20 TIPS FOR MINIMIZING YOUR TAXES IN 2012 & BEYOND

You may want to exploit these strategic opportunities.

Presented by Gregg Hancock – Wealth Advisor at First Midwest Wealth Management

Will the Bush-era tax cuts expire next year? We may not have an answer to that question for several months. After the November elections, you could see them extended once again. Nothing is certain: with the daunting financing challenges the federal government faces, they may finally expire in 2013.

If your goal is tax minimization, here are 20 "to-dos" you might want to accomplish before 2013 arrives; alone or in combination, they could save you some money. Just one note beforehand: consult the tax or financial professional you trust before you make these moves, so you can see how they fit within your overall financial picture.

1) Sell some stocks or funds before 2013 arrives. If you sell highly appreciated investments that you have held for at least a year during 2012, you can exploit the current 0-15% capital gains rates. In 2013, all but those in the 15% income tax bracket will face 20% capital gains taxes. On top of that, a potential 3.8% Medicare surtax could be levied on certain net investment income for individuals with MAGI of $200,000+ and married couples with MAGI of $250,000+. Just think: you could use your tax savings for tuition, mortgage payments or other priorities.[1,2]

2) Think about taking some profits while 2012 is still here. The current 15% tax rate for qualified dividends could disappear in 2013. If the EGTRRA/JGTRRA cuts aren't extended again, these dividends will be taxed as ordinary income next year (the maximum tax rate on them will jump to 39.6%).[1]

3) Retired & wealthy? Consider withdrawing more from your IRA. Are you in the top tax bracket? You might end up paying as much as 43.4% in income taxes to Uncle Sam next year (projected 39.6% top tax rate + possible 3.8% Medicare surtax). This is assuming the EGTRRA/JGTRRA cuts expire in 2013 – and with the federal deficit and Social Security's revenue issues, they may. The top tax rate for 2012 is just 35%, so if a sunset for the Bush-era tax cuts looks pretty certain, it may be worthwhile to withdraw some IRA assets in late 2012 for 2013 needs.[2]

4) Consider going Roth. If tax brackets reset to 2001 levels and stay there for years to come, then converting a traditional IRA to a Roth IRA may be a really smart move (future tax-free withdrawals of earnings, assets passing tax-free to heirs).[2]

5) Think about exploiting the current $5.12 million lifetime gift tax exemption. A 2010 law reset the lifetime federal gift, estate and GST tax exemptions at $5,120,000 through the end of 2012 and made the exemption portable between married spouses. This means a) you currently have the ability to gift up to $4.12 million more than the old $1 million lifetime limit and b) married couples can currently gift up to $10.24 million. This gives you an amazing opportunity to reduce the size of your taxable estate. On January 1, 2013 (barring Congressional action), the lifetime unified gift/estate/GST exemption will reset to $1 million and portability will be lost.[3]

6) Consider a donation of appreciated stock to charity. Instead of a cash gift, you could do this and get 1) a charitable deduction for the full market value of donated shares and 2) a way to avoid tax on the unrealized gains of the security. The investors who can get the most out of this are those who itemize deductions and fall into the 15% tax bracket or higher. A reminder: you have to have owned the shares for at least a year. (Speaking of itemized deductions, take a look at #18 below.)[4]

7) Arrange tuition payments to take advantage of the AOTC. The American Opportunity Tax Credit is set to expire in 2013. So it might be worth it to pay 2013 tuition during 2012, as the AOTC provides up to $2,500 in tax credits on the first $4,000 of qualifying educational expenses. Even better, 40% of the credit (up to $1,000) is refundable – you will get that portion back even if you owe no taxes for 2012. Generally speaking, a single filer with MAGI of $80,000 or less or joint filers with MAGI of $160,000 or less can claim the AOTC for the qualified expenses of an eligible student. Phase-outs kick in at those levels; single filers with MAGI above $90,000 and joint filers with MAGI above $180,000 cannot claim the credit for 2012.[5]

8) A huge tax credit is available in 2012 for adoptive parents. The federal adoption tax credit is up in the air for 2013; it may be renewed or made permanent, but such a move might come at the eleventh hour. For 2012, the adoption tax credit is $12,650. It isn't refundable (so if your total tax bill is less than the credit, you won't get additional money back from the IRS). It can be carried forward for up to five years – if you don't end up using 100% of the credit for the 2012 tax year, you can use the remainder to offset some federal income taxes through 2017.[6]

9) 50% business expensing is scheduled to be eliminated in 2012. The bonus depreciation limit that benefited large companies (50% for 2012) will be gone if the Bush-era tax cuts sunset. So next year, big businesses could lose a chance to take a 50% write-off on new capital equipment.[7]

10) Section 179 limits could really drop in 2013. In 2012, the maximum Section 179 deduction allowance is $139,000. For 2013, it is slated to return to $25,000. The limit on capital purchases - $560,000 in 2012 – is scheduled to fall back to $200,000 in 2013.[7]

11) You may want to roll over assets from a Coverdell ESA into a 529 plan. Should the Bush-era tax cuts expire, Coverdells will also be hit hard: the annual contribution limit for any one beneficiary will drop to $500 from $2,000, only college-related expenses will be considered "qualified spending", and contributions to a Coverdell and a 529 plan will no longer be allowed in the same year (among other drawbacks). If the Bush-era cuts are extended for the middle class, Coverdell ESA benefits may not be so impacted – but no one knows at this point.[8]

12) Before 2013 arrives, you might want to exercise some stock options. As the prospect of higher taxes looms, it may be a good time to weigh taxable hedging strategies and make 83(b) elections on restricted securities.

13) Think about municipal bonds. The potential tax hikes of 2013 have made them more attractive, as the interest on these securities is tax-exempt. Their yields might presently increase, as President Obama has talked of restricting the tax break on muni bond interest at 29% for single filers earning more than $200,000 and couples earning more than $250,000.[9]

14) Take another look at REITs. Some publicly traded REITs have shown positive returns; if dividends are taxed as ordinary income starting in 2013, then investments paying dividends and taxable interest may be at par with each other.

15) Cash value insurance might prove handy. It may be worth it to run the numbers here: a whole life policy could be a nice source of funds if the projected tax savings will outweigh the policy costs.

16) An MLP might prove to be a useful business structure. Typically, around 80-90% of the distributions from a Master Limited Partnership (MLP) are tax-deferred and characterized as return of capital, reducing cost basis for the individual investor.[10]

17) You may want to have that dental work or elective surgery done in 2012. Next year, you will only be able to deduct the medical expenses exceeding 10% of your AGI. For 2012, you can deduct medical expenses when they surpass 7.5% of your AGI.[9]

18) Alert: phase-outs on itemized deductions may return in 2013. The phase-out on the personal exemption is also slated to come back. So it may be smart for higher-income families to fulfill pledges made to 501(c)(3) non-profits in 2012.[1]

19) Pay attention to asset location. You may want to move income-producing assets into tax-deferred accounts or shift assets that generate capital gains into taxable accounts. Doing this may give you opportunities to defer those gains and practice tax-loss harvesting.

20) Lastly, beware portfolio churn. The reality is that some funds make frequent trades. These trades result in taxable gains (including short-term gains, which are taxed severely). Getting out of certain funds may save you some tax dollars.

Gregg Hancock may be reached at 309-797-7622 or gregg.hancock@firstmidwest.com

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Citations.

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