

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

# 2011 Year-End Tax Planning Guide

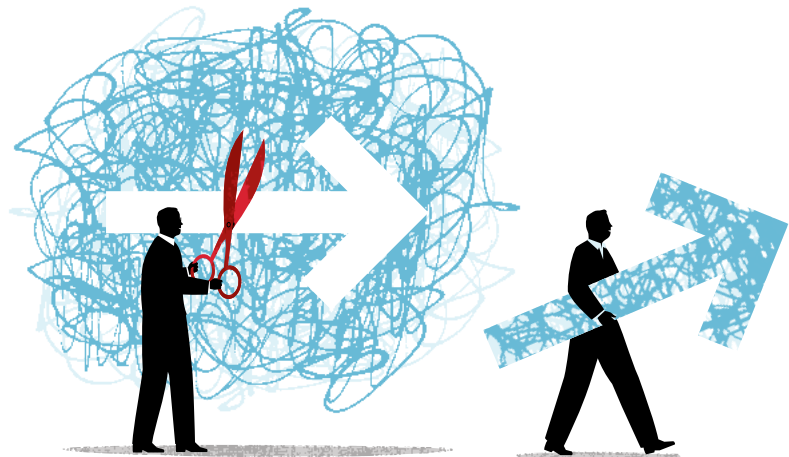
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## Waiting to Exhale

While legislation passed in December 2010 extended lower tax rates and provided a short reprieve from the high level of uncertainty created by a divided Congress, tax reform remains at the top of the political agenda.

The reasons are plain to see: The federal deficit and national debt continue to grow, and the US economy continues to struggle. While budget cuts will play perhaps the biggest role in reining in the debt, tax reform of one kind or another is sure to receive significant attention from lawmakers in the coming year.

Unfortunately for taxpayers, no single tax reform proposal has garnered enough support, which has made tax planning both complex and uncertain. The looming sunset of the Bush-era tax cuts at the end of 2012 only compounds the situation.

At this point no one can predict the outcome of the debate; however, there are a few developments we'll continue to monitor closely as 2011 draws to a close.

First, the Budget Control Act of 2011 had charged the Joint Select Committee on Deficit Reduction (the so-called supercommittee) with producing recommendations that would cut at least \$1.5 trillion from the deficit over the next 10 years. Unfortunately, the committee was unable to reach an agreement before the November 23 deadline, triggering automatic spending cuts of \$1.2 trillion beginning in January 2013. Pressure is now building for Congress to work out an alternative agreement.

Second, President Obama's jobs bill, parts of which are currently being debated, contains several tax provisions, including a 5.6 percent surtax on an individual's earnings in excess of \$1 million, informally known as the Buffett Rule. Republicans have introduced their own jobs plan, which features a reduction in both individual and corporate tax rates, to 25 percent, and contains major changes in international tax rules.

Although the tumult makes planning difficult, the silver lining in this cloud of uncertainty is that taxpayers still find themselves enjoying relatively favorable income, gift, and estate tax rates and rules for the remainder of 2011 and 2012. And while most commentators believe major tax reform won't take place until sometime in 2012, the above developments, along with a number of other reform proposals, give us clues about the shape of an eventual overhaul.

### What Lies Ahead?

What we do know is that tax rates are scheduled to increase and various tax benefits are scheduled to sunset by the end of 2012. Also lurking on the horizon is a new 3.8 percent surtax on net investment income and an increase in the Medicare payroll tax of 0.9 percent, both of which arose out of 2010's health care legislation. These come into play in 2013 for individuals with adjusted gross income (AGI) above \$200,000 and married couples filing jointly with AGI over \$250,000. All of this creates a tidal wave of tax changes, as highlighted in the chart below, and makes 2011 and 2012 very important for tax planning to ensure that you can blunt the wave's impact.

One planning item to highlight: the lifetime exemption for estate and gift taxes. For 2011 and 2012, the amount of taxable gifts excluded from gift tax liability is \$5 million; however, this amount is scheduled to decrease back to \$1 million on January 1, 2013. This provides a unique window of opportunity for taxpayers to significantly reduce their estate tax liability, but the planning must begin now to take full advantage of the existing law.

In this guide we present this and other planning ideas for you to consider before the end of this year and into 2012. In light of the complexity of these issues and the possibility of unforeseen changes on the horizon, please consult your Moss Adams LLP tax professional before undertaking any major tax planning actions. He or she can help you structure a personalized long-term financial strategy that leverages the short-term stability in tax rates and takes into account how the different tax reform proposals might affect your investment approach and your individual goals. We also encourage you to visit [www.mossadams.com](http://www.mossadams.com) to stay abreast of any late-breaking tax changes that might affect you or your business.

### TOP TAX RATES

	RATE		INCREASE
	2011-2012	2013*	
Ordinary income	35%	43.4%	24%
Long-term capital gains	15%	23.8%	59%
Qualified dividends	15%	43.4%	189%
Estate and gift	35%	55%	57%

\* Includes a 3.8 percent surtax on net investment income with AGI over \$200,000 (single filers) or \$250,000 (joint filers). Note that net investment income doesn't include certain defined income or gains attributable to qualified business holdings in flow-through entities, such as S corporations and partnerships.

### DEDUCTIONS

	2011	2012	2013
Maximum Section 179 deduction	\$500,000	\$125,000	\$25,000
Bonus depreciation	100%	50%	0%



## Tax Planning Checklist for Businesses

### FLOW-THROUGH ENTITY OWNERSHIP PLANNING

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*Entity Basis*

If you have adequate tax basis and at-risk basis, you may claim losses generated by flow-through entities. If you anticipated losses in 2011 for your flow-through business, talk to your tax advisor before year-end to consider whether you can take advantage of these losses to an appropriate level.

*Buy-Sell Agreements*

Review agreements, funding structures, and insurance policies to determine whether they're aligned, current, and relevant. Buy-sell agreements should be reviewed every two years to evaluate whether they're functioning as intended.

*Ownership Transition*

Planning in advance of a potential exit or ownership transition pays dividends both financially and in peace of mind. Coordinated planning helps you develop a comprehensive strategy that addresses business financial planning, personal financial planning, management succession, estate planning, and ownership transition. Moss Adams has a team of advisors who specialize in precisely these areas, and we can customize a plan that takes into account your business, personal, and family needs.

*C Corporation to S Corporation Election*

- Consider making a change from C to S corporation status to avoid double taxation of annual income and recognized gains at the time of a future sale or liquidation, first at the corporate level and then again at the shareholder level. After a conversion from C to S, a 10-year lead time exists before a future sale or liquidation can completely escape double taxation, but this applies only to the gain that exists at the time of the S election; future appreciation avoids double taxation.

- If you converted a C corporation to an S corporation between the years 2002 and 2006 and have unrealized built-in gains, special rules apply in 2011 that could shorten the recognition period from the original 10 years.

□ *Qualified Dividends*

- Through 2012, qualified dividends are taxed at 15 percent, similar to long-term capital gains. C corporations (and S corporations with undistributed C corporation earnings) might consider distributing dividends to shareholders, especially in light of the significantly higher tax rate on dividends scheduled to begin in 2013. If your corporation doesn't have the cash to distribute the dividend, you might be able to effectively lock in the 15 percent rate. Check with your Moss Adams tax advisor regarding this possibility.
- To the extent your business has qualified foreign gross receipts, consider whether you might benefit from setting up an Interest Charge Domestic International Sales Corporation.

## DEPRECIABLE REAL ESTATE AND BUSINESS EQUIPMENT

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□ *Cost Segregation*

Accelerate the cash flow benefit of depreciation deductions via a detailed review of the depreciable components of a building by an integrated team of accountants and engineers. In many cases a cost segregation study results in the ability to take a large current-year tax deduction for depreciation. This can result in dramatic cash flow from tax savings. It's particularly appropriate to do a cost segregation study on buildings purchased either during 2011 or within the past five years.

□ *Section 179 Depreciation Deduction*

- The Section 179 depreciation deduction for qualifying assets acquired in 2011 is \$500,000. The depreciation deduction decreases dollar-for-dollar for depreciable assets purchased for more than \$2 million. The deduction is scheduled to decline to \$125,000 for 2012 and revert to \$25,000 for 2013 and thereafter.
- Certain real property can qualify for the Section 179 expense deduction. However, the new rules are complex and require a careful review.

□ *Bonus Depreciation for Qualifying Purchases*

For qualified assets acquired and placed in service during 2011, 100 percent of the cost can be deducted in the current year using accelerated bonus depreciation. This bonus depreciation provision declines to 50 percent of the cost of qualified assets in 2012, and it's scheduled to expire at the end of 2012. Thus, if you're considering a significant asset purchase, it's paramount to consider the timing of that purchase in light of the dramatic upcoming change in the available tax deduction.

- *State Conformity with Section 179 and Bonus Depreciation*

Be sure to check your state's rules regarding bonus depreciation and Section 179 depreciation deductions, since not all states conform to federal depreciation laws.
- *Generous Luxury Auto Depreciation Limits*

A generous first-year depreciation deduction on vehicles subject to "luxury auto" rules is available through 2012 as long as the auto otherwise qualifies for bonus depreciation.
- *Enhanced Charitable Contribution Deductions*
  - C corporations can take an enhanced deduction for contributions of certain wholesome food inventory, computer technology or equipment, or book inventory through the end of 2011. The deduction is equal to the lesser of (a) basis plus half of the property's appreciation or (b) twice the property's basis. The enhanced deduction for wholesome food inventory is available to other entities but cannot exceed 10 percent of the taxpayer's aggregate net income for the year.
  - S corporations can deduct the fair market value of appreciated assets contributed to charity while reducing shareholders' basis in the S corporation by the assets' basis. This provision is available through the end of 2011.
- *Expensing of Environmental Remediation Costs*

Taxpayers can elect to treat qualified environmental remediation expenses that would otherwise be chargeable to a capital account as deductible in the year paid or incurred, but only if the expenses are paid or incurred before January 1, 2012. To qualify, the costs must be in connection with the abatement or control of hazardous substances at a qualified contaminated site.

## BUSINESS CREDITS

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- *Credit for Employee Health Insurance Expenses of Small Employers*

Eligible small employers (generally those with 10 or fewer full-time equivalent [FTE] employees with wages of \$25,000 or less) are allowed a credit for 35 percent of certain contributions made to purchase health insurance for their employees. The credit amount begins to phase out for employers with either 11 FTEs or an average annual per-employee wage of more than \$25,000. The credit is phased out completely for employers with 25 or more FTEs or an average annual per-employee wage of \$50,000 or more.
- *Employer-Provided Child Care Credit*

Employers can claim a credit of up to \$150,000 for supporting employee child care or child care resource and referral services.

*Empowerment Zone Credit*

Businesses and individual residents within areas designated as Empowerment Zones may be eligible for special tax incentives, including 20 percent wage credits, increased Section 179 expensing rules, deferral of capital gain recognition on the sale of qualified Empowerment Zone assets when replaced with qualified assets, and tax-exempt bond financing.

*Research and Development Credit*

Companies that develop new or improved products or processes may be able to benefit from research tax credit incentives. The research tax credit is a dollar-for-dollar credit against taxes owed or paid and is available for amounts paid or incurred through the end of 2011.

*Refundable Alternative Minimum Tax Credit in Lieu of Bonus Depreciation*

A special provision allows for certain corporations to claim refundable AMT credits in lieu of bonus depreciation in 2011 and 2012. Only corporations with pre-2006 unused AMT credits qualify.

*Differential Wage Payment Credit for Employers*

Eligible small businesses can claim a credit equal to 20 percent of up to \$20,000 of differential wages paid during 2011. Differential wages are payments to employees for periods during which they're called to active duty in the US armed forces. An eligible small business is one that employs on average fewer than 50 employees and, under a written plan, provides eligible differential wage payments to each of its qualified employees.

*New Energy Efficient Home Credit*

An eligible contractor can claim a credit of \$2,000 or \$1,000 during 2011 for each qualified new energy-efficient home either constructed by the contractor or acquired by a person from the contractor for use as a residence during the tax year.



## Tax Planning Checklist for Individuals and Families

### PERSONAL INCOME TAX

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#### *Income Planning*

Federal income tax rates for individuals will remain constant from 2011 to 2012. Therefore, the decision to defer or accelerate income at the end of 2011 should be based on the best use of deductions and losses between the two years.

#### *Deduction Planning*

- Accelerate or defer expenditures to maximize use of deductions.
- Bunch medical expenses into tax years when they'll exceed 7.5 percent of adjusted gross income.
- Consider whether to pay a fourth-quarter state estimated income tax payment in December 2011 or January 2012.

#### *Alternative Minimum Tax*

- AMT warning signs include large deductions for state income and real estate taxes, large miscellaneous itemized deductions, and sizable capital gains.
- The AMT exemption amounts have again been increased through 2011, reducing the number of individuals that would have otherwise been affected by the additional AMT in 2011. The exemption amount isn't automatically indexed for inflation and is scheduled to revert to pre-2001 levels in 2012, making it important to take AMT into account for deduction-planning purposes.

#### *Capital Gain and Capital Loss Planning*

- The 15 percent federal long-term capital gains rate has been extended through 2012. Consider tax loss harvesting strategies before year-end to offset current-year gains or to accumulate losses to offset future gains that would be taxed at a higher rate.

- Taxpayers contemplating an installment sale, in which taxes are paid over time as payments are received, should consider electing out of installment-sale treatment to take advantage of today's historically low 15 percent federal capital gains tax rate. Also, where circumstances are appropriate, if you're carrying an installment obligation, consider feasible alternatives, if any, to triggering the gain on those contracts to effectively lock in the 15 percent rate.

*Cancellation of Indebtedness*

New rules have eliminated the income recognition from cancellation of indebtedness income in certain circumstances related to home mortgages. Consult with your tax advisor before agreeing to any loan modifications.

*College Education Tax Incentives*

- The American Opportunity Tax Credit was extended to 2012. The credit, available for the first four years of education, has more liberal income limitations and provides for a portion of the credit to be refundable.
- Section 529 accounts can be used to accumulate funds for college-related expenses. Appreciation of the investments within the account is tax-free for qualified distributions. If college funds are currently maintained in taxable accounts, it may make sense to shift these funds to a Section 529 account to reduce future taxable income.

*Energy Incentives*

- For 2011 only, the Nonbusiness Energy Property Credit of up to 30 percent of the cost incurred is available for qualifying property, including windows, exterior doors, insulation, fans, furnaces, water heaters, and other property meeting certain energy standards.
- Until 2016 the Residential Energy Efficient Property Credit is available for the installation of certain energy-efficient property, such as photovoltaic panels or solar water heaters.

## RETIREMENT PLANNING

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*Retirement Plans*

Certain plans, such as 401(k) and Keogh plans, allow larger tax deductions but must be established by year-end, even though contributions don't need to be made by that time.

*Roth IRA Conversion*

Any taxpayer can now convert a traditional IRA to a Roth IRA, regardless of income. Certain qualified plans may allow for an "inside the plan" conversion. These should also be considered where appropriate.

*Child's Earned Income*

If a child has earned income, consider various strategies he or she can use to contribute to a traditional or Roth IRA.

## CHARITABLE GIVING

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### *Appreciated or Depreciated Property*

- Consider giving appreciated property to a charity instead of cash. You'll get a deduction for the fair market value, and you'll avoid paying tax on the capital gain.
- Depreciated investment assets should be sold first, and the cash donated to charity. That way you'll get the benefit of the capital loss.

### *Charitable Donation of IRA-Required Minimum Distribution*

You can donate your 2011 required minimum IRA distribution, up to \$100,000, tax-free. To be eligible, you must be at least 70½ years old, required to take annual distributions, and make the donation directly from the IRA. The distribution income isn't taxable to the IRA owner, nor is the contribution a deductible donation. This strategy can benefit an individual who would otherwise be making a comparable gift with after-tax dollars. This provision is scheduled to expire after 2011.

### *Timing of Larger Charitable Gifts*

- Consider whether larger charitable contributions should be made in early 2012 instead of 2011 to maximize the tax benefit.
- You can make year-end charitable contributions using your credit card, but the gift must be processed and charged to the card by December 31 to be deductible on your 2011 tax return. Similarly, checks to charities must be written and postmarked by December 31 for a 2011 deduction.

### *Charitable Giving As Part of an Overall Estate Plan*

Incorporate your charitable contributions within a comprehensive long-term estate plan strategy, taking into account the various tax- and cash flow-efficient ways to structure charitable gifts. With the large disparity between required payouts and current applicable federal rates, certain charitable giving structures have become more difficult—for example, charitable remainder trusts. If you're interested in exploring these vehicles and possible solutions and alternatives, please contact your Moss Adams tax advisor.

## INVESTMENT MANAGEMENT

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### *Coordinated Advice*

- Looming tax law changes mean getting coordinated advice from your tax and investment advisors is more important than ever.
- Work with your investment advisor to optimize net capital gains and take advantage of any inherent capital losses that may be in your account (tax loss harvesting).

- *Investment Strategy*
  - In light of recent economic performance, review your investment strategy to determine whether it's consistent with your personal goals.
  - Reevaluate tax-exempt yields versus taxable yields in light of current market conditions.

## PERSONAL FINANCIAL PLANNING

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- *Create a Road Map and Start the Process*

For those without a clear set of short- and long-term personal financial goals, take the time to create a personal financial plan and begin to monitor your progress toward those goals.
- *Update Existing Plans in Light of Recent Economic Performance*

The uncertainty owing to the economic events of the past few years is a good reason to update an existing personal financial plan and verify progress toward achieving your goals.

## ESTATE AND GIFT PLANNING

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- *Lifetime Gifts*
  - Maximize the \$13,000-per-recipient annual exclusion by giving assets that match your cash flow needs and long-term estate planning goals. Remember that a spouse can also gift \$13,000 per recipient.
  - Currently the amount you can give during your lifetime without incurring any gift tax is \$5 million (this is in addition to the annual exclusions for lifetime gifts referenced above). The gift tax rate for gifts greater than \$5 million is 35 percent for 2011 and 2012. The lifetime gift amount will decrease to \$1 million, and the gift tax rate will increase to 55 percent, beginning January 1, 2013. This provides individuals with a short window of opportunity to transfer more wealth during their lifetime to shift future appreciation to the next generation.
  - When considering lifetime gifts above the annual exclusion, please remember that certain strategies are of critical importance. For example, should the gifts be in cash or property? Outright or in trust? Also, consider certain state inheritance tax issues (see below) as part of this planning process.
- *Low Interest Rate and Low Valuation Opportunities*
  - Applicable federal rates (AFRs), which are the minimum interest rates that must be charged for bona fide loans between related parties, are at historical lows. As such, it may be possible to refinance loans between family members or with a closely held business and significantly reduce interest payments.
  - The combination of the \$5 million gift tax exemption (available in 2011 and 2012) with historically low AFRs creates a brief window of opportunity to transfer unprecedented amounts of wealth to your heirs through the use of leverage and

certain types of trusts. These types of structures are complex, and you should consult with your Moss Adams estate planning professional and your estate attorney about how you could benefit from this type of planning.

- Certain assets have declined in value as a result of the uncertain economy. However, if you're holding assets you believe might rebound in value, it might be advantageous to consider making a lifetime gift to—or a lifetime sale for—your beneficiaries. Your Moss Adams estate planning professional can evaluate your assets and help you determine whether this strategy makes sense for your individual situation.

*Develop or Update a Long-Term Estate Plan*

- Understand your goals and the effect of federal and state (if applicable) estate taxes. Consider working with an estate planning professional in conjunction with your attorney to build a plan that addresses your cash flow, business, and family needs as well as your charitable wishes.
- After you've developed an estate plan, confirm that your assets are properly titled and the beneficiary designations are correct.
- Gain an understanding of how changing federal and state estate tax laws will affect you. Legislation passed in late 2010 temporarily reinstated and modified the estate and generation-skipping transfer tax retroactive to the beginning of 2010 and modified the gift tax beginning in 2011:
  - Every estate will have an exemption of \$5 million per spouse and a top rate of 35 percent through 2012, including full step-up for all estate assets.
  - For 2011 and 2012, there may be opportunities to use a deceased spouse's unused estate tax exemption.
  - Many states have their own estate tax, and in many cases the exemption amounts are lower than the federal amounts. Don't overlook gifting and estate planning opportunities as they relate to applicable state inheritance tax.

## INSURANCE MANAGEMENT

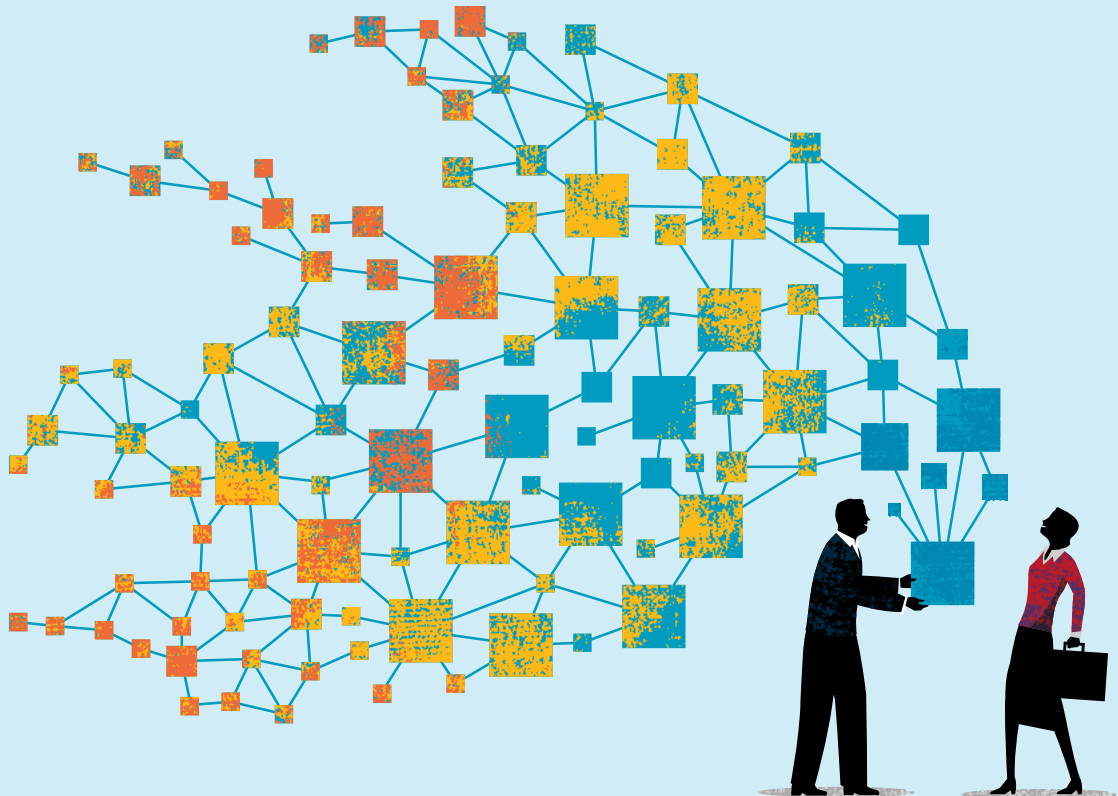
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*Changed Circumstances*

Review your life insurance policies to ensure they're in accordance with your current wealth management needs, transfer goals, and liquidity concerns. Pay particular attention to policy type, coverage amounts, ownership, and beneficiary designations.

*Efficiency and Cost-Effectiveness*

- Check that existing policies are operating efficiently and as expected.
- Lower premiums may be available to current policyholders.
- For employer-owned policies, be certain that required formalities are being followed on the purchase of new life insurance for any employee. Failure to do so could trigger the proceeds as taxable income when received. Contact your Moss Adams advisor if you have any questions regarding this matter.



## Contact Us

[www.mossadams.com](http://www.mossadams.com) | (800) 243-4936

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