PIASCIK & ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

Main / 804-527-1815
Toll Free / 866-527-1815
Fax / 804-527-1816
Innsbrook Corporate Center
4470 Cox Road, Suite 250
Glen Allen, Virginia 23060

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Mr. Smith

Year-end Tax Planning

Dear Mr. Smith:

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. These include, for individuals: the option to deduct state and local sales and use taxes instead of state and local income taxes; the above-the-line deduction for qualified higher education expenses; and tax-free distributions by those age 70- 1/2 or older from IRAs for charitable purposes. For businesses, tax breaks that are available through the end of this year but won't be around next year unless Congress acts include: 100% bonus first-year depreciation for most new machinery, equipment and software; an extraordinarily high $500,000 expensing limitation (and within that dollar limit, $250,000 of expensing for qualified real property); and the research tax credit.

We have compiled a checklist of actions based on current tax rules that may help you save tax dollars if you act before year-end. Not all actions will apply in your particular situation, but you will likely benefit from many of them. We can narrow down the specific actions that you can take once we meet with you to tailor a particular plan. In the meantime, please review the following list and contact us at your earliest convenience so that we can advise you on which tax-saving moves to make.

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, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.

- 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.

- It may be advantageous to try to arrange with your employer to defer a bonus that may be coming your way until 2012.

- Consider using a credit card to prepay expenses that can generate deductions for this year.

- If you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding of state and local taxes (or pay estimated tax payments of state and local taxes) before year-end to pull the deduction of those taxes into 2011 if doing so won't create an alternative minimum tax (AMT) problem.

- Take an eligible rollover distribution from a qualified retirement plan before the end of 2011 if you are facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2011. You can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2011, but the withheld tax will be applied pro rata over the full 2011 tax year to reduce previous underpayments of estimated tax.

- Estimate the effect of any year-end planning moves on the AMT for 2011, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on your residence, state income taxes (or state sales tax if you elect this deduction option), miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes. As a result, in some cases, deductions should not be accelerated.

- 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.

- You may be able to save taxes this year and next by applying a bunching strategy to "miscellaneous" itemized deductions, medical expenses and other itemized deductions.

- 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.

- You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.

- You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.

- 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. Our office can fill you in on the 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. If you turned age 70- 1/2 in 2011, you can delay the first required distribution to 2012, but if you do, you will have to take a double distribution in 2012—the amount required for 2011 plus the amount required for 2012. Think twice before delaying 2011 distributions to 2012—bunching income into 2012 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2012 if you will be in a substantially lower bracket that year, for example, because you plan to retire late this year.

- 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. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

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-ofphaseout amount will drop to $560,000, and expensing won't be available for qualified real property. The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

- ❑ 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 writeoff 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.

- ❑ Nail down a work opportunity tax credit (WOTC) by hiring qualifying workers (such as certain veterans) before the end of 2011. Under current law, the WOTC won't be available for workers hired after this year.

- ❑ Make qualified research expenses before the end of 2011 to claim a research credit, which won't be available for post-2011 expenditures unless Congress extends the credit.

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

- ❑ Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2012, and disposing of a passive activity to allow you to deduct suspended losses.

- ❑ 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. If you would like to discuss one or more of the above planning or payment possibilities, or any other alternatives, in more detail, please feel free to call me directly at (804) 228-4179 or rlosi@piascik.com.

Very truly yours,
PIASCIK & ASSOCIATES, P.C.

Ryan L. Losi, CPA
Executive Vice President

Ryan L. Losi, CPA, is a partner and Executive Vice President of Piascik & Associates, P.C. (www.piascik.com), providing domestic and international tax services to a broad range of clients throughout the United States and abroad. Losi leads the firm's international tax practice, advising clients in numerous countries spanning five continents. Since 2005, Losi has served as a program partner with the Virginia Economic Development Partnership's (VEDP) national award winning export program known as the Virginia Leaders in Export Trade (VALET), where his focus is to assist Virginia based companies grow internationally. He also speaks regularly about 20 times a year and teaches domestic and international taxation at the Executive MBA program at Virginia Commonwealth University. In 2010, Losi was recognized among Virginia's “rising stars” in the CPA profession, with a Top 5 Under 35 Award by the Virginia Society of CPAs. Losi is a 1997 graduate of Virginia Commonwealth University. He can be contacted at Piascik & Associates by phone (877) 527-2046 or e-mail rlosi@piascik.com.