



## 2011-2012 TAX PLANNING GUIDE



# Take steps now to save tax — while you still can

The Tax Relief Act of 2010 extended some tax breaks and expanded others. But certain provisions expire at the end of 2011 and others — including lower tax rates — after 2012. In light of this uncertainty, minimizing taxes over the next few years will require smart planning and timely action. To that end, we're pleased to offer this tax guide. But we don't have room here to cover all tax law changes and strategies that may apply to you. So consult an advisor about your best course of action.



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# The right timing can maximize the benefit of deductions



*Deductions can be powerful tax-saving tools because they reduce the amount of your income that's taxed. And through 2012, the income-based phaseouts that limited the benefit of many deductions have been lifted. When possible, review your potentially deductible expenses with your tax advisor before you incur them, because the right timing can maximize their benefit.*

## The AMT

The first step when planning for deductions is to consider the alternative minimum tax (AMT) — a separate tax system that limits some deductions and doesn't permit others, such as:

- ◆ State and local income tax deductions,
- ◆ Property tax deductions, and
- ◆ Miscellaneous itemized deductions subject to the 2% of adjusted gross income (AGI) floor, including investment advisory fees and employee business expenses.

You must pay the AMT if your AMT liability exceeds your regular tax liability. (See Chart 6 on page 31 for AMT rates and exemptions.) You may be able to time income and deductions to avoid the AMT, or at least reduce its impact — or perhaps take advantage of its lower maximum rate. But, planning for the AMT will be a challenge until Congress passes long-term relief. Unlike the regular tax system, the AMT system isn't regularly adjusted for inflation. Instead, Congress must legislate any adjustments. Typically, it has done so in the form of a "patch" — an increase in the AMT exemption. Such a patch is in effect for 2011, but, as of this writing, not for 2012.

## Home-related breaks

These valuable tax breaks go beyond just deductions:

**Property tax deduction.** Before paying your bill early to accelerate the itemized deduction into 2011, review your AMT situation. If

you're subject to the AMT, you'll lose the benefit of the deduction for the prepayment.

**Mortgage interest deduction.** You generally can deduct interest on up to a combined total of \$1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your *principal* residence also may be deductible.

**Home equity debt interest deduction.** Interest on home equity debt used to improve your principal residence — and interest on home equity debt used for any purpose (debt limit of \$100,000) — may be deductible. So consider using a home equity loan or line of credit to pay off credit cards or auto loans, for which interest isn't deductible. But beware of the AMT: If the home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes.

**Home sale gain exclusion.** When you sell your principal residence, you can exclude up to \$250,000 (\$500,000 for joint filers) of gain if you meet certain tests. **Warning:** Gain on the sale of a principal residence generally isn't excluded from income if the gain is allocable to a period of "nonqualified" use. Check with your tax advisor for details.

Losses on the sale of a principal residence aren't deductible. But if part of your home is rented or used exclusively for your business, the loss attributable to that portion will be deductible, subject to various limitations. Because a second home is ineligible for the exclusion, consider converting it to rental use before selling. It can be considered a business asset, and you may be able to defer tax on any gain through an installment sale or a Section 1031 ("like-kind") exchange. Or you may be able to deduct a loss, but only to the extent attributable to a decline in value *after* the conversion.

**Debt forgiveness exclusion.** Homeowners who receive debt forgiveness in a foreclosure or a mortgage workout for a principal residence generally don't have to pay federal income taxes on that forgiveness.

**Rental income exclusion.** If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses related to the rental won't be deductible.

**Energy-related breaks.** A wide variety of breaks designed to encourage energy efficiency and conservation are available. Consult your tax advisor for details.

## Case Study I

# Home office deduction can save you tax — *if you're eligible*

If you have a home office, you may be entitled to a deduction — but be aware that this requires more than just “regular” use of the office. Let’s look at an example. Mark works at home because his company, in an effort to save money on office space, is requiring employees who don’t need to be in the office regularly to work remotely.

Because Mark’s home office use is for his employer’s benefit and it’s the *only* use of the space (his wife and children don’t use it), he can deduct a portion of his mortgage interest, real estate taxes, insurance, utilities, security system and certain other expenses. Further, he can take a deduction for the depreciation allocable to the portion of his home used for the office. He can also deduct direct expenses, such as business-only phone and fax lines and office supplies.

Mark must claim these expenses as a miscellaneous itemized deduction, which means he’ll enjoy a tax benefit only if his home office expenses plus his other miscellaneous itemized expenses exceed 2% of his adjusted gross income (AGI). If Mark instead were self-employed, he could use the deduction to offset his self-employment income and the AGI floor wouldn’t apply.

## Health care breaks

If your medical expenses exceed 7.5% of your AGI, you can deduct the excess amount. Eligible expenses include:

- ◆ Health insurance premiums,
- ◆ Long-term care insurance premiums (limits apply),
- ◆ Medical and dental services, and
- ◆ Prescription drugs.

Consider “bunching” nonurgent medical procedures and other controllable expenses into one year to exceed the 7.5% floor. But keep in mind that, for AMT purposes, only medical expenses exceeding 10% of your AGI are deductible.

Also remember that expenses that are reimbursed (or reimbursable) by insurance or paid through one of the following accounts aren’t deductible:

**HSA.** If you’re covered by qualified high-deductible health insurance, a Health Savings Account allows contributions of pretax

income (or deductible after-tax contributions) up to \$3,050 for self-only coverage and \$6,150 for family coverage. (The limits will be \$3,100 and \$6,250, respectively, for 2012.) Account holders age 55 and older can contribute an additional \$1,000.

HSAs bear interest or are invested and can grow tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

**FSA.** You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit. The plan pays or reimburses you for medical expenses not covered by insurance. What you don't use by the end of the plan year, you generally lose. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

**Warning:** Beginning in 2011, you no longer can use HSA or FSA funds to pay for over-the-counter drugs unless they're prescribed.

## Sales tax deduction

The break allowing you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes is available for 2011 but, as of this writing, not for 2012. It can be valuable to taxpayers who reside in states with no or low income tax or who purchase major items, such as a car or boat. If you're considering such a purchase, you may want to make it by year end in case the break isn't extended.

## Charitable donations

Donations to qualified charities are generally fully deductible. For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example:

**Appreciated assets.** Publicly traded stock and other securities you've held more than one year are long-term capital gains property, which can make one of the best charitable gifts. Why? Because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property. **Warning:** Donations of such property are subject to tighter deduction limits. Excess contributions can be carried forward for up to five years.

**CRTs.** For a given term, a charitable remainder trust pays an amount to you annually (some of which may be taxable). At the term's end, the CRT's remaining assets pass to one or more charities. When you fund the CRT, you receive an income tax deduction. If you contribute appreciated assets, you also may be able to minimize and defer capital gains tax. You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different. ■

# How to save taxes from birth to graduation — and beyond



*Whether you're the parent of a newborn or a college student — or your children are somewhere in between — there are numerous tax breaks you and your family may benefit from. Some breaks also offer you the opportunity to teach your children about the value of saving for the future.*

## Child and adoption credits

Tax credits reduce your tax bill dollar-for-dollar, so make sure you're taking every credit you're entitled to. For each child under age 17 at the end of the year, you may be able to claim a \$1,000 credit. If you adopt in 2011, you may be eligible for a credit or use an employer adoption assistance program income exclusion; both are \$13,360 per eligible child. These credits phase out for higher-income taxpayers. Check with your tax advisor for details.

## Child care expenses

A couple of tax breaks can help you offset these costs:

**Tax credit.** For children under age 13 or other qualifying dependents, you may be eligible for a credit for a portion of your dependent care expenses. Eligible expenses are limited to \$3,000 for one dependent, \$6,000 for two or more. Income-based limits reduce the credit but don't phase it out altogether.

**FSA.** You can contribute up to \$5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. You can't use those same expenses to claim a tax credit.

## Children with jobs

If your children work after school, on weekends or during vacations, additional tax-saving opportunities may be available:

**IRAs for teens.** IRAs can be perfect for teenagers because they likely have many years to let their accounts grow tax-deferred or

tax-free. The 2011 contribution limit is the lesser of \$5,000 or 100% of earned income. (See Case Study II on page 8.)

**Employing your children.** If you own a business, consider hiring your children. As the business owner, you can deduct their pay, and other tax benefits may apply. They can earn up to \$5,800 (the 2011 standard deduction for singles) and pay zero federal income tax. **Warning:** They must perform actual work and be paid in line with what you'd pay nonfamily employees for the same work.

## The “kiddie tax”

The income shifting that once — when the “kiddie tax” applied only to those under age 14 — provided families with significant tax savings now offers much more limited benefits. Today, the kiddie tax applies to children under age 19 as well as to full-time students under age 24 (unless the students provide more than half of their own support from earned income). For children subject to the kiddie tax, any unearned income beyond \$1,900 (for 2011) is taxed at their parents' marginal rate rather than their own, likely lower, rate. Keep this in mind before transferring income-generating assets to them.

## Saving for education

If you're saving for education, there are two tax-advantaged vehicles you should consider:

**1. Section 529 plans.** You can choose a prepaid tuition program to secure current tuition rates or a tax-advantaged savings plan to fund college expenses:

- ◆ Contributions aren't deductible for federal purposes, but plan assets grow tax-deferred.
- ◆ Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, equipment, supplies and, generally, room and board) are income-tax-free for federal purposes and may be tax-free for state purposes.
- ◆ The plans typically offer high contribution limits, and there are no income limits for contributing.
- ◆ There's generally no beneficiary age limit for contributions or distributions.
- ◆ You remain in control of the account — even after the child is of legal age.
- ◆ You can make rollovers to another qualifying family member.
- ◆ The plans provide estate planning benefits: A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make a \$65,000 contribution (or \$130,000 if you split the gift with your spouse).

## Case Study II

# Traditional vs. Roth IRA: Which is better for a teen?

Choosing a Roth IRA is a no-brainer if a teen doesn't earn income exceeding the standard deduction (\$5,800 for 2011 for single taxpayers), because he or she will gain no benefit from the ability to deduct a traditional IRA contribution. But what if a teen earns enough that he or she will owe current income tax? Let's look at an example.

When Ashley turns age 16, she starts to do administrative work for her mother's business, part-time during the school year and full-time during the summers, earning around \$12,000 per year — enough that a portion of her income will be taxed. Her father wants her to learn the benefits of tax-advantaged compounding and suggests that she start contributing to an IRA.

But first they need to decide whether she should contribute to a traditional or Roth account. So they do some projections. The projections consider only contributions she'll make until she graduates from college at age 22 and gets a full-time job. They assume that the income she contributes to a Roth IRA would first be taxed and that her rate is 10%. So her annual traditional IRA contribution would be \$5,000 while her annual Roth IRA contribution would be only \$4,500 (\$5,000 – 10% of \$5,000). They also assume a 6% rate of return.

Although the age-67 balance of the Roth IRA is \$57,769 less than that of the traditional IRA, Ashley will be able to withdraw the Roth IRA funds tax-free. Let's say that starting at age 67 she wanted to net \$50,000 per year from her IRA, and her tax rate was 35%. She'd need to withdraw nearly \$77,000 from a traditional IRA, compared to \$50,000 from a Roth IRA. So income taxes could quickly eat up the additional balance in the traditional account. In fact, after less than 10 years, the traditional IRA would be exhausted, while the Roth IRA would continue for another five-plus years. The total distributions net of tax would be significantly higher for the Roth IRA.

| Balance at age 67              |           |
|--------------------------------|-----------|
| Traditional IRA                | \$577,690 |
| Roth IRA                       | \$519,921 |
| Total distributions net of tax |           |
| Traditional IRA                | \$475,357 |
| Roth IRA                       | \$762,394 |

*Note: This example is for illustrative purposes only and isn't a guarantee of future results.*

The biggest downsides may be that your investment options — and when you can change them — are limited.

**2. ESAs.** Coverdell Education Savings Account contributions aren't deductible for federal purposes, but plan assets grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free. Perhaps the biggest ESA advantage is that you have direct control over how and where your contributions are invested. Another advantage is that tax-free distributions aren't limited to college expenses; they also can fund elementary and secondary school costs.

However, if Congress doesn't extend this treatment, distributions used for precollege expenses will be taxable starting in 2013. Additionally, the annual ESA contribution limit per beneficiary is only \$2,000 through 2012, and it will go down to \$500 for 2013 if Congress doesn't act. Contributions are further limited based on income. Generally, contributions can be made only for the benefit of a child under age 18. Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

## Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

**American Opportunity credit.** An expanded version of what was previously known as the Hope credit, this tax break covers 100% of the first \$2,000 of tuition and related expenses and 25% of the next \$2,000 of expenses. The maximum credit is \$2,500 per year for the first four years of postsecondary education.

**Lifetime Learning credit.** If you're paying postsecondary education expenses beyond the first four years, you may be eligible for the Lifetime Learning credit (up to \$2,000 per tax return).

**Tuition and fees deduction.** If you don't qualify for one of the credits because your income is too high, you might be eligible to *deduct* up to \$4,000 of qualified higher education tuition and fees. The deduction is limited to \$2,000 for taxpayers with incomes exceeding certain limits and is unavailable to taxpayers with higher incomes.

**Student loan interest deduction.** If you're paying off student loans, you may be able to deduct up to \$2,500 of interest (per tax return).

**Warning:** Income-based phaseouts apply to these breaks, and expenses paid with 529 plan or ESA distributions can't be used to claim them. ■

## 15% rate extension provides only a temporary reprieve



*Last year, the biggest tax planning concern related to your investments likely was the return of higher long-term capital gains and dividend rates scheduled for 2011. Fortunately, in December Congress extended the 15% rate — but only through 2012. (See Chart 1.) So you may want to take steps this year and next to lock in lower rates while they're still available. There are other valuable tax planning strategies to consider as well.*

### Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. The 15% long-term capital gains rate (which also applies to qualified dividends) is 20 percentage points lower than the highest ordinary-income rate of 35%. It generally applies to investments held for more than 12 months. (Higher long-term gains rates apply to certain types of assets — see Chart 1.)

Holding on to an investment until you've owned it more than a year may help substantially cut tax on any gain. Here are some other tax-saving strategies related to timing:

**Use unrealized losses to absorb gains.** To determine capital gains tax liability, realized capital gains are netted against realized capital losses. If you've cashed in some big gains during the year and want to reduce your 2011 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains.




**Avoid wash sales.** If you're trying to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid the wash sale rule. For example, you may immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. Or, you can wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

**Swap your bonds.** With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

Chart 1

## What's the maximum capital gains tax rate?

| Maximum tax rate for assets held   | 2011–2012        | 2013             |
|--|------------------|------------------|
| 12 months or less ( <i>short term</i> )  | 35%              | 39.6%            |
| More than 12 months ( <i>long term</i> )   | 15%              | 20%              |
| Some key exceptions  | 2011–2012        | 2013             |
|  Long-term gain on collectibles, such as artwork and antiques                                   | 28%              | 28%              |
|  Long-term gain attributable to certain recapture of prior depreciation on real property        | 25%              | 25%              |
|  Gain on qualified small business stock held more than 5 years                                  | 14% <sup>1</sup> | 14% <sup>1</sup> |
|  Long-term gain that would be taxed at 15% or less based on the taxpayer's ordinary-income rate | 0%               | 10%              |

<sup>1</sup> Effective rate based on 50% exclusion from a 28% rate.

## What's new!

### 100% gain exclusion for certain small business stock purchased by Dec. 31

**Who's affected:** Investors considering small business stock.

**Key changes:** Generally, taxpayers selling qualified small business (QSB) stock are allowed to exclude up to 50% of their gain if they've held the stock for more than five years. Because the 50% exclusion is computed based on an old tax rate of 28%, the 14% rate is only slightly less than the rate for other long-term gains. But under 2010 tax legislation, the exclusion is 100% for stock acquired after Sept. 27, 2010, and before Jan. 1, 2012. (If the stock was acquired after Feb. 17, 2009, and before Sept. 28, 2010, the exclusion is 75%.) The five-year holding requirement still applies. To be a QSB, a business must be engaged in an active trade or business and must not have assets that exceed \$50 million.

**Planning tips:** You may want to purchase QSB stock by year end so you can potentially take advantage of the 100% gain exclusion. In addition to providing substantial tax benefits, investing in QSB stock can help diversify your portfolio. But keep in mind that the tax benefits are subject to additional requirements. Consult your tax or financial advisor to be sure investing in QSB stock is right for you.

**Mind your mutual funds.** Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

**See if a loved one qualifies for the 0% rate.** The long-term capital gains rate is 0% for gain that would be taxed at 10% or 15% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated or dividend-producing assets to them so they can enjoy the 0% rate, which also applies to qualified dividends. The 0% rate is also scheduled to expire after 2012, so you may want to act soon.

**Warning:** If the child is under age 24, first make sure he or she won't be subject to the kiddie tax. (See "The 'kiddie tax'" on page 7.) Also, consider any gift tax consequences. (See page 27.)

### Loss carryovers

If net losses exceed net gains, you can deduct only \$3,000 (\$1,500 for married taxpayers filing separately) of the net losses per year against ordinary income (such as wages, self-employment and business income, interest, and dividends).

You can carry forward excess losses to future years indefinitely. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains.

But if you don't expect substantial future gains, it could take a long time to fully absorb a large loss carryover. So, from a tax perspective, it may not be desirable to sell an investment at a loss if you won't have enough gains to absorb most of it. Plus, if you hold on to the investment, it may recover the lost value. Nevertheless, if you're ready to divest yourself of a poorly performing investment because you think it will continue to lose value — or because your investment objective or risk tolerance has changed — don't hesitate solely for tax reasons.

## Other important rules

For some types of investments, special rules apply, so you'll have more tax consequences to think about than just gains and losses:

**Interest-producing investments.** Interest income generally is taxed at ordinary-income rates. So, through 2012, stocks that pay qualified dividends may be more attractive tax-wise than, for example, CDs or money market accounts. But nontax issues must be considered as well, such as investment risk and diversification.

**Bonds.** These also produce interest income, but the tax treatment varies:

- ♦ Interest on U.S. government bonds is taxable on federal returns but generally exempt on state and local returns.
- ♦ Interest on state and local government bonds is excludible on federal returns. If the bonds were issued in your home state, interest also may be excludible on your state return.
- ♦ Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT) in some situations.
- ♦ Corporate bond interest is fully taxable for federal and state purposes.
- ♦ Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

**Stock options.** Before exercising (or postponing exercise of) options or selling stock purchased via an exercise, consult your tax advisor about the complicated rules that may trigger regular tax or AMT liability. He or she can help you plan accordingly. ■

# Take advantage of new, extended and long-standing tax breaks



*This year offers some new tax breaks, such as 100% bonus depreciation and the retained worker credit. It also offers another chance to take advantage of some breaks that have been extended through 2011. So it's important to be aware of all of these opportunities. But don't forget about long-standing breaks — they can also provide valuable savings.*

## Projecting income

Projecting your business's income for this year and next will allow you to time income and deductions to your advantage. It's generally better to defer tax. So if you expect to be in the same or a lower tax bracket next year, consider:

**Deferring income to next year.** If your business uses the cash method of accounting, you can defer billing for your products or services. Or, if you use the accrual method, you can delay shipping products or delivering services.

**Accelerating deductions into the current year.** If you're a cash-basis taxpayer, you may want to make an estimated state tax payment before Dec. 31, so you can deduct it this year rather than next. But consider the alternative minimum tax (AMT) consequences first. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when paid.

**Warning:** Think twice about these strategies if you're experiencing a low-income year. Their negative impact on your cash flow may not be worth the potential tax benefit. And, if it's likely you'll be in a higher tax bracket next year, the opposite strategies (accelerating income and deferring deductions) may save you more tax.

## Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be

## What's new!

100% bonus depreciation provides strong incentive to invest in your business this year

**Who's affected:** Businesses that have made or are considering asset purchases.

**Key changes:** The 2010 Tax Relief act significantly enhances bonus depreciation by temporarily increasing this additional first-year depreciation allowance to 100% and providing a 50% allowance for 2012. (See the chart below.) Qualified assets include *new* tangible property with a recovery period of 20 years or less (such as office furniture, equipment and company-owned vehicles), off-the-shelf computer software, water utility property and qualified leasehold-improvement property. The act also extends the provision allowing corporations to accelerate certain credits in lieu of claiming bonus depreciation for qualified assets acquired and placed in service through Dec. 31, 2012 (Dec. 31, 2013, for certain long-lived and transportation property).

**Planning tips:** Bonus depreciation will benefit more taxpayers than Section 179 expensing, because it isn't subject to any asset purchase limits. However, unlike Sec. 179 expensing, bonus depreciation isn't available for *used* property. If you're anticipating major purchases of assets in the next year or two that would qualify, you may want to time them so you can benefit from 100% bonus depreciation.

| Qualified assets acquired and placed in service | Bonus depreciation |
|---|--------------------|
| Jan. 1, 2008, through Sept. 8, 2010             | 50%                |
| Sept. 9, 2010, through Dec. 31, 2011            | 100%               |
| Jan. 1, 2012, through Dec. 31, 2012             | 50%                |
| After Dec. 31, 2012                             | none               |

*Note: Later deadlines apply to certain long-lived and transportation property. Also, an extension of 100% bonus depreciation has been proposed; check with your tax advisor for the latest information.*

preferable to the straight-line method because you'll get a larger deduction in the early years of an asset's life. But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning during the year can help you maximize depreciation deductions in the year of purchase. Other depreciation-related breaks and strategies also are available:

**Section 179 expensing election.** Business owners can use this election to deduct (rather than depreciate over a number of years) the cost of purchasing such assets as equipment, furniture and

off-the-shelf computer software. For 2011, the expensing limit is \$500,000, and up to \$250,000 of that amount can be for qualified leasehold-improvement, restaurant and retail-improvement property. (Heating and air conditioning units aren't eligible for the \$250,000 amount.) The break begins to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed \$2 million. You can claim the election only to offset net income, not to reduce it below zero.

Sec. 179 may be less important while 100% bonus depreciation is available. (See "What's new!" on page 15.) Depending on the type of asset, 100% bonus depreciation may provide the same tax savings — without any net income requirement or limit on asset purchases. But only Sec. 179 expensing can be applied to *used* assets, and you'll also want to consider state tax consequences.

**Accelerated depreciation.** This allows a shortened recovery period of 15 years — rather than 39 years — for qualified leasehold-improvement, restaurant and retail-improvement property, but, as of this writing, only through 2011. If you're considering making such investments, you may want to do so this year to ensure you can take advantage of this break. But you'll also need to consider how this fits in with bonus depreciation and Sec. 179 expensing opportunities, which will provide a greater benefit if the property is eligible.

**Cost segregation study.** If you've recently purchased or built a building or are remodeling existing space, consider a cost segregation study. It identifies property components and related costs that can be depreciated much faster, dramatically increasing your current deductions. Typical assets that qualify include decorative fixtures, security equipment, parking lots, landscaping and architectural fees allocated to qualifying property. The benefit of a cost segregation study may be limited in certain circumstances.

## Vehicle-related deductions

Business-related vehicle expenses can be deducted using the mileage-rate method (51 cents per mile driven Jan. 1 through June 30, 2011, and 55.5 cents per mile driven July 1 through Dec. 31, 2011) or the actual-cost method (total out-of-pocket expenses for fuel, insurance and repairs, plus depreciation).

Purchases of *new or used* vehicles may be eligible for Sec. 179 expensing, and purchases of *new* vehicles may be eligible for bonus depreciation. (See "What's new!" on page 15.) However, many rules and limits apply. For example, under Sec. 179 expensing, you can deduct up to \$25,000 of the purchase price of an SUV that weighs more than 6,000 pounds but no more than 14,000 pounds. The normal Sec. 179 expensing limits generally apply to vehicles weighing more than 14,000 pounds.

Vehicles weighing 6,000 pounds or less don't satisfy the SUV definition and thus are subject to the passenger automobile limits. For autos placed in service in 2011, the depreciation limit is \$3,060. The limit is increased by \$8,000 for autos eligible for bonus depreciation. The amount that may be deducted under the combination of MACRS depreciation, Sec. 179 and bonus depreciation rules for the first year is limited under the luxury auto rules. In addition, if a vehicle is used for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and non-deductible personal use. The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing, bonus depreciation or the accelerated regular MACRS; you must use the straight-line method.

## Manufacturers' deduction

The manufacturers' deduction, also called the Section 199 or domestic production activities deduction, has been fully phased in and is now 9% of the lesser of qualified production activities income or taxable income. The deduction is also limited by W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts. The deduction is available to traditional manufacturers and to businesses engaged in activities such as construction, engineering, architecture, computer software production and agricultural processing. The deduction isn't allowed in determining net earnings from self-employment and generally can't reduce net income below zero. But it can be used against the AMT.

## Employee benefits

Offering a variety of benefits can help you not only attract and retain the best employees, but also manage your tax liability:

**Qualified deferred compensation plans.** These include pension, profit-sharing, SEP and 401(k) plans, as well as SIMPLEs. You can enjoy a tax deduction for your contributions to employees' accounts, and the plans offer tax-deferred savings benefits for employees. Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a \$500 credit per year for three years. The credit is limited to 50% of qualified startup costs.

**HSAs and FSAs.** If you provide employees with qualified high-deductible health insurance, you can also offer them Health Savings Accounts. Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts.

**Fringe benefits.** Some fringe benefits — such as group term-life insurance (up to \$50,000), health insurance, parking and mass transit / van pooling (up to \$230 per month), and employee

## What's new!

### Enhanced deductions for certain donations extended

**Who's affected:** Eligible businesses considering certain inventory donations.

**Key changes:** Enhanced deductions had expired at the end of 2009 for certain inventory donations: food inventory, book inventory to public schools, and computer inventory for educational purposes. The 2010 Tax Relief act extends the enhanced deductions for these donations through 2011.

**Planning tips:** The rules are complex and vary somewhat for each type of inventory donation, so talk to your tax advisor to determine whether you're eligible for an enhanced deduction. If you are, you may want to make the contribution by Dec. 31, 2011, to ensure you can take advantage of the enhanced deduction.

discounts — aren't included in employee income. Yet the employer can still receive a deduction and typically avoids payroll tax as well. Certain small businesses providing health care coverage to their employees may be eligible for a new tax *credit* that became available in 2010. (See "Tax credits" below.)

**NQDC.** Nonqualified deferred compensation plans generally aren't subject to nondiscrimination rules, so they can be used to provide substantial benefits to key employees. But the employer generally doesn't get a deduction for NQDC plan contributions until the employee recognizes the income.

### NOLs

A net operating loss occurs when operating expenses and other deductions for the year exceed revenues. Generally, an NOL may be carried back two years to generate a refund. Any loss not absorbed is carried forward up to 20 years. Carrying back an NOL may provide a needed influx of cash. But carrying the entire loss forward can be more beneficial in some situations.

### Tax credits

Tax credits reduce your business's tax liability dollar-for-dollar, making them particularly valuable. Numerous types of credits are available to businesses. Here are a few that have been extended or created by recent legislation:

**Research credit.** The 2010 Tax Relief act extended the research credit (also commonly referred to as the "research and development" or "research and experimentation" credit) through 2011, and there's been much discussion about making it permanent. The credit generally is equal to a portion of qualified research

expenses. It's complicated to calculate, but savings can be substantial, so consult your tax advisor.

**Work Opportunity credit.** The 2010 Tax Relief act also extended the Work Opportunity credit through Dec. 31, 2011. It benefits businesses hiring employees from certain disadvantaged groups, such as ex-felons, food stamp recipients and disabled veterans. (Note that the provision expanding the eligible groups to include unemployed veterans and disconnected youth was *not* extended.) The credit equals 40% of the first \$6,000 of wages paid to qualifying employees (\$12,000 for wages paid to qualified veterans).

**Health care coverage credit for small businesses.** For tax years 2010 to 2013, the maximum credit is 35% of group health coverage premiums paid by the employer. To get the credit, you must contribute at least 50% of the total premium or of a benchmark premium. The full credit is available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than \$25,000 per employee. Partial credits are available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than \$50,000.

**Retention credit.** If you hired workers in 2010, you may be eligible for a retention credit. It generally applies to workers who qualified for payroll tax forgiveness under the Hiring Incentives to Restore Employment (HIRE) Act of 2010 and are retained for 52 consecutive weeks. The tax savings per qualified retained worker are equal to the lesser of 6.2% of wages paid to the worker during the 52-week retention period or \$1,000.

**Energy-related credits.** The 2010 Tax Relief act extends certain energy-related incentives. While most typically apply to either home builders or manufacturers of energy-efficient appliances, there are some that are more generally applicable. For example, if you buy or lease hybrid or lean-burn-technology vehicles, you may be able to claim tax credits, but these credits phase out once a certain number of a particular vehicle has been sold.

**Other credits.** The 2010 Tax Relief act also extended the empowerment zone tax credit, as well as certain disaster relief credits for the Gulf Opportunity Zone.

## Business structure

Income taxation and owner liability are the main factors that differentiate one business structure from another. Many businesses choose entities that combine flow-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations. (See Chart 2 on page 20 to compare the tax treatments.) Sometimes it makes sense to change business structures, but there may be unwelcome tax consequences.

## Chart 2

### Tax differences based on business structure

| Pass-through entity or sole proprietorship                                  | C corporation  |
|---|--|
| One level of taxation: The business's income flows through to the owner(s). | Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.  |
| Losses flow through to the owner(s).  | Losses remain at the corporate level.  |
| Top individual tax rate is 35%.   | Top corporate tax rate is generally 35% <sup>1</sup> . Dividends are generally taxed at 15%.<br><small><sup>1</sup> See Chart 7 on page 32 for exceptions.</small> |

Some tax differences between structures may provide planning opportunities, such as those related to salary vs. distributions:

**S corporations.** To reduce their employment taxes, shareholder-employees may want to keep their salaries relatively low and increase their distributions of company income (which generally isn't taxed at the corporate level). But to avoid potential back taxes and penalties, they must take a "reasonable" salary.

**C corporations.** Shareholder-employees may prefer to take more income as salary (which is deductible at the corporate level) because the overall tax paid by both the corporation and the shareholder-employee may be less.

**Warning:** The IRS is cracking down on misclassification of corporate payments to shareholder-employees, and Congress also has been looking at this issue, so tread carefully.

### Sale or acquisition

Whether you're selling your business as part of your exit strategy or acquiring another company to help grow it, the tax consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

**Asset vs. stock sale.** With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. Buyers generally want an asset sale to maximize future depreciation write-offs.

**Taxable sale vs. tax-deferred transfer.** A transfer of corporation ownership can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying

reorganization. But the transaction must comply with strict rules. Although it's generally better to postpone tax, there are some advantages to a taxable sale:

- ♦ The parties don't have to meet the technical requirements of a tax-deferred transfer.
- ♦ The seller doesn't have to worry about the quality of buyer stock or other business risks of a tax-deferred transfer.
- ♦ The buyer benefits by receiving a stepped-up basis in its acquisition's assets and not having to deal with the seller as a continuing equity owner.

**Installment sale.** A taxable sale may be structured as an installment sale, due to the buyer's lack of sufficient cash or the seller's desire to spread the gain over a number of years, or when the buyer pays a contingent amount based on the business's performance. But an installment sale can backfire. For example:

- ♦ Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- ♦ If tax rates increase, the overall tax could wind up being more. (Remember, the favorable 15% rate on long-term capital gains is scheduled to end after Dec. 31, 2012.)

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition.

## The self-employed

If you're self-employed, you can deduct 100% of health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to the net income you've earned from your trade or business. (The 2010 break that allowed the self-employed to also deduct these costs for self-employment tax purposes hasn't, as of this writing, been extended to 2011.) You also can deduct above the line all contributions made to a retirement plan and, if you're eligible, an HSA for yourself.

You pay both the employee and employer portions of employment taxes on your self-employment income, and generally half of the tax paid is deductible above-the-line. However, for 2011 only, the 2010 Tax Relief act reduces the employee portion of the Social Security tax from 6.2% to 4.2%, and thus the Social Security tax on self-employment income is reduced from 12.4% to 10.4%. This doesn't reduce your deduction for the employer's share of these taxes — you can still deduct the full 6.2% employer portion of Social Security tax, along with one-half of the Medicare tax, for a full 7.65% deduction. And you may be able to deduct home office expenses against your self-employment income. (See Case Study I on page 4.) ■

# Plan now to live the retirement lifestyle you desire



*Tax-advantaged retirement plans offer valuable opportunities to save taxes now (or later, in the case of Roth accounts) and build up significant funds to help ensure you can live the lifestyle you desire during retirement. But it takes planning to make the most of these opportunities and to avoid potential tax pitfalls. Many limits and rules apply to both contributions and distributions.*

## 401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined-contribution plan, such as a 401(k), 403(b), 457, SARSEP or SIMPLE, is usually the first step in retirement planning:

- ◆ Contributions are typically pretax, so they can reduce your taxable income.
- ◆ Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- ◆ Your employer may match some or all of your contributions — also on a pretax basis.

Chart 3 shows the 2011 employee contribution limits. If you're age 50 or older by year end, you may be able to make an additional "catch-up" contribution. If your employer offers a match, contribute at least the amount necessary to get the maximum employer match so you avoid missing out on that "free" money. If your employer has suspended matching contributions to reduce costs, don't use that as an excuse to suspend your own contributions. Doing so will only exacerbate the negative impact on your retirement nest egg — plus your taxable 2011 income will increase compared to what it would be if you'd contributed to the plan.

If your employer provides a SIMPLE, it's required to make contributions (though not necessarily annually). But the employee contribution limits are lower than for other employer-sponsored plans. (See Chart 3.)

## More tax-deferred options

In certain situations, other tax-deferred savings options may be available:

**If you're a business owner or self-employed.** You may be able to set up a plan that allows you to make much larger contributions. Depending on the type of plan, you might not have to make 2011 contributions, or even set up the plan, before year end. Check with your tax advisor for details.

**If your employer doesn't offer a retirement plan.** Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited based on your income if your spouse participates in an employer-sponsored plan. You can make 2011 contributions as late as April 16, 2012.

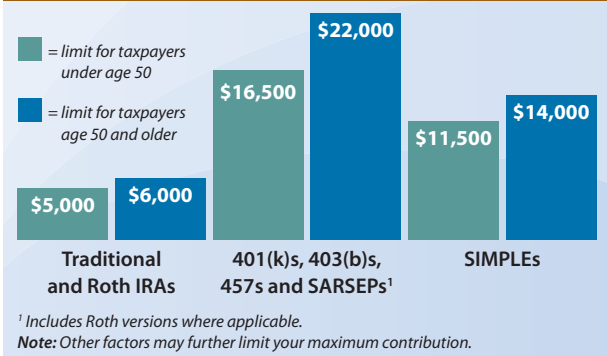
## Roth accounts

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Two retirement plan options allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

**1. Roth IRAs.** In addition to tax-free distributions, an important benefit is that, unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime. This can provide estate planning advantages: You can let the entire balance grow tax-free over your lifetime for the benefit of your heirs. If, for example, you name your child as the beneficiary, he or she will be required to start taking distributions upon

Chart 3

### No increase in retirement plan contribution limits for 2011



inheriting the Roth IRA. But the distributions will be tax-free and spread out over his or her lifetime, and funds remaining in the account can continue to grow tax-free for many years to come. (See page 26 for more on estate planning.)

But Roth IRAs are subject to the same low annual contribution limit as traditional IRAs (see Chart 3 on page 23), and your Roth IRA limit is reduced by any traditional IRA contributions you make for the year. It may be further reduced based on your income.

If you have a traditional IRA, consider whether you might benefit from converting all or a portion of it to a Roth IRA. A conversion can allow you to turn *tax-deferred* future growth into *tax-free* growth and take advantage of a Roth IRA's estate planning benefits.

There's no longer an income-based limit on who can convert. But, unlike when the limit was first lifted last year, the converted amount is now taxable in the year of the conversion. Whether a conversion makes sense for you depends on a variety of factors, such as your age, whether you can afford to pay the tax on the conversion, your tax bracket now and expected tax bracket in retirement, and whether you'll need the IRA funds in retirement.

**2. Roth 401(k)s, Roth 403(b)s and Roth 457s.** If the plan allows it, you may designate some or all of your contributions as Roth contributions. (Employer matches aren't eligible.) These plans may be especially beneficial for higher-income earners who are ineligible to contribute to Roth IRAs. Under recent legislation, you may be able to make a rollover from your traditional account to a Roth account under the same plan, but there will be tax consequences similar to those of a Roth IRA conversion.

## Early withdrawals

If you're facing financial challenges this year, it may be tempting to make withdrawals from your retirement plans. But generally this should be a last resort. With a few exceptions, retirement plan distributions made before age 59½ are subject to a 10% penalty, in addition to income tax. This means that you can lose a substantial amount to taxes and penalties. Additionally, you'll lose the potential tax-deferred future growth on the amount you've withdrawn.

If you must make an early withdrawal and you have a Roth account, you may be better off withdrawing from that. You can withdraw up to your contribution amount free of tax and penalty. Another option, if your employer-sponsored plan allows it, is to take a loan from the plan. You'll have to pay it back with interest (which generally won't be deductible), but you won't be subject to current taxes or penalties.

### Case Study III

## Avoiding retirement plan pitfalls when leaving a job

Eric and Kevin both change jobs in 2011 and decide to roll over funds from their traditional 401(k) plans with their former employers to traditional IRAs so that they'll have more investment choices. Each has a balance of \$100,000. Eric requests a direct rollover from his old plan to his IRA. Because he never personally receives the funds, he owes no income tax or penalties.

Kevin, however, doesn't request a direct rollover. Instead, he receives a lump-sum check. Much to his surprise, the check is for only \$80,000, because his employer withheld 20% for federal income taxes. After consulting with his tax advisor, he learns that he needs to make an indirect rollover to his IRA within 60 days to avoid tax and potential penalties. (He may be able to receive a refund of the \$20,000 withheld when he files his 2011 tax return, depending on his overall tax liability for the year.)

He also learns that if he doesn't roll over the gross amount of \$100,000 — which will require him to make up for the withheld amount with other funds — he'll be subject to income tax on the \$20,000 difference. And, because he's under age 59½, he'll also owe the 10% early withdrawal penalty.

Early distribution rules are also important to be aware of if you change jobs or retire. See Case Study III.

### Required minimum distributions

Normally, once you reach age 70½ you must take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and defined contribution plans. If you don't comply, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't. You can avoid the RMD rule for a Roth 401(k), Roth 403(b) or Roth 457 by rolling the funds into a Roth IRA.

So, should you take distributions between ages 59½ and 70½, or more than the RMD after age 70½? Distributions in any year your tax bracket is low may be beneficial. But also consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause your Social Security payments to become taxable, 2) increase Medicare prescription drug charges, or 3) affect other deductions or credits with income-based limits.

If you've inherited a retirement plan, consult your tax advisor regarding the distribution rules that apply to you. ■

# Changes provide opportunities, but uncertainty remains



*There's good news and bad news this year when it comes to estate planning. On the positive side, the 2010 Tax Relief act prevents pre-2001 tax act law (lower exemptions and higher rates) from going into effect in 2011 as originally scheduled. The act also provides some new tax-saving opportunities. But, on the negative side, these provisions apply only through 2012. Thus, much uncertainty remains, making estate planning an ongoing challenge.*

## Estate tax

The 2010 Tax Relief act retroactively brought back the estate tax for 2010 (along with the unlimited step-up in basis), but with an exemption increase and a rate reduction compared to 2009. It

**Chart 4**

### Transfer tax exemptions and highest rates

| Year | Gift tax exemption       | Estate <sup>1</sup> and GST tax exemptions | Highest estate and gift tax rates and GST rate |
|------|--------------------------|--|--|
| 2009 | \$1 million              | \$3.5 million                              | 45%  |
| 2010 | \$1 million              | \$ 5 million <sup>2</sup>                  | 35% <sup>2</sup><br>(0% GST tax)               |
| 2011 | \$5 million              | \$ 5 million                               | 35%  |
| 2012 | \$5 million <sup>3</sup> | \$ 5 million <sup>3</sup>                  | 35%  |
| 2013 | \$1 million              | \$ 1 million <sup>4</sup>                  | 55% <sup>5</sup>                               |

<sup>1</sup> Less any gift tax exemption already used during life. For 2011 and 2012, these amounts are "portable" between spouses.

<sup>2</sup> For estate tax purposes only, estates can elect to follow the pre-2010 Tax Relief act regime (estate tax repeal + limited step-up in basis).

<sup>3</sup> Indexed for inflation.

<sup>4</sup> GST tax exemption indexed for inflation.

<sup>5</sup> The benefits of the graduated gift and estate tax rates and exemptions are phased out for gifts/estates over \$10 million.

extended these levels through 2012. (See Chart 4.) The act also temporarily provides exemption “portability” between spouses. (See “What’s new!” on page 28.)

If you have a loved one who died in 2010 and you haven’t already consulted a tax advisor, be sure to do so. The option is available to follow the pre-2010 Tax Relief act estate tax repeal / limited step-up in basis regime instead of the new regime, but which is better depends on a variety of factors.

## GST tax

The generation-skipping transfer tax generally applies to transfers (both during life and at death) made to people two generations or more below you, such as your grandchildren. The GST tax also had been repealed for 2010, and the 2010 Tax Relief act brought it back with the same exemption amounts as for the estate tax through 2012. However, the act set the GST tax rate for 2010 at 0%. The GST tax rate goes back up to match the top estate tax rate for 2011 and 2012. (See Chart 4.)

## Gift tax

Gifts to your spouse are tax-free under the marital deduction (a limit applies to noncitizens), but most other gifts are potentially taxable. The gift tax was never repealed, and it follows the estate tax exemptions and top rates for 2011 and 2012. (See Chart 4.) Any gift tax exemption used during life reduces the estate tax exemption available at death.

If you can afford to do so without compromising your own financial security, consider using part or all of your gift tax exemption this year and next, in case the \$5 million exemption isn’t extended beyond 2012. But keep in mind that you can exclude certain gifts of up to \$13,000 per recipient each year (\$26,000 per recipient if your spouse elects to split the gift with you or you’re giving community property) without using up any of your gift tax exemption. So first consider maximizing your annual exclusion gifts.

## Tax-smart giving

Giving away assets now will help you reduce the size of your taxable estate. Here are some additional strategies for tax-smart giving:

**Choose gifts wisely.** Take into account both estate and income tax consequences and the economic aspects of any gifts you’d like to make:

- ♦ To minimize *estate tax*, gift property with the greatest future appreciation potential.

## What's new!

### More flexibility — temporarily — for married couples

**Who's affected:** Married couples and their loved ones.

**Key changes:** Under the 2010 Tax Relief act, if one spouse dies in 2011 or 2012 and part (or all) of his or her estate tax exemption is unused at his or her death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption.

**Planning tips:** Although similar results can be achieved by making asset transfers between spouses during life and/or setting up certain trusts at death, making this election will be much simpler and provide flexibility if proper planning hasn't been done before the first spouse's death.

Still, this election is currently available for only two years unless Congress extends it. Also, exemption portability doesn't protect future growth on assets from estate tax as effectively as applying the exemption to a credit shelter trust does. So married couples should still consider making asset transfers and setting up trusts to ensure that they take full advantage of both spouses' exemptions. Also be aware that the provision doesn't apply to the generation-skipping transfer tax exemption.



- ◆ To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it.
- ◆ To minimize *your own income tax*, don't gift property that's declined in value. Instead, sell the property so you can take the tax loss and then gift the sale proceeds.

**Plan gifts to grandchildren carefully.** Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts that don't qualify for the exclusion to be completely tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

**Gift interests in your business.** If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the discounts total 30%, in 2011 you can gift

an ownership interest equal to as much as \$18,571 tax-free because the discounted value doesn't exceed the \$13,000 annual exclusion. **Warning:** The IRS may challenge the value; a professional appraisal is strongly recommended.

**Gift FLP interests.** Another way to benefit from valuation discounts is to set up a family limited partnership (FLP). You fund the FLP and then gift limited partnership interests.

**Warning:** The IRS scrutinizes FLPs, so be sure to set up and operate yours properly.

**Pay tuition and medical expenses.** You may pay these expenses for a loved one without the payment being treated as a taxable gift, as long as the payment is made directly to the provider.

## Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. Here are some trusts you may want to consider:

- ◆ A credit shelter (or bypass) trust can help minimize estate tax by taking advantage of both spouses' estate tax exemptions.
- ◆ A qualified domestic trust (QDOT) can allow a non-U.S.-citizen spouse to benefit from the unlimited marital deduction.
- ◆ A qualified terminable interest property (QTIP) trust is good for benefiting first a surviving spouse and then children from a prior marriage.
- ◆ A qualified personal residence trust (QPRT) allows you to give your home to your children today — removing it from your taxable estate at a reduced tax cost (provided you survive the trust's term) — while you retain the right to live in it for the trust's term.
- ◆ A grantor-retained annuity trust (GRAT) works similarly to a QPRT but allows you to transfer other assets; you receive payments from the trust for a certain period.

Finally, a GST — or “dynasty” — trust can help you leverage both your gift and GST tax exemptions, and it can be an excellent way to lock in the current \$5 million exemptions.

## Insurance

Along with protecting your family's financial future, life insurance can be used to pay estate taxes, equalize assets passing to children who aren't involved in a family business, or pass leveraged funds to heirs free of estate tax. Proceeds are generally income-tax-free to the beneficiary. And with proper planning, you can ensure proceeds aren't included in your taxable estate. ■

## TAX RATES

Chart 5

### 2011 individual income tax rate schedules

| Tax rate | Regular tax brackets  |                       |
|----------|-----------------------|-----------------------|
|          | Single                | Head of household     |
| 10%      | \$ 0 – \$ 8,500       | \$ 0 – \$ 12,150      |
| 15%      | \$ 8,501 – \$ 34,500  | \$ 12,151 – \$ 46,250 |
| 25%      | \$ 34,501 – \$ 83,600 | \$ 46,251 – \$119,400 |
| 28%      | \$ 83,601 – \$174,400 | \$119,401 – \$193,350 |
| 33%      | \$174,401 – \$379,150 | \$193,351 – \$379,150 |
| 35%      | Over \$379,150        | Over \$379,150        |



| Tax rate | Regular tax brackets                       |                           |
|----------|--|---------------------------|
|          | Married filing jointly or surviving spouse | Married filing separately |
| 10%      | \$ 0 – \$ 17,000                           | \$ 0 – \$ 8,500           |
| 15%      | \$ 17,001 – \$ 69,000                      | \$ 8,501 – \$ 34,500      |
| 25%      | \$ 69,001 – \$139,350                      | \$ 34,501 – \$ 69,675     |
| 28%      | \$139,351 – \$212,300                      | \$ 69,676 – \$106,150     |
| 33%      | \$212,301 – \$379,150                      | \$106,151 – \$189,575     |
| 35%      | Over \$379,150                             | Over \$189,575            |



## Chart 6

### 2011 individual AMT tax rate schedules

| Tax rate                    | AMT brackets          |                       |
|-----------------------------|-----------------------|-----------------------|
|                             | Single                | Head of household     |
| 26%                         | \$ 0 – \$175,000      | \$ 0 – \$175,000      |
| 28%                         | Over \$175,000        | Over \$175,000        |
| <b>Exemption</b>            | \$ 48,450             | \$ 48,450             |
| <b>Phaseout<sup>1</sup></b> | \$112,500 – \$306,300 | \$112,500 – \$306,300 |

| Tax rate                    | AMT brackets                               |                           |
|-----------------------------|--|---------------------------|
|                             | Married filing jointly or surviving spouse | Married filing separately |
| 26%                         | \$ 0 – \$175,000                           | \$ 0 – \$ 87,500          |
| 28%                         | Over \$175,000                             | Over \$ 87,500            |
| <b>Exemption</b>            | \$ 74,450                                  | \$ 37,225                 |
| <b>Phaseout<sup>1</sup></b> | \$150,000 – \$447,800                      | \$ 75,000 – \$223,900     |

<sup>1</sup> The alternative minimum tax (AMT) income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

**Note:** Consult your tax advisor for AMT rates and exemptions for children subject to the kiddie tax.



## Chart 7

### 2011 corporate income tax rate schedule

| Tax rate | Tax bracket                   |
|----------|-------------------------------|
| 15%      | \$ 0 – \$ 50,000              |
| 25%      | \$ 50,001 – \$ 75,000         |
| 34%      | \$ 75,001 – \$ 100,000        |
| 39%      | \$ 100,001 – \$ 335,000       |
| 34%      | \$ 335,001 – \$ 10,000,000    |
| 35%      | \$ 10,000,001 – \$ 15,000,000 |
| 38%      | \$ 15,000,001 – \$ 18,333,333 |
| 35%      | Over \$ 18,333,333            |

*Note: Personal service corporations are taxed at a flat 35% rate.*



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