



Year-end tax planning

Dear Clients:

Year-end tax planning is especially challenging this year because of uncertainty over whether Congress will enact sweeping tax reform that could have a major impact in 2012 and beyond. And even if there's no major tax legislation in the immediate future, Congress next year still will have to grapple with a host of thorny issues, such as whether to once again "patch" the alternative minimum tax (e.g., to avoid a drastic drop in post-2011 exemption amounts), and what to do about the post-2012 expiration of the Bush-era income tax cuts (including the current rate schedules, and low tax rates for long-term capital gains and qualified dividends), and the expiration of favorable estate and gift rules for estates of decedents dying, gifts made, or generation-skipping transfers made after Dec. 31, 2012.

Regardless of what Congress does late this year or early the next, there are solid tax savings to be realized by taking advantage of tax breaks that are on the books for 2011 but may be gone next year unless they are extended by Congress. Below we have highlighted some of the more common strategies for individuals and businesses.

Year-End Tax Planning Moves for Individuals

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year. Don't forget that you can no longer set aside amounts to get tax-free reimbursements for over-the-counter drugs, such as aspirin and antacids.
- If you become eligible to make health savings account (HSA) contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2011.
- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, and then buy back the same securities at least 31 days later.
- Postpone income until 2012 and accelerate deductions into 2011 to lower your 2011 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2011 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial

circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2011. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year.

- If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your AGI for 2011.

- If you converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value, and if you leave things as-is, you will wind up paying a higher tax than is necessary. You can back out of the transaction by recharacterizing the rollover or conversion, that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.

- Accelerate big ticket purchases into 2011 in order to assure a deduction for sales taxes on the purchases if you will elect to claim a state and local general sales tax deduction instead of a state and local income tax deduction. Unless Congress acts, this election won't be available after 2011.

- If you are a homeowner, make energy saving improvements to the residence, such as putting in extra insulation or installing energy saving windows, and energy efficient heaters or air conditioners. You may qualify for a tax credit if the assets are installed in your home before 2012.

- Unless Congress extends it, the up-to-\$4,000 above-the-line deduction for qualified higher education expenses will not be available after 2011. Thus, consider prepaying eligible expenses if doing so will increase your deduction for qualified higher education expenses. Generally, the deduction is allowed for qualified education expenses paid in 2011 in connection with enrollment at an institution of higher education during 2011 or for an academic period beginning in 2011 or in the first 3 months of 2012.

- Purchase qualified small business stock (QSBS) before the end of this year. There is no tax on gain from the sale of such stock if it is (1) purchased after September 27, 2010 and before January 1, 2012, and (2) held for more than five years. In addition, such sales won't cause AMT preference problems. To qualify for these breaks, the stock must be issued by a regular (C) corporation with total gross assets of \$50 million or less, and a number of other technical requirements must be met. Please call us for more details.

- If you are age 70- 1/2 or older, own IRAs and are thinking of making a charitable gift, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer, if made before year-end, can achieve important tax savings.

□ Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70- 1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn.

□ Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give \$13,000 in 2011 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next.

Year-End Tax-Planning Moves for Businesses & Business Owners

□ Businesses should consider making expenditures that qualify for the business property expensing option. For tax years beginning in 2011, the expensing limit is \$500,000 and the investment ceiling limit is \$2,000,000. And a limited amount of expensing may be claimed for qualified real property. However, unless Congress changes the rules, for tax years beginning in 2012, the dollar limit will drop to \$139,000, the beginning-of-phaseout amount will drop to \$560,000, and expensing won't be available for qualified real property.

□ Businesses also should consider making expenditures that qualify for 100% bonus first-year depreciation if bought and placed in service this year. This 100% first-year write-off generally won't be available next year unless Congress acts to extend it. Thus, enterprises planning to purchase new depreciable property this year or the next should try to accelerate their buying plans, if doing so makes sound business sense.

□ If you are self-employed and haven't done so yet, set up a self-employed retirement plan.

□ If you own an interest in a partnership or S corporation, you may need to increase your basis in the entity so you can deduct a loss from it for this year.

These are just some of the year-end steps that can be taken to save taxes. Again, by contacting us, we can tailor a particular plan that will work best for you.

Very truly yours,

Pelletier, Chase & Associates LLC

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