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Dear Client and Colleague:

Enclosed is the October issue of our CPA Client Bulletin. This issue focuses on estate planning, and in addition, some income tax savings ideas. Even though your estate may be currently under the $5 million Federal estate tax exemption, you still need to review and update your will and beneficiary designations periodically (eg-life insurance policies, IRA's, and other retirement accounts, etc.) After reviewing these articles, call us if you have any questions, and have one of our seasoned tax planning professionals assist you.

THE PRESIDENT'S NEW JOBS BILL CONTAINS MANY TAX INCREASES

President Barack Obama submitted his American Jobs Act to Congress a couple of weeks ago, and among its provisions are several tax items, including a temporary payroll tax cut, a limit on itemized deductions for certain high-income taxpayers, and a proposal to tax carried interests as ordinary income rather than capital gains.

The proposed bill follows the president's pledge in a speech to a joint session of Congress to create more jobs. He has asked Congress to take up the measure promptly, but its fate in Congress is unknown.

Specific tax breaks in the proposal include the following:

Temporary payroll tax cut for employers, employees, and the self-employed: The current temporary reduction in payroll taxes would be expanded. For 2012, the employee's portion of Social Security tax would be 3.1%; the employer's portion would also be 3.1%, up to the first $5 million of wages paid by the employer. The tax on self-employed workers would be reduced to 6.2%.

Temporary tax credit for increased payroll: From Oct. 1, 2011, through Dec. 31, 2012, the proposed bill would provide a payroll tax credit to offset the employer portion of Social Security tax due to wage increases over the corresponding period in the prior year.

Extension of temporary 100% bonus depreciation for certain business assets: The proposal would extend 100% bonus depreciation under IRC § 168(k) through the end of 2012.

Delay in application of withholding on government contractors: The measure would delay the effective date of the 3% withholding requirement on payments to government contractors until after 2013.

Returning heroes and wounded warriors work opportunity tax credits: The measure would double the section 51(b) credit available for hiring certain unemployed, disabled veterans. It also would create two new credits: One for hiring veterans who have been unemployed for at least four weeks and another for hiring veterans who have been unemployed for at least six months.

Long-term unemployed workers work opportunity tax credits: Another credit would be available for employers who hire individuals who have been unemployed for at least six months.

Revenue Raisers

The proposal also contains a number of tax-related revenue raisers:

28% limitation on certain deductions and exclusions: This provision would limit the value of deductions and exclusions to 28% of the taxpayer's taxable income. This would apply to joint filers with adjusted gross income over $250,000 and single filers with adjusted gross income over $200,000.

Buffett Tax Increase: Last week the President also proposed an additional tax increase for individuals making more than $1,000,000. The timing is controversial, and even though it makes sense to look at this, it should be done as part of a tax overhaul. Remember that the Healthcare Reform provisions already will impose tax increases on middle income.

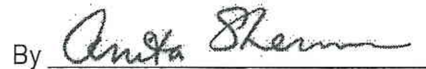
Under the provisions of the new Healthcare Reform law, which takes effect in 2013, most taxpayers will continue to pay the 1.45% Medicare hospital insurance tax, but single people earning more than $200,000 and married couples earning more than $250,000 will be taxed at an additional 0.9% (2.35% in total) on the excess over those base amounts. Employers will collect the extra 0.9% on wages exceeding $200,000 just as they would withhold Medicare taxes and remit them to the IRS. Companies won't be responsible for determining whether a worker's combined income with his or her spouse makes them subject to the tax.

Beginning in 2013, a Medicare tax will, for the first time, be applied to investment income. A new 3.8% tax will be imposed on net investment income of single taxpayers with adjusted gross income (AGI) above $200,000 and joint filers with AGI over $250,000 (unindexed). Net investment income is interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). Net investment income is reduced by allocable deductions to such income. However, the new tax won't apply to income in tax-deferred retirement accounts such as 401(k) plans. Also, the new tax will apply only to income in excess of the $200,000/$250,000 thresholds. So if a couple earns $200,000 in wages and $100,000 in capital gains, $50,000 will be subject to the new tax.

Somewhat confusing isn't it? We will keep you apprised of these potential changes when they occur and the planning for how you can best deal with it. It does appear that higher income individuals would be well served to continue to maximize their retirement plan distributions.

Very truly yours,

Greenwalt CPAs, Inc.

By 

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Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

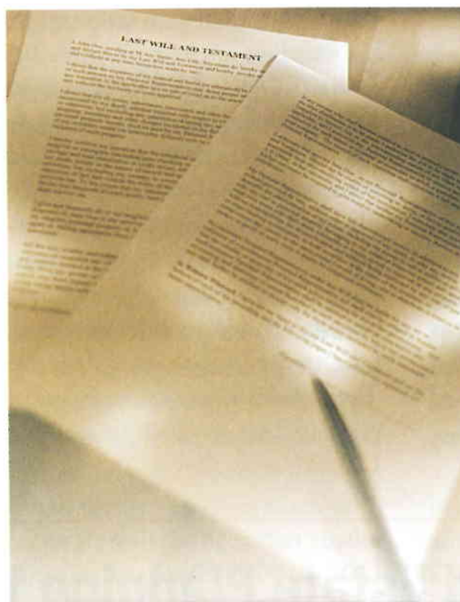
Estate Planning Beyond Estate Taxes

October 2011

Congress has designated the third full week in October as National Estate Planning Awareness Week. In truth, all 52 weeks of the year are good times to be aware of your estate plan, which should be an essential part of your overall financial plan. A faulty estate plan can cause unfortunate results for yourself and your loved ones.

In 2011 and 2012 (and perhaps in future years), everyone has a $5 million exemption from federal estate tax. Therefore, relatively few people will leave an estate that is subject to this tax. If your net worth is below $5 million, you may be tempted to ignore estate planning.

That could be a serious mistake. Estate planning is for everyone with any assets, above or below the $5 million mark. With a thoughtful estate plan, you can make it more likely that your assets will pass to the intended recipients with a minimum of inconvenience and expense. Estate planning also can protect you in case you lose the ability to manage your own financial affairs.



Will power

Generally, a will should be a crucial part of your estate plan. If you die without one, your assets might go to one or more people you'd rather not enrich.

Example 1. Linda Morgan was married with two children. Linda discovered that her husband was cheating on her and was in the process of filing for divorce when she died without a will. A person who dies with no will dies "intestate," and his or her assets are distributed according to state law. In Linda's case, state law provided that the first $30,000 of her assets passed to her husband, who also received one third of her remaining estate. The other two thirds went to Linda's children. Her husband walked away with assets that Linda would have wanted to go to her

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From 2000 to 2011, IRAs increased from 22% of U.S. retirement savings to 27% of the total, passing government plans and defined contribution plans such as 401(k)s.

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children, and he refused to pay for Linda's burial expenses.

As you can see, not having a will can deprive loved ones while benefitting someone for whom you have no regard. Anyone who is cohabiting with someone but not married should make a special effort to have a will, because state intestacy laws generally don't recognize unrelated persons. Whether you're single or married, though, you probably should have a will that was drawn up by an experienced attorney.

Title tactics

Even if you have a properly executed will, some of your assets may not be covered by its provisions. For instance, any assets that you own as joint tenants with right of survivorship (JTWROS) will pass directly to the surviving co-owner after the first death. Again, this may lead to unforeseen results.

Example 2. Matt Thomas and his brother Nate pooled their money to buy a lakeside cabin when they were young adults. They owned it as JTWROS. Both brothers married and had children; their families used the cabin for many vacations and watched the house grow in value.

Matt died and left his assets to his wife and their two children in his will. However, Matt and Nate had never changed ownership of the cabin from JTWROS. As a result, this valuable property passed to Nate rather than to Matt's intended heirs.

That's not to say that JTWROS is a poor way to hold property. On the contrary—JTWROS offers advantages. Assets held this way go to the co-owner without going through probate, a process that governs assets that pass under a will. Avoiding probate can save time and money. However, you should evaluate property titling as part of your estate plan to avoid results such as the one the hypothetical Thomas family experienced.

Beneficiary blunder

Properties held as JTWROS are not the only assets beyond the reach of your will. IRAs, employer retirement plans, life insurance policies, and various other types of assets pass to named beneficiaries. Again, improper beneficiary designations can send an inheritance in the wrong direction. The following example is based on a real case that went all the way to the U.S. Supreme Court.

Example 3. Phil Chandler worked for a major company for many years, building a six figure amount in his 401(k) account. His wife Peg was the beneficiary. When Phil and Peg divorced after a lengthy marriage, they worked out a comprehensive property settlement, which included Peg relinquishing her rights to Phil's 401(k).

The catch? Phil never changed his beneficiary designation. When he died, the plan administrator saw that Peg was the beneficiary and paid her the account balance. Phil's daughter sued to get the money but lost the case. To avoid such an outcome, you should make certain your beneficiary designations reflect your wishes and check them periodically to keep them current. ■

Did You Know?

In the spring of 2011, the Standard & Poor's/Case-Shiller Home Price Indices had dropped nearly 33% from the peak levels of mid-2006. They were back to the price levels of the summer of 2003.

Source: Standard & Poor's

Income Tax and Estate Planning With Your Parents

Taxpayers in high brackets may enjoy family tax savings by shifting taxable income to relatives in low brackets. However, the so-called kiddie tax limits the impact of shifting income to children. Shifting income to parents who are in a low tax bracket may be much more effective. Moreover, such income shifts can be profitably paired with participation in a parent's estate plan.

Recent legislative changes have tightened the kiddie tax rules. Many youngsters are now considered kiddies; full-time students under age 24 are included, for example. For these youngsters, unearned income over $1,900 will be taxed at their parents' rate in 2011.

The kiddie tax does not apply to parents. Your parents may have relatively low income and substantial tax deductions, perhaps from unreimbursed medical expenses. In such a situation, you may be able to take advantage of their low tax bracket.

Senior strategies

Some examples can illustrate income-shifting to low-bracket parents.

Example 1. Roger and Kate Donovan are in the top 35% federal income tax bracket. Kate's parents are in their late 70s, with taxable income—after all deductions—of around $40,000 a year. Kate's father has $200,000 in a traditional IRA, all in pretax money. Because Kate's parents live comfortably on their current income, her father has been

taking only the required minimum distribution from his IRA.

In 2011, married couples who file joint tax returns can have up to $69,000 of taxable income and remain in the 15% federal income tax bracket. Therefore, Kate's father can convert an additional $29,000 of his traditional IRA to a Roth IRA this year and owe only 15% on the taxable income generated by the conversion. Kate's father executes this conversion and names Kate, his only child, as the Roth IRA beneficiary.

The Roth IRA conversion will add $4,350 to the federal income tax bill owed by Kate's parents. To ease that burden, Roger and Kate might increase the birthday, anniversary, and holiday presents they give to her parents. In 2011, each individual generally can give up to $13,000 each, to any number of people, without incurring gift tax.

By making a Roth IRA conversion, the family is able to take money from the traditional IRA at a low 15% tax rate. Kate's father can execute similar partial conversions each year, until he has moved all the money from the traditional IRA to a Roth IRA at a low tax cost.

Roth IRA owners never have to take required distributions. Moreover, all distributions from a Roth IRA are tax free after five years and after age 59½. (The age requirement does not apply to Roth IRA beneficiaries.) If Kate's father has a pressing need for money before the five-year mark, he can withdraw the converted amount without owing income tax because he will already have paid income tax on the Roth IRA conversion. Otherwise, the money can keep growing inside the Roth IRA until it passes to Kate, who can take tax-free withdrawals.

Pretax money in a traditional IRA eventually will be subject to income tax, paid either by the account owner or by the beneficiary after the owner's death. In this example, if the money is left in a traditional IRA, some withdrawals might end up being taken by Kate, who is in a high tax bracket.

Give and get

Other families may benefit by transferring assets from middle aged children to elderly parents, with the understanding that those assets eventually will pass back to the children.

Example 2. Brian and Jean Russell are in the top 35% federal income tax bracket. They have been helping to support Brian's widowed mother, who has scant income beyond Social Security checks. Instead of making periodic cash gifts to Brian's mother, Brian and Jean transfer $200,000 worth of dividend paying stock to her. The Russells bought that stock many years ago for $50,000. In 2011, each individual has a $5 million gift tax exemption, so Brian and Jean can make this gift without paying gift tax. (Gifts over $13,000 a year reduce the giver's estate tax exemption, now set at $5 million.)

Assume the transferred stock pays a 4% dividend. If so, Brian's mother will receive $8,000 per year in extra income: 4% of $200,000. Assuming the dividends are "qualified," which is the case for most investment income dividends, low bracket taxpayers owe 0% tax. As long as Brian's mother keeps her taxable income at $34,500 or less this year, she will owe no tax on the dividends. Brian and Jean would have owed 15% tax on the dividends if they had kept the shares.

In this example, Brian's mother revises her will so that Brian will inherit the shares she now owns. Suppose Brian's mother dies when those shares are worth $215,000. If Brian's mother has lived for more than one year after the gift, Brian will have a $215,000 basis (cost for tax purposes) in the inherited shares. He can sell them for $215,000 and owe no tax. Therefore, no one will ever owe capital gains tax on the shares' appreciation from $50,000. However, if Brian's mother dies before a year has passed since the gift, he will not get a step up in basis.

These are a few ways that high bracket taxpayers might take advantage of parents' low brackets. Our office can go over your personal circumstances and suggest ways to save taxes by teaming up with low bracket parents. ■

Don't Take a Vacation From Estate Planning

According to the National Association of Realtors' 2011 Investment and Vacation Home Buyers Survey, there are 7.9 million vacation homes in the United States, Many people like the idea of going to their own place for weekends and longer stays. Owners may dream of seeing children and grandchildren get together for wonderful family experiences at a treasured vacation home.

These experiences may happen during the owner's lifetime, but reality can be quite different after the owner's death. If a vacation home owner leaves the house to more than one heir, serious disputes can arise. The new owners may not agree on capital expenses or who should pay them.

Example: Jim and Karen Warner bought a New Jersey beach house decades ago. Over the years, their

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children and then grandchildren spent time there. Jim died and left the beach house to Karen, who left it equally to their three children at her death.

The oldest child, Chris, now works for a software company in California and never uses the New Jersey beach house. Sarah, a prosperous real estate attorney in New York, uses the house often with her husband and her three children. Emily, the youngest, is an aspiring but as yet unsuccessful actress and novelist who uses the house infrequently. After a severe winter, Sarah wants to hire a roofer for extensive and expensive repairs, but Emily doesn't think they're necessary. Chris doesn't bother to respond to calls or emails about the roof contract; he doesn't intend to pay one-third of the cost if a roofer is hired.

Avoiding acrimony

Such an outcome may be the norm rather than the exception if a vacation home is simply left to more than one individual. Therefore, if you own a vacation home, it should be integrated into your estate plan. Be realistic about the prospects of the new owners handling the bequest without disputes.

One solution is to sell the vacation house while you are alive, perhaps when family use has declined. Any profit probably will be taxed as a long-term capital gain, which now qualifies for a favorable tax rate. The sales proceeds can be given or bequeathed to your heirs, who can buy their own vacation home or use the money for other purposes. If you do not sell your vacation home while you are alive, your designated heir or heirs could inherit during a weak real estate market and therefore be stuck with ongoing expenses as well as a property that's difficult to sell.

Another approach is to leave the house to just one child while equalizing inheritances. In the Warner family example, Karen might leave the house to Sarah, the attorney who is most likely to use the house, and bequeath other assets of comparable value to Chris and Emily. Without the beach house to promote discord, Sarah might invite her siblings for occasional visits.

Alternatively, the owner of a desirable vacation home might place the property in trust or in a limited liability company (LLC). Some funding could be provided to cover the operating expenses, and the trust or LLC documents could describe a procedure for the buyout of a beneficiary who would rather have cash than the right to use the home. If this arrangement appeals to you, our office can help you determine the necessary funding to keep your vacation home a family retreat. ■

TAX CALENDAR

OCTOBER 2011

October 17

Individuals. If you have an automatic six-month extension to file your income tax return for 2010, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, or penalties due.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in September if the monthly rule applies.

Electing large partnerships. If you were given an additional six-month extension, file a 2010 calendar year tax (Form 1065-B).

October 31

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2011. Deposit any undeposited tax. (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.

For federal unemployment tax, deposit the tax owed through September if more than $500.

NOVEMBER 2011

November 10

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2011. This due date applies only if you deposited the tax for the quarter in full and on time.

November 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in October if the monthly rule applies.

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