

2011 TAX-PLANNING GUIDE

Maximize your

WHAT THE NEW LAWS MEAN FOR YOU, YOUR HEIRS,

Despite the predictions of many pundits, Congress' "lame duck" session was productive after all: Among other accomplishments, the long-awaited tax cuts are now law, at least through 2012. What do the new laws mean to you? For one, an opportunity to convert IRAs to Roth IRAs, providing you and your heirs with lifetime tax-free income. In addition, your payroll taxes, income taxes, and estate taxes will all go down, enabling you to optimize your tax planning for the next 2 years.

ESTATE TAXES DOWN, EXEMPTIONS UP

The estate tax exemption increased to \$5 million per decedent through 2012. The exemption amount is scheduled to increase starting in 2012. The top estate tax bracket if you exceed the exemption has been reduced from 45% to 35%. Equally important, for the first time, the exemption is portable from spouse to spouse. This means that if one spouse dies, the surviving spouse gets to use both \$5 million exemptions unless the surviving spouse remarries and the new spouse dies. Sophisticated planning is required when wealthy widows or widowers marry again.

Many clients are starting to revise their estate-

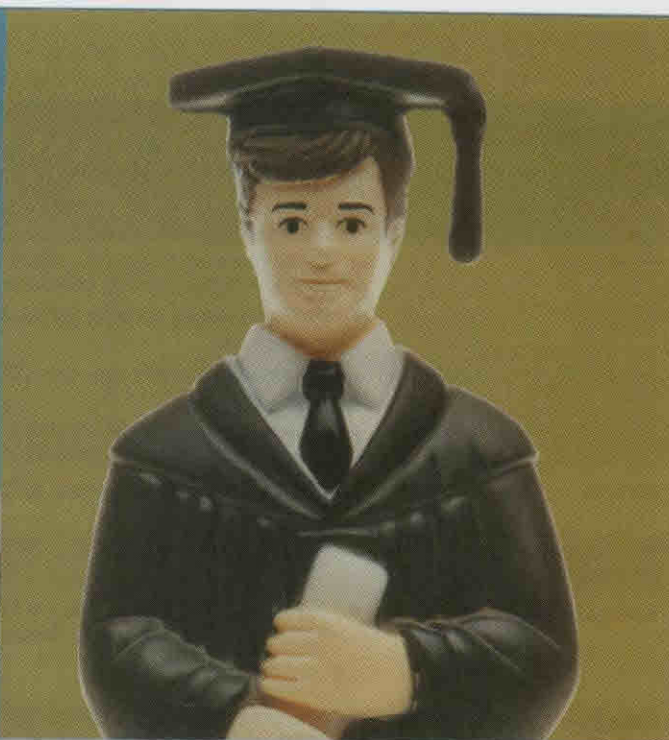
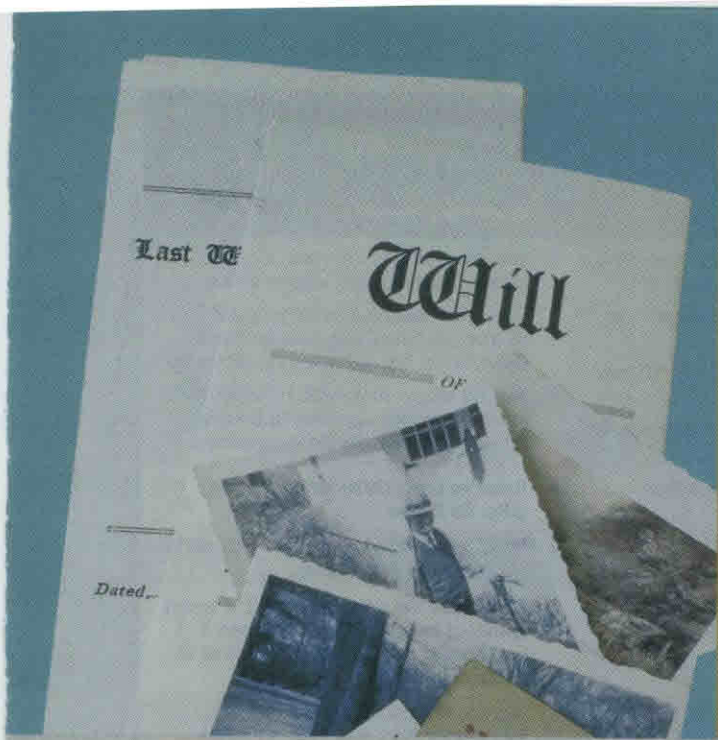
planning documents to skip credit shelter trusts, which had been a common method for avoiding estate taxes, because their net worth is less than \$10 million. If you are approaching the limits, however, credit shelter trusts still may make sense because growth within such trusts would be exempt from estate tax in the survivor's estate. These trusts still may be desirable as a way for the wealthy, first-to-die spouse to make certain that some assets pass to the children.

Also, more clients are using disclaimer trusts, a form of trust that allows a deceased spouse's assets to go directly into a trust without being taxed. This strategy gives the surviving spouse additional flexibility to do post-death estate planning that takes into account the law at the time of death.

Many estate-planning documents today have a "formula" requiring the maximum tax-free amount to go into a trust for the surviving spouse and children. Following such a formula unnecessarily ties up assets and creates restrictions that no longer are necessary with the new \$5 million exemption.

These changes mean that it is time to update your estate planning documents, or your spouse could end up begging a trustee for distributions. An "I love you" will, with most assets passing to the

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tax advantages

AND YOUR PLANNING STRATEGY [By DAVID J. SCHILLER, JD]

surviving spouse, now will be the best structure in most situations.

Equally important, the generation-skipping tax exemption was increased to \$5 million per decedent for 2011 and 2012. This tax would apply if you are trying to avoid estate taxes on the death of your children by leaving assets to beneficiaries at least two generations below you (your grandchildren or their descendants). Also, the lifetime exemption on the gift tax has been increased from \$1 million to \$5 million, allowing you to get assets out of your estate through 2012.

Consequently, if you can afford to gift now, consider taking advantage of this option. And don't forget the annual gift tax exemption of \$13,000 per donor per donee, which does not count in your lifetime limit.

Using grantor retained annuity trusts remains a beneficial practice because they permit you to gift assets into a trust for your children, thereby letting you enjoy ongoing distributions while removing the assets from your estate. These trusts are irrevocable and are best suited for people not inclined to change their minds.

Congress also extended the existing asset basis step-up at death through 2012. This means that the beneficiary uses the value of assets (tax "basis") at the date of death when calculating taxes on their sale,

and any prior appreciation is ignored.

In the past, I usually would recommend that a physician separate assets between himself or herself and the spouse to take full advantage of the estate tax exemptions, even though many states protect assets owned by husband and wife against the creditor of either individual. But because of the portability of the credits and increased exemptions, it now makes more sense to own assets jointly with a spouse under most circumstances. Transition rules apply to deaths occurring in 2010, allowing you to use the "old rules" or "new rules." The new rules are better for estates valued at less than \$5 million.

PERSONAL INCOME TAX REDUCTIONS

For 2011 only, the Social Security tax is reduced, and most physicians will see savings as a result. It is important to revise your withholding for yourself and your staff to account for this change. If you haven't been withholding the correct amount from your employees' pay, you should begin doing so immediately, retroactive to January 1, 2011. The Social Security tax cut only affects employees; employers still pay the regular tax.

Further, in the past, many taxpayers with adjusted gross incomes exceeding \$250,000 may have lost the deductibility of some itemized deductions and

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A QUICK GUIDE TO THE NEW TAX LAW AND ITS IMPACT

	Changes	What they mean for you
Estate tax	<ul style="list-style-type: none"> Exemption increased to \$5 million per decedent (\$10 million per married couple) through 2012. Exemption made portable between spouses in most cases. Tax rate on amounts over exemption decreased from 45% to 35%. Generation-skipping tax exemption increased to \$5 million per decedent through 2012. 	<ul style="list-style-type: none"> You are less likely to need a credit shelter trust to avoid estate taxes. Consider using a disclaimer trust to give your surviving spouse more flexibility in his or her estate planning. You no longer may need to separate assets between spouses to take full advantage of estate tax exemptions.
Gift tax	<ul style="list-style-type: none"> Lifetime exemption increased to \$5 million through 2012. Extended through 2012. 	<ul style="list-style-type: none"> If you've been considering making gifts, do it now. Hold appreciated assets until death to avoid capital gains taxes.
Basis step-up on inherited property	<ul style="list-style-type: none"> Extended through 2012. 	<ul style="list-style-type: none"> Hold appreciated assets until death to avoid capital gains taxes.
Social Security taxes	<ul style="list-style-type: none"> Tax rate for employees reduced from 6.2% to 4.2% for 2011, retroactive to January 1, 2011. 	<ul style="list-style-type: none"> Make sure the correct amount is being withheld from employee pay, and if not, correct the amount retroactive to January 1, 2011.
Exemptions and itemized deductions	<ul style="list-style-type: none"> Restored for the years 2010 to 2012 for taxpayers with adjusted gross incomes of more than \$250,000. 	<ul style="list-style-type: none"> Accelerate itemized deductions into 2011 or 2012 prior to a possible reduction in the deductibility of itemized deductions.
Tax base records	<ul style="list-style-type: none"> Brokerage houses and other financial institutions required to begin tracking tax basis on purchase of individual stocks and issue 1099B forms at time of disposition. 	<ul style="list-style-type: none"> Track your basis for all securities purchased so you can calculate capital gains and losses.

personal exemptions. These deductions have been restored for the years 2010 through 2012. Income tax rates remain at their 2010 levels, with a maximum rate of 35% (plus payroll taxes).

Brokerage houses and other financial institutions must track your tax basis on most stocks purchased starting in 2011 and issue 1099B forms reflecting your tax basis at the time you dispose of the asset. You should track your basis for all securities purchased previously so that you can properly calculate your capital gains and losses on the sale of investments.

Congress still permits you to deduct certain expenses under the revised energy tax credits if you purchase certain types of furnaces, water heaters, windows, and biomass fuel stoves. This credit has a lifetime cap and thus is not enjoyed each year.

Employers can use the retained worker business credit, which provides tax credits of up to \$1,000 per employee for retaining workers in their business. If your practice purchases new equipment, the so-called Section 179 of the Internal Revenue Code and bonus depreciation sections of the new tax law allow you to write off most assets immediately instead of taking a small annual deduction over many years.

CHANGES FOR INVESTORS

The maximum tax rate of 15% on capital gains and dividends has been extended through 2012, creating incentives for investors to purchase high dividend-

yielding stocks and hold on to appreciating stocks to get long-term capital gains treatment. The increased gift tax exemption can be especially useful if you have adult children (generally at least 19 years old, but 24 years old if a student) who are in a low or 0% tax bracket and you have significant capital gains. By gifting appreciated stock to the children, they could sell the stock and avoid capital gains tax.

CERTAIN TAXES ARE INCREASING

Under the healthcare reform legislation passed last year, starting in 2013 the Medicare tax on earned income will increase from 2.9% to 3.8%. This increase, however, only applies to taxpayers with adjusted gross incomes of more than \$250,000 for married people or \$200,000 in the case of unmarried people.

The revised tax will apply to *unearned* income based on the income limits. This means that the Medicare tax will apply to interest, dividends, royalties, rents, and capital gains, but not to retirement plan or IRA distributions. You may be able to reduce your adjusted gross income by converting your IRA to a Roth IRA, described below, before 2013.

ROTH IRA CONVERSIONS

If you converted your IRA to a Roth IRA in 2010, you can split the income tax between 2011 and 2012. This is generally the best strategy unless your income will increase significantly during those years. Be sure

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Section 179 of the Internal Revenue Service tax code	<ul style="list-style-type: none"> Write-offs for qualifying equipment up to \$500,000 increased to 100% during 2011. 	<ul style="list-style-type: none"> If an equipment purchase for your practice qualifies for the write-off, make the purchase in 2011.
Capital gains and dividend taxes	<ul style="list-style-type: none"> Tax rate of 15% extended through 2012. 	<ul style="list-style-type: none"> Consider gifting stocks on which you have substantial capital gains to a child 19 years or older, or 24 if a student, and in a low or 0% tax bracket, so he or she can sell the stock and avoid capital gains entirely.
Medicare tax	<ul style="list-style-type: none"> Tax on earned income to increase from 2.9% to 3.8%. Tax applies to adjusted gross incomes, including unearned income, of \$250,000+ for married couples or \$200,000 for a single person. 	<ul style="list-style-type: none"> Consider converting a regular IRA to a Roth IRA before 2013 to reduce your adjusted gross income in subsequent years.
IRAs	<ul style="list-style-type: none"> Tax on regular IRAs converted to Roth IRAs in 2010 can be split between 2011 and 2012. Some pretax retirement plan contributions permitted to be rolled over into a Roth IRA account or Roth 401(K) account. 	<ul style="list-style-type: none"> Split taxes as allowed unless you expect your income to increase significantly in 2011 or 2012. Execute a new beneficiary designation if you do a Roth conversion.
Charitable contributions	<ul style="list-style-type: none"> Contributions from IRAs (if you're at least 70½) of up to \$100,000 extended through 2011. 	<ul style="list-style-type: none"> Remember this often-overlooked option when considering making a charitable contribution.
Student loan forgiveness	<ul style="list-style-type: none"> Forgiven student loans for doctors to receive income tax-free treatment if the doctor works in an area lacking sufficient numbers of healthcare professionals. 	<ul style="list-style-type: none"> If you work in an underserved area, you may be entitled to loan forgiveness and will not be taxed on this benefit.

to execute a new beneficiary designation if you do a Roth conversion; the old beneficiary designation may be ineffective for this new account.

Absent a properly executed beneficiary designation form, your beneficiary will have to take a distribution of the entire account within 5 years following your demise. A "designated beneficiary" can spread distributions over his or her lifetime. Don't name a minor child as a beneficiary, because a court would appoint a non-parent guardian to oversee the money in most states—an expensive process.

The Small Business Jobs Act of 2010 permits rollovers of certain pretax retirement plan contributions into Roth accounts. An in-plan Roth rollover is limited to amounts eligible for a distribution.

If your plan permits in-service profit-sharing plan distributions, these could be retitled as Roth assets. Of course, you will pay tax on their value at the time of the conversion.

If you anticipate being in a higher bracket in the future or like the idea of tax-free income down the road, a Roth conversion may be right for you. Note that, unlike a Roth IRA, an in-plan conversion to a Roth *cannot* be reversed.

CHARITABLE CONTRIBUTIONS

The government extended through 2011 your ability to contribute to a charity from your IRA if you are aged 70½ or older. You can contribute up to

\$100,000 per year to qualified charities in this manner. Note that a charitable distribution from your IRA counts towards satisfying your required minimum distribution.

In deciding whether to do this, you should review how the tax benefit compares with gifting appreciated stock, because appreciated stock provides you with a charitable deduction and avoids the capital gains tax.

STUDENT LOANS

Most loans are considered taxable income if you receive loan forgiveness. If you are a healthcare professional who receives student loan forgiveness, however, you enjoy tax-free treatment if you are working in an area lacking sufficient numbers of healthcare professionals.

Now is the time to take advantage of the new legislation outlined here, to keep your taxes as low as they can be. By updating your tax-planning and estate documents today, you create more wealth for you and your loved ones tomorrow. ■



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