Moves you make in 2012 can benefit you now, later

USE THESE STRATEGIES TO LOWER THE AMOUNT OF TAX YOU OWE AND MAINTAIN HEALTHY FINANCES FOR YOU AND YOUR HEIRS

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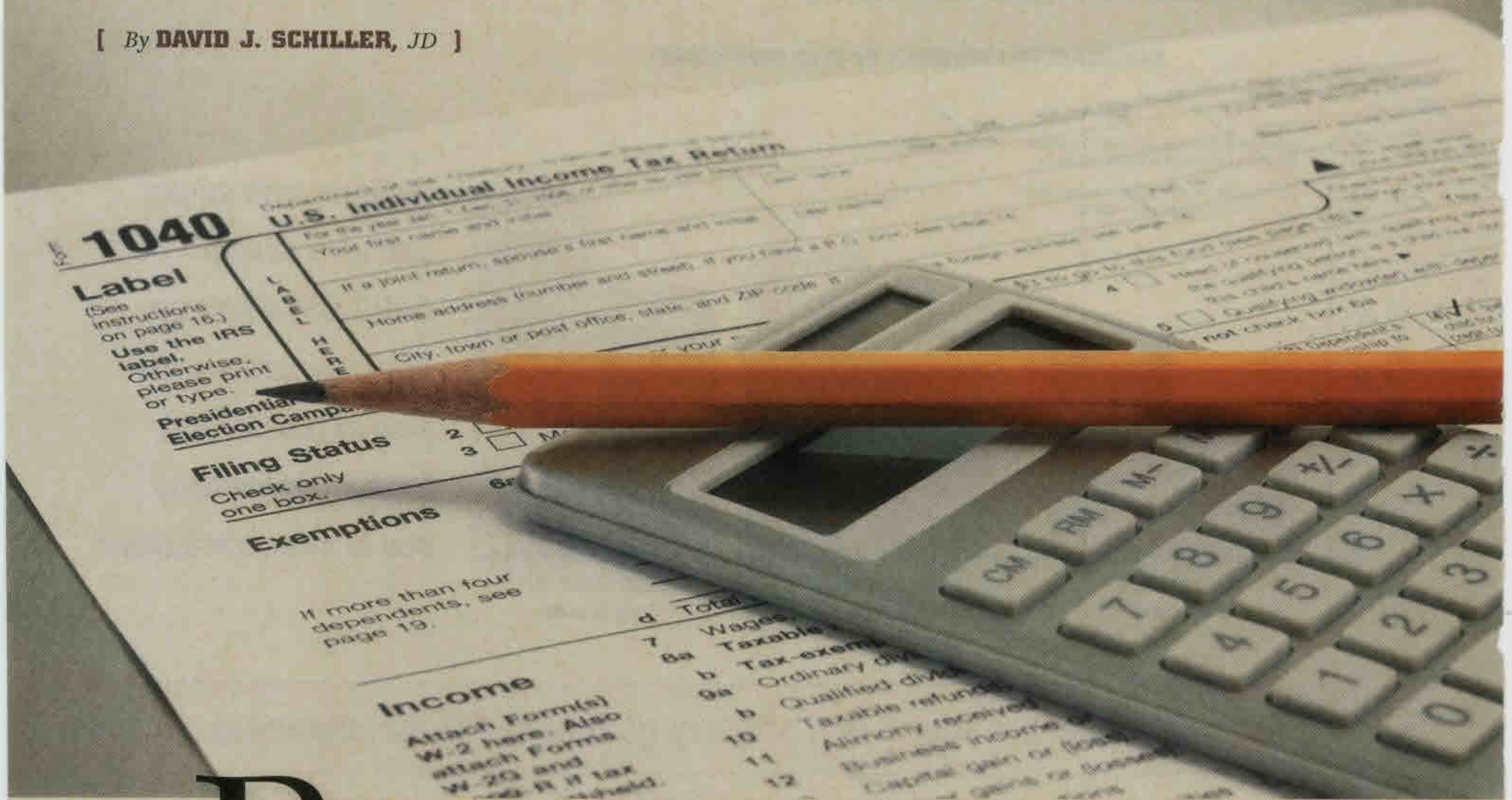

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Regardless of who wins the current tax debate and who wins the upcoming elections, planning opportunities in 2012 will help you minimize both income taxes and estate taxes.

Under current law, after 2012, long-term capital gains tax rates are scheduled to increase from 15% to 20%. The additional 3.8% Medicare tax also will be applied if you are married and your joint income exceeds $250,000 annually. This is in addition to the 0.9% surtax on earned income.

CAPITAL GAINS TAX

What does this mean for you? You will want to review closely your stocks this year to determine which should be sold at the current 15% federal long-term capital gains tax rate. If you have long-term capital losses carried forward from prior years, these will offset any gains you may incur and help you minimize any taxes you owe. It seems better to pay any long-term capital gains taxes at the favored 15% rate in 2012 instead of at the new 23.8% rate in 2013.

Similarly, if you intend to sell real estate (except

for your principal residence where other rules apply), you may wish to sell during 2012 to minimize capital gains taxes. The new 3.8% surtax also applies to taxable interest, dividends, rent, some annuities, and royalties.

In addition to capital gains tax rates increasing, the top tax rate on wages is scheduled to reset to 39.6% from 35% starting in 2013. You might want to accelerate earned income in 2012 to avoid higher rates in 2013. Starting in 2013, the law (unless changed) will disallow the first 3% of your itemized deductions, including charitable gifts. You may wish, therefore, to accelerate such deductions in 2012 while watching out for the alternative minimum tax.

POWER POINTS

Current tax law changes provide many opportunities to lower your income taxes and estate taxes.

Update your estate-planning documents if you have an individual retirement account or trust.

Consider selling certain investments to reduce capital gains taxes.

Tax laws let you deduct the cost of equipment you purchase for your practice.

INDIVIDUAL RETIREMENT ACCOUNTS

Now is also the time to consider whether making a Roth individual retirement account (IRA) conversion makes sense. Although doing so would result in your paying income taxes now, with higher tax rates in 2013 and beyond, biting the bullet may be wise. Once converted, as long as the funds remain in the Roth IRA for at least 5 years and until after you are age 59 ½, all of the growth will be tax-free (not tax-deferred, as with a regular IRA). You can have many years of tax-free income building within a Roth IRA.

Further, your tax-free Roth IRA is an excellent estate-planning vehicle because it can pass to your children or grandchildren and remain income tax-free throughout their lives, making this a multigenerational tax avoidance strategy. Unlike a regular IRA, a Roth IRA does not require that minimum distributions commence at age 70 ½. Essentially, you do not have to withdraw any amount of money throughout your lifetime. You can also make post-tax IRA contributions, regardless of your income, and then convert them into Roth IRA contributions to build up the tax-free aspect of your portfolio. Roth IRA income won't be subject to the 3.8% tax on net investment income that starts in 2013.

If you maintain a 401(k) plan, contribution limits increased in 2012. You can contribute $17,000 per calendar year and an additional $5,500 per calendar year if you are at least 50 years old in 2012.

ESTATE PLANNING

Many estate-planning changes have gone into effect, so it is time to revisit your estate-planning documents.

The estate tax exclusion amount increased to $5.12 million per person, and the lifetime gift tax exclusion amount increased to the same level. If you can afford it, lifetime gifting makes tremendous sense. It takes advantage of these historically high limits while moving any future growth out of your estate and to your children, grandchildren, or other beneficiaries.

Although the annual exclusion is still $13,000 per donee per calendar year, using the $5.12 million lifetime exclusion can help your spouse and children avoid owing death taxes that otherwise may be due on your demise. You also must factor in any state, estate, or inheritance tax.

Retirees move to Florida for reasons other than the weather. For most people, Florida does not have an estate tax. Therefore, they can pass assets to their spouse and children without losing a portion to the state's government. Combined with the absence of an income tax, Florida is a haven for the well-healed.

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TRUSTS

For the previous generation, it was common to create a bypass trust (also called a credit shelter trust, family trust, or exemption equivalent trust) whereby assets pass into the trust on the death of the first spouse to avoid owing estate taxes in the estates of both spouses. This strategy results in a loss of control of the assets by the surviving spouse, who must ask the trustee for permission to withdraw funds.

Part of the new law currently in effect permits "portability," which essentially allows the surviving spouse to enjoy the entire $5.12 million credit for each spouse ($10.24 million in the aggregate) on the demise of the second spouse without having to use a bypass trust. This means that under many circumstances you can leave all of your assets to a surviving spouse without a trust, have the assets pass to your

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children on the demise of the spouse, and not lose the tax benefit for either of you.

Unless the current law is extended, this provision will expire December 31, 2012, and the $5.12 million exemption will revert to the previous $1 million limit. Further, the former 55% top rate will apply again. It is widely believed, however, that the 2012 rules, or similar rules, will be extended into 2013 and beyond.

Naturally, potential complications exist when eliminating trusts. Trusts are particularly beneficial if you remarry and have children from your previous marriage that you want to protect. Or if you are concerned about creditors, you may wish to use a bypass trust. To use portability, the executor must file a federal estate tax return on the first death even if the decedent has less than $5.12 million. There are also complications and the potential loss of portability if your spouse remarries and is predeceased by the new spouse, because the portability credit is extinguished at that time. When updating your estate plan, raise these issues with your estate attorney.

BENEFICIARIES

If you help a parent with his or her estate plan and he or she is unmarried, it is particularly important that you review beneficiary designations on IRAs and qualified plans. For you to delay receiving plan distributions immediately following a parent's demise, you must plan for a "stretch IRA," and the IRA owner must designate specific beneficiaries and not his or her own estate. Following a parent's demise, there must be a trustee-to-trustee transfer of the IRA to a newly inherited IRA, and it must be properly titled.

This transfer is different from a rollover IRA, because only a spouse is permitted to opt for a rollover into his or her own IRA. Should you accidentally take a distribution, you will immediately owe tax. It is better to distribute funds over your remaining life expectancy because it minimizes the tax burden over the years. Even if you are younger than age 59 ½, you will not pay a 10% premature distribution penalty because distributions due to death are exempt from this payment. A surviving spouse who opts for a rollover into his or her own IRA and then takes distributions prior to age 59 ½, however, will incur a 10% penalty. Therefore, if the surviving spouse is younger than 59 ½ and anticipates needing the money prior to attaining age 59 ½, he or she should not opt for a rollover but instead consider using an inherited IRA.

Medical Economics online

To find out how to protect more of your assets from estate taxes, see MedicalEconomics.com/estatetaxlaw

Learn how to enhance the value of your charitable contributions at MedicalEconomics.com/charitablegiving

GIFTS TO CHILDREN OR CHARITIES

When making significant gifts either to your children or to a charity, usually it makes sense to use securities or other assets that have substantially increased in value. That way, you will avoid capital gains taxes. In the case of charities, you will enjoy a deduction for the entire fair market value, creating a double tax benefit.

Another alternative for people who are at least age 70 ½ is to transfer IRA funds directly to a charity, if permitted. In the case of assets passing to children, although you will shift the capital gains to your children, in many situations they are in a lower tax bracket and will pay tax that is less than, or equal to, the tax that you would have paid because they assume your cost basis.

EQUIPMENT PURCHASES

If you are considering purchasing additional business equipment for your practice, you will want to do so in 2012 to be able to enjoy the Internal Revenue Code's Section 179 expense deduction instead of capitalizing equipment and depreciating it over many years. You can deduct all of it up front up to at least $125,000 in each year.

It may be a good time to take advantage of current tax rules throughout this year. Update your estate-planning documents and your tax planning today to help you maintain your wealth for you and your family tomorrow. ME

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