations.
Self-employed business owners who do not already have a tax-deferred retirement plan should consider starting before year-end 2012. Options to examine include a so-called "solo 401(k)" plan, a Simplified Employee Pension (SEP) plan, or a SIMPLE plan. We would be happy to discuss the advantages and restrictions of each type.

We can help

We can provide you with personal and business tax planning assistance -- now or in the coming months. Call us for an appointment to review your specific situation.

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