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TAX AND  
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**Alert**™

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Thanks to the extension late last year of the 2001 and 2003 tax cuts, the current federal income tax environment remains favorable. Now is a good time to take advantage of the low tax rates because we obviously can't predict future tax rates. This article presents several tax planning ideas to consider this fall while you have time to think and plan before the holidays. Some of the ideas may apply to you, some to family members, and others to your business. Finally, don't forget that AMT can impact your planning decisions.

## Leverage the Standard Deduction by Bunching Deductible Expenditures

Are your 2011 itemized deductions likely to be just under, or just over, the standard deduction amount? If so, consider the strategy of bunching expenditures for itemized deduction items every other year, while claiming the standard deduction in the intervening years. The 2011 standard deduction is \$11,600 for married joint filers; \$5,800 for single filers; and \$8,500 for heads of households. Examples of deductible items that can be bunched every other year to lower your federal income taxes include charitable contributions, state income taxes, and property tax payments.

## Fourth Quarter Tax Planning Ideas

### Consider Deferring Income

It may also pay to defer some taxable income from this year into next year, especially if you expect to be in a lower tax bracket in 2012. For example, if you're self-employed and a cash-method taxpayer, you can postpone taxable income by waiting until late in the year to send out some client or customer invoices. That way, you won't receive payment for them until early 2012. You can also postpone taxable income by accelerating some deductible business expenditures into this year. Both moves will defer taxable income from this year until next year. Deferring income may also be helpful if you're affected by unfavorable phase-out rules that reduce or eliminate various tax breaks (child tax credit, education tax credits, and so forth). By deferring income every other year, you may be able to take more advantage of these breaks in those years.



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## Tax Calendar


**O**ctober 17—Personal returns that received an automatic six-month extension must be filed today and any tax, interest, and penalties due must be paid.

—Electing large partnerships that received an additional six-month extension must file their Forms 1065-B today.

October 31—The third quarter Form 941 (Employer's Quarterly Federal Tax Return) is due today and any undeposited tax must be depos-

ited. (If your tax liability is less than \$2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until November 10 to file the return.

—If you have employees, a federal unemployment tax (FUTA) deposit is due if the FUTA liability through September exceeds \$500.

December 15—Calendar-year corporations must deposit the fourth installment of estimated income tax for 2011. 

## Education Planning— Start Early

**T**he increasing costs of higher education have made education planning an important aspect of personal financial planning. However, education planning does not always receive the

necessary attention required because some parents are counting on scholarships to cover the cost of their children's education. Others procrastinate, as they


do with retirement planning, because the actual expenditure may not be incurred for many years and is a low current priority.

Often, parents have made a mental commitment to a certain standard of education for their children, but have done very little planning for the day when the tuition bill arrives. This tendency to postpone the issue may eliminate several education planning strategies that offer opportunities for financial gain when implemented early.

In general, the six basic methods of paying for a child's higher education include a child working his or her way through school; obtaining

financial aid (scholarships and federal loans); paying college expenses out of parents' current income or assets; using education funds accumulated over time; obtaining private loans; and grandparents (or others) paying college costs.

The first method (child pays) can work, and many successful persons have obtained a good education while working to pay their way. But this often limits the student's choice of schools and can adversely affect grades. Planning to rely on financial aid (the second method) is risky, and the family may not qualify for enough. The third method (parents paying out of current income or assets) works for some, but many parents will not know if their current income and/or assets will be sufficient until it is too late. In addition, this method is not as tax-efficient as some strategies used to accumulate separate education funds (the fourth method). However, these strategies are not without risks. Poor investment choices could prove costly. The fifth method (private loans) can result in a serious debt burden. Obviously, the sixth method is ideal, but it is not available to many.

In summary, the key to effective education planning is to start planning and saving early to create future options. In addition, the use of tax-sheltered investment and savings vehicles like a 529 plan can help ensure adequate funds are available when a child enters college. 



## Be Bold About Timing Investment Gains and Losses

As you evaluate investments held in your taxable brokerage accounts, consider the impact of selling appreciated securities this year. The maximum federal income tax rate on long-term capital gains realized from 2011 sales of securities held longer than a year is only 15%. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling. Biting the bullet and selling some loser securities (securities that are currently worth less than you paid for them) before year-end can also be a good idea. The resulting capital losses will offset capital gains from other sales this year, including short-term gains from securities owned for one year or less, which could otherwise be taxed at higher ordinary income tax rates. The bottom line is that you don't have to worry about paying a higher tax rate on short-term gains if you have enough capital losses to shelter them.

If capital losses for this year exceed capital gains, you will have a net capital loss for 2011. You can use that net capital loss to shelter up to \$3,000 of this year's high-taxed ordinary income from salaries, bonuses, self-employment, and so forth (\$1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

### Take Advantage of Generous but Temporary Business Tax Breaks

Several favorable business tax provisions have a limited shelf life that may dictate taking action between now and year-end. They include the following:

**Bigger Section 179 Deduction.** Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. For tax years beginning in 2011, the maximum Section 179 deduction is \$500,000 (same as for tax years

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beginning in 2010). For tax years beginning in 2012, however, the maximum deduction is scheduled to drop back to \$125,000.

**Note:** Watch out if your business is expected to have a tax loss for the year before considering any Section 179 deduction since you cannot claim a Section 179 write-off that would create or increase an overall business tax loss.

**Section 179 Deduction for Real Estate.** Real property improvement costs are generally ineligible for the Section 179 deduction privilege. However, an exception applies to tax years beginning in 2010 and 2011. Under the exception, your business can immediately deduct up to \$250,000 of qualified improvement costs for the following types of real property under the Section 179 deduction privilege:

- Interiors of leased nonresidential buildings.
- Restaurant buildings.
- Interiors of retail buildings.

The \$250,000 Section 179 allowance for real estate improvements is part of the overall \$500,000 allowance. This temporary real estate break will not be available for tax years beginning after 2011 unless Congress extends it.

**100% First-Year Bonus Depreciation.** Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 100% of the cost of most new (not used) equipment and software placed in service by December 31, 2011. For a new passenger auto or light truck that's used for business and subject to the luxury auto depreciation limitations, the 100% bonus depreciation break increases the maximum first-year depreciation deduction by \$8,000 for vehicles placed in service this year. The 100% bonus depreciation break will expire at year-end unless Congress extends it.



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# Federal Taxation of Social Security Benefits

With millions of baby boomers close to retirement age and job losses inflicting



financial strain on additional millions, many taxpayers are looking to social security benefits for financial assistance. So, we thought this would be a good time

to discuss how social security benefits are taxed by the federal government.

Individuals may have to pay federal income taxes on up to 85% of their social security benefits. Inclusion within taxable income can occur if you have other substantial income from wages, self-employment, interest, dividends, and other taxable income in addition to your social security benefits. However, no one pays federal income tax on more than 85% of his or her social security benefits.

The amount of your social security benefits included in federal taxable income depends on your *provisional income*. Provisional income (PI) is generally your adjusted gross income (AGI) plus nontaxable interest, one-half of your social security benefits, and some other

AGI add-backs. If you file as an individual, head of household, or a qualifying widow or widower, and your PI is between \$25,000 and \$34,000, you may pay federal income tax on up to 50% of your benefits. If your PI is more than \$34,000, then up to 85% of your benefits may be taxable.

If you are married and file a joint return and you and your spouse have combined PI of between \$32,000 and \$44,000, you may have to pay federal income tax on up to 50% of your benefits. If your PI is more than \$44,000, then up to 85% of your benefits may be taxable. If you are married and file a separate return, you will probably pay taxes on your benefits.

Social security recipients can have federal income tax withheld from their benefit payments, if desired. Withholding is voluntary and can be initiated at 7%, 10%, 15%, or 25% by filing Form W-4V (Voluntary Withholding Request).

**Boomer Alert:** The percentage of workers who have little or no money in savings or investments is disturbingly high. The Employee Benefits Research Institute ([www.ebri.org](http://www.ebri.org)) reported in its annual Retirement Conference Survey that 56% of respondents had less than \$25,000 saved in 2011 (not including the value of their primary residence or any defined benefit plan). This is up from previous years (54% in 2010, 52% in 2009, 49% in 2008, and 48% in 2007).

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