2012 - 2013 Tax Planning Strategies

U.S. Bancorp Investments, Inc.

Proper tax planning is a team effort

Virtually every financial decision you make has tax consequences. From buying a home to paying off a mortgage…from getting married to having children or transitioning back to life alone…from earning a paycheck to generating predictable income during retirement…taxes affect your bottom line.

Through the years, the tax code has become increasingly complex and difficult to navigate. Changes to tax laws occur on a regular basis, and from time-to-time, dramatic alterations to tax policy may have an even more significant impact.

How can you identify effective strategies to help minimize your tax burden? One of the best opportunities is to turn to the support of professionals who understand the tax impact of the choices you make in your financial life and can keep up with the constant changes in tax law.

This guide is a starting point, providing you with an overview of many ways to help manage taxes in today's environment. The information included is important, but it is far from comprehensive. Be sure to check with your tax advisor to discuss your specific circumstances.

Your U.S. Bancorp Investments, Inc. Financial Advisor or U.S. Bank Relationship Manager can help you incorporate tax planning into your overall financial strategy.

In these uncertain times, planning is more important than ever

Minimizing taxes is never easy. But in times of legislative and economic uncertainty, it can be a real challenge. As of this writing, the lower tax rates currently in effect are scheduled to expire at the end of 2012. Whether they'll be extended, raised or changed in some other way is anyone's guess.

This means you'll need to base your tax plan on the way things are now but be ready to revise it in a flash if Congress makes significant tax law changes before year end. The more you know about the areas subject to change, and the more familiar you are with various tax planning strategies, the easier it will be to determine your best course of action.

This guide is intended to help you do exactly that. But we don't have room here to cover all strategies that may apply to your situation. So please check with your tax advisor to find out the latest information and the best ways to minimize your tax liability for 2012 and beyond.

Rising rates and expiring breaks complicate tax planning

Deductions are more powerful when tax rates are higher because they save tax at that higher rate — a $1,000 deduction saves you $280 when your tax rate is 28% but $310 when your tax rate is 31%. With tax rates, as of this writing, scheduled to rise in 2013, you may want to defer, where possible, incurring deductible expenses to next year, when they might save more tax. But the tax advantage could be reduced or eliminated by the expiration of certain tax breaks. An income-based phaseout limiting the benefit of many deductions, for example, is scheduled to return for 2013. Yet it's possible that lower rates and various breaks could be extended. So planning for deductions is especially complicated this year.

The AMT

When planning for deductions, the first step is to consider the alternative minimum tax (AMT) — a separate tax system that limits some deductions and doesn't permit others, such as:

- State and local income tax deductions,
- Property tax deductions, and
- Miscellaneous itemized deductions subject to the 2% of adjusted gross income (AGI) floor, including investment expenses and unreimbursed employee business expenses.

You must pay the AMT if your AMT liability exceeds your regular tax liability. (See Chart 7 on page 16 for AMT rates and exemptions.) You may be able to time income and deductions to avoid the AMT, reduce its impact or even take advantage of its lower maximum rate. But, such planning will be a challenge until Congress passes long-term relief.

Unlike the regular tax system, the AMT system isn't regularly adjusted for inflation. Instead, Congress must legislate any adjustments. Typically, it has done so via an increase in the AMT exemption. Such a "patch" was in effect for 2011, but, as of this writing, Congress hasn't passed a patch for 2012. (Check with your tax advisor for the latest information.)

Charitable donations

Donations to qualified charities are generally fully deductible for both regular tax and AMT purposes, and they may be the easiest deductible expense to time to your tax advantage. After all, you control exactly when and how much you give. For large donations, discuss with your tax advisor which assets to give and the best ways to give them. For example:

Appreciated assets. Publicly traded stock and other securities you've held more than one year are long-term capital gains property, which can make one of the best charitable gifts. Why? Because you can deduct the current fair market value and avoid the capital gains tax you'd pay if you sold the property. ***Warning:*** Donations of such property are subject to tighter deduction limits. Excess contributions can be carried forward for up to five years.

CRTs. For a given term, a charitable remainder trust pays an amount to you annually (some of which may be taxable). At the term's end, the CRT's remaining assets pass to one or more charities. When you fund the CRT, you receive an income tax deduction. If you contribute appreciated assets, you also may be able to minimize and defer capital gains tax. You can name someone other than yourself as income beneficiary or fund the CRT at your death, but the tax consequences will be different.

CHART 1 Scheduled ordinary income tax rate increases

2012 rate	2013 rate[1]
10%	15%
15%	15%
25%	28%
28%	31%
33%	36%
35%	39.6%

[1] *Assuming legislation isn't signed into law extending lower rates or making other rate changes. Contact your tax advisor for the latest information.*

Home-related breaks

These valuable tax breaks go beyond just deductions:

Property tax deduction. Before paying your bill early to accelerate the itemized deduction into 2012, review your AMT situation. If you're subject to the AMT, you'll lose the benefit of the deduction for the prepayment.

Mortgage interest deduction. You generally can deduct interest on up to a combined total of $1 million of mortgage debt incurred to purchase, build or improve your principal residence and a second residence. Points paid related to your *principal* residence also may be deductible.

Home equity debt interest deduction. Interest on home equity debt used to improve your principal residence — and interest on home equity debt used for any purpose (debt limit of $100,000) — may be deductible. So consider using a home equity loan or line of credit to pay off credit cards or auto loans, for which interest isn't deductible. ***Warning:*** Beware of the AMT — if the home equity debt isn't used for home improvements, the interest isn't deductible for AMT purposes.

Home office deduction. If your use of a home office is for your employer's benefit and it's the only use of the space, you generally can deduct a portion of your mortgage interest, real estate taxes, insurance, utilities and certain other expenses, as well as the depreciation allocable to the office space. You can also deduct direct expenses, such as business-only phone lines.

You must claim these expenses as a miscellaneous itemized deduction, which means you'll enjoy a tax benefit only if your home office expenses plus your other miscellaneous itemized expenses exceed 2% of your AGI. If, however, you're self-employed, you can use the deduction to offset your self-employment income and the 2% of AGI "floor" won't apply.

Home sale gain exclusion. When you sell your principal residence, you can exclude up to $250,000 ($500,000 for joint filers) of gain if you meet certain tests. ***Warning:*** Gain that's allocable to a period of "nonqualified" use generally isn't excludible.

Home sale loss deduction. Losses on the sale of a principal residence aren't deductible. But if part of your home is rented or used exclusively for your business, the loss attributable to that portion will be deductible, subject to various limitations.

Debt forgiveness exclusion. Homeowners who receive debt forgiveness in a foreclosure, short sale or mortgage workout for a principal residence generally don't have to pay federal income taxes on that forgiveness. ***Warning:*** As of this writing, this break is scheduled to expire after 2012.

Rental income exclusion. If you rent out all or a portion of your principal residence or second home for less than 15 days, you don't have to report the income. But expenses associated with the rental won't be deductible.

Sales tax deduction

The break allowing you to take an itemized deduction for state and local *sales* taxes in lieu of state and local *income* taxes was available for 2011 but, as of this writing, hasn't been extended for 2012. (Check with your tax advisor for the latest information.) When available, the deduction can be valuable to taxpayers who reside in states with no or low income tax or who purchase major items, such as a car or boat.

Saving for health care

Here are two tax-advantaged vehicles you should consider if available to you:

1. HSA. If you're covered by qualified high-deductible health insurance, a Health Savings Account allows contributions of pretax income (or deductible after-tax contributions) up to $3,100 for self-only coverage and $6,250 for family coverage (for 2012). Account holders age 55 and older can contribute an additional $1,000.

HSAs bear interest or are invested and can grow tax-deferred similar to an IRA. Withdrawals for qualified medical expenses are tax-free, and you can carry over a balance from year to year.

2. FSA. You can redirect pretax income to an employer-sponsored Flexible Spending Account up to an employer-determined limit (not to exceed $2,500 for plan years beginning in 2013). The plan pays or reimburses you for qualified medical expenses. What you don't use by the end of the plan year, you generally lose. If you have an HSA, your FSA is limited to funding certain "permitted" expenses.

WHAT'S NEW! **Medical expense deduction floor scheduled to rise in 2013**

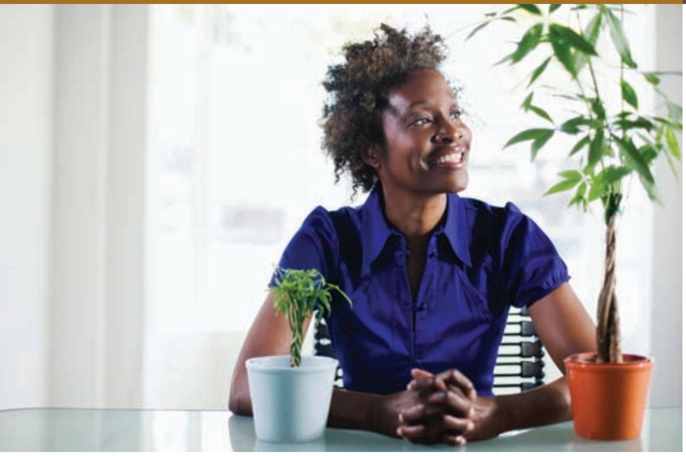
Who's affected: Taxpayers who incur medical expenses.

Key changes: Currently, if your eligible medical expenses exceed 7.5% of your adjusted gross income (AGI), you can deduct the excess amount. But in 2013, the 2010 health care act increases this "floor" to 10% for taxpayers under age 65.

Eligible expenses can include health insurance premiums, medical and dental services and prescription drugs. Expenses that are reimbursed (or reimbursable) by insurance or paid through a tax-advantaged health care account *aren't* eligible.

Planning tips: Consider "bunching" nonurgent medical procedures and other controllable expenses into one year to exceed the AGI floor. Bunching expenses into 2012 may be especially beneficial because of the scheduled floor increase. But keep in mind that, for alternative minimum tax purposes, the 10% floor already applies. Also, if tax rates go up in 2013 as scheduled, your deductions might be more powerful then. Finally, be aware that the floor increase could be repealed by Congress.

Green your family tree with these tax-saving opportunities



Many ways to save tax dollars are available to parents, students and even grandparents. So take advantage of the deductions, credits and tax-advantaged savings opportunities available to you and your family. Also be aware that certain breaks will become less beneficial in 2013 if Congress doesn't take action to extend the enhancements currently in effect.

Child and adoption credits

Tax credits reduce your tax bill dollar-for-dollar, so make sure you're taking every credit you're entitled to. For each child under age 17 at the end of the year, you may be able to claim a $1,000 child credit. If you adopt in 2012, you may qualify for an adoption credit or an employer adoption assistance program income exclusion; both are $12,650 per eligible child.

Warning: These credits phase out for higher-income taxpayers. (See Chart 2.)

Child care expenses

A couple of tax breaks can help you offset these costs:

Tax credit. For children under age 13 or other qualifying dependents, you may be eligible for a credit for a portion of your dependent care expenses. Eligible expenses are limited to $3,000 for one dependent and $6,000 for two or more. Income-based limits reduce the credit but don't phase it out altogether. (See Chart 2.)

FSA. You can contribute up to $5,000 pretax to an employer-sponsored child and dependent care Flexible Spending Account. The plan pays or reimburses you for these expenses. You can't use those same expenses to claim a tax credit.

IRAs for teens

IRAs can be perfect for teenagers because they likely will have many years to let their accounts grow tax-deferred or tax-free. The 2012 contribution limit is the lesser of $5,000 or 100% of earned income. Traditional IRA contributions generally are deductible, but distributions will be taxed. On the other hand, Roth IRA contributions aren't deductible, but qualified distributions will be tax-free.

Choosing a Roth IRA is a no-brainer if a teen doesn't earn income that exceeds the standard deduction ($5,950 for 2012 for single taxpayers), because he or she will gain no benefit from the ability to deduct a traditional IRA contribution. (For more on IRAs, see page 12.)

If your children or grandchildren don't want to invest their hard-earned money, consider giving them the amount they're eligible to contribute — but keep the gift tax in mind. (See page 14.) If they don't have earned income and you own a business, consider hiring them. As the business owner, you can deduct their pay, and other tax benefits may apply. ***Warning:*** Your children must be paid in line with what you'd pay nonfamily employees for the same work.

CHART 2 — **2012 family and education tax breaks: Are you eligible?**

Tax break	Modified adjusted gross income phaseout range	
	Single filer	**Joint filer**
Child credit[1]	$ 75,000–$ 95,000	$110,000–$130,000
Adoption credit	$189,710–$229,710	$189,710–$229,710
Child or dependent care credit[2]	$ 15,000–$ 43,000	$ 15,000–$ 43,000
ESA contribution	$ 95,000–$110,000	$190,000–$220,000
American Opportunity credit	$ 80,000–$ 90,000	$160,000–$180,000
Lifetime Learning credit	$ 52,000–$ 62,000	$104,000–$124,000
Student loan interest deduction	$ 60,000–$ 75,000	$125,000–$ 155,000

[1] Assumes one child. The phaseout end is higher for families with more than one eligible child.

[2] The phaseout is based on AGI rather than MAGI. The credit doesn't phase out altogether, but the minimum credit percentage of 20% applies to AGIs above $43,000.

The "kiddie tax"

The income shifting that once — when the "kiddie tax" applied only to those under age 14 — provided families with significant tax savings now offers much more limited benefits. Today, the kiddie tax applies to children under age 19 as well as to full-time students under age 24 (unless the students provide more than half of their own support from earned income).

For children subject to the kiddie tax, any unearned income beyond $1,900 (for 2012) is taxed at their parents' marginal rate rather than their own, likely lower, rate. Keep this in mind before transferring income-generating assets to them.

Saving for education

If you're saving for education, there are two tax-advantaged vehicles you should consider:

1. Section 529 plans. You can choose a prepaid tuition program to secure current tuition rates or a tax-advantaged savings plan to fund college expenses:

- Contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred.
- Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, equipment, supplies and, generally, room and board) are income-tax-free for federal purposes and may be tax-free for state purposes.
- The plans typically offer high contribution limits, and there are no income limits for contributing.
- There's generally no beneficiary age limit for contributions or distributions.
- You remain in control of the account — even after the child is of legal age.
- You can make rollovers to another qualifying family member.
- The plans provide estate planning benefits: A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions and make a $65,000 contribution (or $130,000 if you split the gift with your spouse).

The biggest downsides may be that your investment options — and when you can change them — are limited.

2. ESAs. Coverdell Education Savings Account contributions aren't deductible for federal purposes, but plan assets can grow tax-deferred and distributions used to pay qualified education expenses are income-tax-free.

Perhaps the biggest ESA advantage is that you have direct control over how and where your contributions are invested. Another advantage is that tax-free distributions aren't limited to college expenses; they also can fund elementary and secondary school costs.

However, if Congress doesn't extend this treatment, distributions used for precollege expenses will be taxable starting in 2013. Additionally, the annual ESA contribution limit per beneficiary is only $2,000 through 2012, and it will go down to $500 for 2013 if Congress doesn't act. Contributions are further limited based on income. (See Chart 2.)

Generally, contributions can be made only for the benefit of a child under age 18. Amounts left in an ESA when the beneficiary turns age 30 generally must be distributed within 30 days, and any earnings may be subject to tax and a 10% penalty.

Education credits and deductions

If you have children in college now, are currently in school yourself or are paying off student loans, you may be eligible for a credit or deduction:

American Opportunity credit. This tax break covers 100% of the first $2,000 of tuition and related expenses and 25% of the next $2,000 of expenses. The maximum credit, per student, is $2,500 per year for the first four years of postsecondary education. ***Warning:*** The credit is scheduled to revert to the less beneficial Hope credit after 2012 but may be extended.

Lifetime Learning credit. If you're paying postsecondary education expenses beyond the first four years, you may be eligible for the Lifetime Learning credit (up to $2,000 per tax return).

Tuition and fees deduction. If you don't qualify for one of the credits because your income is too high, you might be eligible to *deduct* up to $4,000 of qualified higher education tuition and fees — if this break is extended for 2012. (Check with your tax advisor for the latest information.)

Student loan interest deduction. If you're paying off student loans, you may be able to deduct up to $2,500 of interest (per tax return).

Warning: Income-based phaseouts apply to these breaks (see Chart 2), and expenses paid with 529 plan or ESA distributions can't be used to claim them.

Time to take another look at the impact of taxes on your portfolio

When it comes to investing, the focus is often on returns — without regard to their potential tax impact. Because tax rates have been relatively low for the past several years, it's not surprising that there's been more focus on stock market volatility and low interest rates than on tax consequences. But, as of this writing, tax rates are scheduled to increase next year, so it's time to take another look at the impact of taxes on your portfolio.

Capital gains tax and timing

Although time, not timing, is generally the key to long-term investment success, timing can have a dramatic impact on the tax consequences of investment activities. The 15% long-term capital gains rate is 20 percentage points lower than the highest ordinary-income rate of 35%. It generally applies to investments held for more than 12 months. (Higher long-term gains rates apply to certain types of assets — see Chart 3.)

Holding on to an investment until you've owned it more than a year may help substantially cut tax on any gain.

Warning: You have only through 2012 to take advantage of the 15% rate, unless Congress extends it. (See "What's new!" below.)

Here are some other tax-saving strategies related to timing:

Use unrealized losses to absorb gains. To determine capital gains tax liability, realized capital gains are netted against any realized capital losses. If you've cashed in some big gains during the year and want to reduce your 2012 tax liability, before year end look for unrealized losses in your portfolio and consider selling them to offset your gains.

WHAT'S NEW! **Low capital gains and qualified-dividend rates set to expire Dec. 31**

Who's affected: Investors holding appreciated or dividend-producing assets.

Key changes: As of this writing, the 15% long-term capital gains rate is scheduled to return to 20% in 2013. The 15% rate also applies to qualified dividends, and in 2013 these dividends are scheduled to return to being taxed at your marginal ordinary-income rate — which likely is also scheduled to increase. (See Chart 1 on page 2.) It's possible, however, that Congress will extend the lower rates or make other rate changes. (Check with your tax advisor for the latest information.)

Planning tips: If as year end approaches it's looking like tax rates will increase next year, consider whether, before year end, you should sell highly appreciated assets you've held long term. It may make sense to recognize gains now rather than risk paying tax at a higher rate next year. If you hold dividend-producing investments, consider whether you should make any adjustments to your portfolio in light of the higher tax rate that may apply to dividends in 2013.

Avoid wash sales. If you want to achieve a tax loss with minimal change in your portfolio's asset allocation, keep in mind the wash sale rule. It prevents you from taking a loss on a security if you buy a substantially identical security (or option to buy such a security) within 30 days before or after you sell the security that created the loss. You can recognize the loss only when you sell the replacement security.

Fortunately, there are ways to avoid triggering the wash sale rule and still achieve your goals. For example, you can immediately buy securities of a different company in the same industry or shares in a mutual fund that holds securities much like the ones you sold. Or, you may wait 31 days to repurchase the same security. Alternatively, before selling the security, you can purchase additional shares of that security equal to the number you want to sell at a loss, and then wait 31 days to sell the original portion.

Swap your bonds. With a bond swap, you sell a bond, take a loss and then immediately buy another bond of similar quality and duration from a different issuer. Generally, the wash sale rule doesn't apply because the bonds aren't considered substantially identical. Thus, you achieve a tax loss with virtually no change in economic position.

CHART 3	What's the maximum capital gains tax rate?	
Maximum tax rate for assets held	**2012**	**2013[1]**
12 months or less *(short term)*	35%	39.6%
More than 12 months *(long term)*	15%	20%
Some key exceptions		
Long-term gain on collectibles, such as artwork and antiques	28%	28%
Long-term gain attributable to certain recapture of prior depreciation on real property	25%	25%
Long-term gain that would be taxed at 15% or less based on the taxpayer's ordinary-income rate	0%	10%

[1] *Assuming legislation isn't signed into law extending lower rates or making other rate changes. Contact your tax advisor for the latest information.*

Mind your mutual funds. Mutual funds with high turnover rates can create income that's taxed at ordinary-income rates. Choosing funds that provide primarily long-term gains can save you more tax dollars because of the lower long-term rates.

See if a loved one qualifies for the 0% rate. The long-term capital gains rate is 0% for gain that would be taxed at 10% or 15% based on the taxpayer's ordinary-income rate. If you have adult children in one of these tax brackets, consider transferring appreciated assets to them so they can enjoy the 0% rate.

Warning: The 0% rate is scheduled to expire after 2012, so you may want to act soon. Also, if the child will be under age 24 on Dec. 31, first make sure he or she won't be subject to the "kiddie tax." (See page 5.) Finally, consider any gift tax consequences. (See page 14.)

Loss carryovers

If net losses exceed net gains, you can deduct only $3,000 ($1,500 for married taxpayers filing separately) of the net losses per year against ordinary income (such as wages, self-employment and business income, and interest).

You can carry forward excess losses indefinitely. Loss carryovers can be a powerful tax-saving tool in future years if you have a large investment portfolio, real estate holdings or a closely held business that might generate substantial future capital gains. They'll be even more powerful if rates go up in 2013.

But if you don't expect substantial future gains, it could take a long time to fully absorb a large loss carryover. So, from a tax perspective, you may not want to sell an investment at a loss if you won't have enough gains to absorb most of it. (Remember, however, that capital gains distributions from mutual funds can also absorb capital losses.) Plus, if you hold on to the investment, it may recover the lost value.

Nevertheless, if you're ready to divest yourself of a poorly performing investment because you think it will continue to lose value — or because your investment objective or risk tolerance has changed — don't hesitate solely for tax reasons.

Beyond gains and losses

With some types of investments, you'll have more tax consequences to consider than just gains and losses:

Dividend-producing investments. Currently, qualified dividends are subject to the same 15% rate (or 0% rate for taxpayers in the 10% or 15% ordinary-income bracket) that applies to long-term capital gains. ***Warning:*** This tax treatment is scheduled to change in 2013. (See "What's new!" at left.)

Interest-producing investments. Interest income generally is taxed at ordinary-income rates. So, in terms of income investments, stocks that pay qualified dividends may be more attractive tax-wise than, for example, CDs or money market accounts. But nontax issues must be considered as well, such as investment risk and diversification.

Bonds. These also produce interest income, but the tax treatment varies:

- Interest on U.S. government bonds is taxable on federal returns but generally exempt on state and local returns.
- Interest on state and local government bonds is excludible on federal returns. If the bonds were issued in your home state, interest also may be excludible on your state return.
- Tax-exempt interest from certain private-activity municipal bonds can trigger or increase the alternative minimum tax (AMT, see page 2) in some situations.
- Corporate bond interest is fully taxable for federal and state purposes.
- Bonds (except U.S. savings bonds) with original issue discount (OID) build up "interest" as they rise toward maturity. You're generally considered to earn a portion of that interest annually — even though the bonds don't pay this interest annually — and you must pay tax on it.

Stock options. Before exercising (or postponing exercise of) options or selling stock purchased via an exercise, consult your tax advisor about the complicated rules that may trigger regular tax or AMT liability. He or she can help you plan accordingly.

Boost your bottom line by reducing taxes

It's not how much money your business makes that really matters, but how much money it keeps. And taxes can take a large bite out of your bottom line. To boost it, reduce your taxes by using all the breaks available to you. Unfortunately, many breaks have expired or become less powerful this year. Still, there are plenty of opportunities out there, and, with smart planning, you can make the most of them.

Projecting income

Projecting your business's income for this year and next will allow you to time income and deductions to your advantage. It's generally — but not always — better to defer tax, so consider:

Deferring income to next year. If your business uses the cash method of accounting, you can defer billing for your products or services. Or, if you use the accrual method, you can delay shipping products or delivering services. But don't let tax considerations get in the way of making sound business decisions.

Accelerating deductible expenses into the current year. This also will defer tax. If you're a cash-basis taxpayer, you may make a state estimated tax payment before Dec. 31, so you can deduct it this year rather than next. But consider the alternative minimum tax (AMT) consequences first. Both cash- and accrual-basis taxpayers can charge expenses on a credit card and deduct them in the year charged, regardless of when the credit card bill is paid.

Warning: Think twice about these strategies if you're experiencing a low-income year. Their negative impact on your cash flow may not be worth the potential tax benefit.

Taking the opposite approach. If it's likely you'll be in a higher tax bracket next year, accelerating income and deferring deductible expenses may save you more tax. ***Warning:*** Individual income tax rates are scheduled to go up in 2013. (See Chart 1 on page 2.) So if your business structure is a flow-through entity, you may face higher rates even if your tax bracket remains the same.

Depreciation

For assets with a useful life of more than one year, you generally must depreciate the cost over a period of years. In most cases, the Modified Accelerated Cost Recovery System (MACRS) will be preferable to the straight-line method because you'll get larger deductions in the early years of an asset's life.

But if you make more than 40% of the year's asset purchases in the last quarter, you could be subject to the typically less favorable midquarter convention. Careful planning can help you maximize depreciation deductions in the year of purchase.

Other depreciation-related breaks and strategies also are available:

Section 179 expensing election. This election allows you to deduct (rather than depreciate over a number of years) the cost of purchasing such assets as equipment, furniture and off-the-shelf computer software. For 2012, the expensing limit is $139,000. The break begins to phase out dollar-for-dollar when total asset acquisitions for the tax year exceed $560,000. You can claim the election only to offset net income, not to reduce it below zero to create a net operating loss. (See "NOLs" on page 10.)

If your asset purchases for the year will exceed the phaseout threshold or your net income, consider 50% bonus depreciation. (See "What's new!" at right.) It may provide greater tax savings because it has no asset purchase limit or net income requirement. But only Sec. 179 expensing can be applied to *used* assets. Also consider state tax consequences.

Warning: The expensing limit and phaseout threshold have dropped significantly from their 2011 levels of $500,000 and $2 million, respectively. And for 2013, these amounts are scheduled to drop again, to $25,000 and $200,000. Also, the break allowing up to $250,000 of Sec. 179 expensing for qualified leasehold-improvement, restaurant and retail-improvement property has expired. Congress may extend the enhanced Sec. 179 breaks, however, so check with your tax advisor for the latest information.

Accelerated depreciation. The break allowing a shortened recovery period of 15 years — rather than 39 years — for qualified leasehold-improvement, restaurant and retail-improvement property has expired, though it may be extended. Check with your tax advisor for the latest information.

Cost segregation study. If you've recently purchased or built a building or are remodeling existing space, consider a cost segregation study. It identifies property components and related costs that can be depreciated much faster, perhaps dramatically increasing your current deductions. Typical assets that qualify include decorative fixtures, security equipment, parking lots and landscaping.

The benefit of a cost segregation study may be limited in certain circumstances — for example, if the business is subject to the AMT or is located in a state that doesn't follow federal depreciation rules.

Vehicle-related deductions

Business-related vehicle expenses can be deducted using the mileage-rate method (55.5 cents per mile driven in 2012) or the actual-cost method (total out-of-pocket expenses for fuel, insurance and repairs, plus depreciation).

Purchases of *new or used* vehicles may be eligible for Sec. 179 expensing, and purchases of *new* vehicles may be eligible for bonus depreciation. (See "What's new!" at right.) However, many rules and limits apply.

For example, the normal Sec. 179 expensing limit generally applies to vehicles weighing more than 14,000 pounds, but the limit is only $25,000 for SUVs weighing more than 6,000 pounds but no more than 14,000 pounds.

Vehicles weighing 6,000 pounds or less don't satisfy the SUV definition and thus are subject to the passenger automobile limits. For autos placed in service in 2012, the depreciation limit is $3,160. The limit is increased by $8,000 for vehicles eligible for bonus depreciation. The amount that may be deducted under the combination of MACRS depreciation, Sec. 179 and bonus depreciation rules for the first year is limited under the luxury auto rules.

In addition, if a vehicle is used for business and personal purposes, the associated expenses, including depreciation, must be allocated between deductible business use and nondeductible personal use. The depreciation limit is reduced if the business use is less than 100%. If business use is 50% or less, you can't use Sec. 179 expensing, bonus depreciation or the accelerated regular MACRS; you must use the straight-line method.

Manufacturers' deduction

The manufacturers' deduction, also called the "Section 199" or "domestic production activities deduction," is 9% of the lesser of qualified production activities income or taxable income. The deduction is also limited to 50% of W-2 wages paid by the taxpayer that are allocable to domestic production gross receipts.

The deduction is available to traditional manufacturers and to businesses engaged in activities such as construction, engineering, architecture, computer software production and agricultural processing. It isn't allowed in determining net self-employment earnings and generally can't reduce net income below zero. But it can be used against the AMT.

Employee benefits

Offering a variety of benefits can help you not only attract and retain the best employees, but also save tax:

Qualified deferred compensation plans. These include pension, profit-sharing, SEP and 401(k) plans, as well

WHAT'S NEW! **Take advantage of bonus depreciation while it's still available**

Who's affected: Businesses that have made or are considering asset purchases.

Key changes: The additional first-year depreciation allowance is 50% for 2012, down significantly from the 2011 percentage. (See the chart below.) Qualified assets include *new* tangible property with a recovery period of 20 years or less (such as office furniture, equipment and company-owned vehicles), off-the-shelf computer software, water utility property and qualified leasehold-improvement property.

Corporations can accelerate certain credits in lieu of claiming bonus depreciation for qualified assets acquired and placed in service through Dec. 31, 2012. (For certain long-lived and transportation property, the deadline is Dec. 31, 2013.)

Planning tips: If you're eligible for full Section 179 expensing (see page 8), it may provide a greater benefit this year because it can allow you to deduct 100% of an asset acquisition's cost. Plus, only Sec. 179 expensing is available for *used* property. However, bonus depreciation may benefit more taxpayers than Sec. 179 expensing, because it isn't subject to any asset purchase limit or net income requirement. If you're anticipating major purchases of assets in the next year or two that would qualify, you may want to time them so you can benefit from bonus depreciation while it's available.

Qualified assets acquired and placed in service	Bonus depreciation
Jan. 1, 2008, through Sept. 8, 2010	50%
Sept. 9, 2010, through Dec. 31, 2011	100%
Jan. 1, 2012, through Dec. 31, 2012	50%
After Dec. 31, 2012	none

Note: *Later deadlines apply to certain long-lived and transportation property. Also, an extension of 100% bonus depreciation has been proposed; check with your tax advisor for the latest information.*

as SIMPLEs. You take a tax deduction for your contributions to employees' accounts, and the plans offer tax-deferred savings benefits for employees. (For more on the benefits to employees, see page 12.) Certain small employers may also be eligible for a credit when setting up a plan. (See "Tax credits" at right.)

HSAs and FSAs. If you provide employees with qualified high-deductible health insurance, you can also offer them Health Savings Accounts. Regardless of the type of health insurance you provide, you can offer Flexible Spending Accounts for health care. (See "Saving for health care" on page 3.) If you have employees who incur day care expenses, consider offering FSAs for child and dependent care. (See "Child care expenses" on page 4.)

Fringe benefits. Some fringe benefits — such as employee discounts, group term-life insurance (up to $50,000 annually per person), health insurance, parking (up to $240 per month) and mass transit / van pooling (up to $125 per month) — aren't included in employee income. Yet the employer can still receive a deduction and typically avoids payroll tax as well. Certain small businesses providing health care coverage may be eligible for a tax *credit*. (See "Tax credits" at right.)

NQDC. Nonqualified deferred compensation plans generally aren't subject to nondiscrimination rules, so they can be used to provide substantial benefits to key employees. But the employer generally doesn't get a deduction for NQDC plan contributions until the employee recognizes the income.

NOLs

A net operating loss occurs when operating expenses and other deductions for the year exceed revenues. Generally, an NOL may be carried back two years to generate a refund. Any loss not absorbed is carried forward up to 20 years to offset income.

Carrying back an NOL may provide a needed influx of cash. But you can elect to forgo the carryback if carrying the entire loss forward may be more beneficial, such as if you expect your income to increase substantially or tax rates to go up. Remember: A hike in individual income tax rates is scheduled for 2013. (See Chart 1 on page 2.) So if your business structure is a flow-through entity (see Chart 4), you may face higher rates in future years.

Tax credits

Tax credits reduce tax liability dollar-for-dollar, making them particularly valuable. Numerous types of credits are available to businesses, but many expired after 2011 and, as of this writing, haven't yet been extended. (Check with your tax advisor for the latest information.) Here are a few credits to consider:

Health care coverage credit for small businesses. For tax years 2010 to 2013, the maximum credit is 35% of group health coverage premiums paid by the employer, provided it contributes at least 50% of the total premium or of a benchmark premium. The full credit is available for employers with 10 or fewer full-time equivalent employees (FTEs) and average annual wages of less than $25,000 per employee. Partial credits are available on a sliding scale to businesses with fewer than 25 FTEs and average annual wages of less than $50,000.

Retirement plan credit. Small employers (generally those with 100 or fewer employees) that create a retirement plan may be eligible for a $500 credit per year for three years. The credit is limited to 50% of qualified startup costs.

Research credit. This credit (also commonly referred to as the "research and development" or "research and experimentation" credit) has expired, but there's been much discussion about extending it and even making it permanent. The credit generally is equal to a portion of qualified research expenses.

Energy-related credits. Because of either 2011 expiration dates or restrictions based on units sold, these credits generally won't be available for 2012 unless extended again.

Other credits. Examples of other credits that have expired but that may be extended are the empowerment zone tax credit and certain disaster relief credits for the Gulf Opportunity Zone.

Business structure

Income taxation and owner liability are the main factors that differentiate one business structure from another. (See Chart 4 to compare the tax treatments.) Many businesses choose entities that combine flow-through taxation with limited liability, namely limited liability companies (LLCs) and S corporations. Sometimes it makes

WHAT'S NEW!

Work Opportunity credit extended and expanded for veterans

Who's affected: Businesses hiring veterans.

Key changes: The Work Opportunity credit generally benefits businesses hiring employees from certain disadvantaged groups, such as ex-felons, food stamp recipients and disabled veterans. As of this writing, the credit has expired for most groups. However, the VOW to Hire Heroes Act of 2011 extended the credit through 2012 for employers that hire qualified veterans. It also expanded the credit by:

- Doubling the maximum credit — to $9,600 — for disabled veterans who've been unemployed for six months or more in the preceding year,
- Adding a credit of up to $5,600 for hiring *non*disabled veterans who've been unemployed for six months or more in the preceding year, and
- Adding a credit of up to $2,400 for hiring *non*disabled veterans who've been unemployed for four weeks or more, but less than six months, in the preceding year.

Planning tips: If you need to add to your staff, consider hiring veterans. To be eligible for the credit, you must take certain actions before and shortly after you hire a qualified veteran. Your tax advisor can help you determine what you need to do.

CHART 4 Tax differences based on business structure

Flow-through entity or sole proprietorship	C corporation
One level of taxation: The business's income flows through to the owner(s).	Two levels of taxation: The business is taxed on income, and then shareholders are taxed on any dividends they receive.
Losses flow through to the owner(s).	Losses remain at the corporate level.
For 2012, the top individual tax rate is 35%.	For 2012, the top corporate tax rate is generally 35%[1], and dividends are generally taxed at 15%.

[1] *See Chart 8 on page 16 for exceptions.*

sense to change business structures, but there may be unwelcome tax consequences. Your tax advisor can help you determine whether a change would make sense for your company.

Some tax differences between structures may provide tax planning opportunities, such as differences related to salary vs. distributions/dividends:

S corporations. To reduce their employment taxes, shareholder-employees may want to keep their salaries relatively low and increase their distributions of company income (which generally isn't taxed at the corporate level). But to avoid potential back taxes and penalties, shareholder-employees must take a "reasonable" salary. What's considered "reasonable" is determined by the specific facts and circumstances, but it's generally what the company would pay an outsider to perform the same services.

C corporations. Shareholder-employees may prefer to take more income as salary (which is deductible at the corporate level though it will be subject to employment taxes) as opposed to dividends (which aren't deductible at the corporate level and are taxed at the shareholder level but not subject to employment taxes) because the overall tax paid by both the corporation and the shareholder-employee may be less.

Warning: The IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

Sale or acquisition

Whether you're selling your business as part of an exit strategy or acquiring another company to help grow your business, the tax consequences can have a major impact on the transaction's success or failure. Here are a few key tax considerations:

Asset vs. stock sale. With a corporation, sellers typically prefer a stock sale for the capital gains treatment and to avoid double taxation. (For more on capital gains tax, see page 6.) Buyers generally want an asset sale to maximize future depreciation write-offs.

Tax-deferred transfer vs. taxable sale. A transfer of corporation ownership can be tax-deferred if made solely in exchange for stock or securities of the recipient corporation in a qualifying reorganization. But the transaction must comply with strict rules.

Although it's generally better to postpone tax, there are some advantages to a taxable sale:

- The parties don't have to meet the technical requirements of a tax-deferred transfer.
- The seller doesn't have to worry about the quality of buyer stock or other business risks of a tax-deferred transfer.
- The buyer enjoys a stepped-up basis in its acquisition's assets and doesn't have to deal with the seller as a continuing equity owner.

Installment sale. A taxable sale may be structured as an installment sale, due to the buyer's lack of sufficient cash or the seller's desire to spread the gain over a number of years — or when the buyer pays a contingent amount based on the business's performance. But an installment sale can backfire on the seller. For example:

- Depreciation recapture must be reported as gain in the year of sale, no matter how much cash the seller receives.
- If tax rates increase, the overall tax could wind up being more. (Remember, the favorable 15% rate on long-term capital gains is scheduled to end after Dec. 31, 2012. See Chart 3 on page 7.)

Of course, tax consequences are only one of many important considerations when planning a sale or acquisition.

The self-employed

If you're self-employed, you can deduct 100% of health insurance costs for yourself, your spouse and your dependents. This above-the-line deduction is limited to your net self-employment income. You also can take an above-the-line deduction for contributions made to a retirement plan and, if you're eligible, an HSA for yourself.

You pay both the employee and employer portions of employment taxes on your self-employment income. Generally, half of the tax paid is deductible above the line.

However, the 2011 reduction of the employee portion of the Social Security tax from 6.2% to 4.2% has been extended to 2012, and thus the Social Security tax on self-employment income is reduced from 12.4% to 10.4%. This doesn't reduce your deduction for the employer's share of these taxes — you can still deduct the full 6.2% employer portion of Social Security tax, along with one-half of the Medicare tax, for a full 7.65% deduction.

And you may be able to deduct home office expenses against your self-employment income. (See "Home office deduction" on page 3.)

The ins and outs of tax-advantaged retirement plans

For many, building and preserving a substantial nest egg for retirement is among their most important financial goals. Fortunately, there are many tax-advantaged retirement plans available that can help you do just that. By contributing as much as possible, you can help ensure a financially secure retirement. But these plans also come with some potential pitfalls that you can fall into if you're not careful. So it's important to understand the ins and outs of the plans you use.

401(k)s and other employer plans

Contributing to a traditional employer-sponsored defined contribution plan is usually the first step in retirement planning:

- Contributions are typically pretax, reducing your taxable income.
- Plan assets can grow tax-deferred — meaning you pay no income tax until you take distributions.
- Your employer may match some or all of your contributions pretax.

Chart 5 shows the 2012 employee contribution limits. Because of tax-deferred compounding, increasing your contributions sooner rather than later can have a significant impact on the size of your nest egg at retirement. (See Case Study I.)

If your employer offers a match, at minimum contribute the amount necessary to get the maximum match so you don't miss out on that "free" money. (If your employer provides a SIMPLE, it's *required* to make contributions — though not necessarily annually.)

More tax-deferred options

In certain situations, other tax-deferred savings options may be available:

You're a business owner or self-employed. You may be able to set up a plan that allows you to make much larger contributions. You might not have to make 2012 contributions, or even set up the plan, before year end.

Your employer doesn't offer a retirement plan. Consider a traditional IRA. You can likely deduct your contributions, though your deduction may be limited if your spouse participates in an employer-sponsored plan. You can make 2012 contributions as late as April 15, 2013. (See Chart 5 for contribution limits.)

Roth options

A potential downside of tax-deferred saving is that you'll have to pay taxes when you make withdrawals at retirement. Roth plans, however, allow tax-free distributions; the tradeoff is that contributions to these plans don't reduce your current-year taxable income:

1. Roth IRAs. An added benefit is that Roth IRAs can provide estate planning advantages: Unlike other retirement plans, Roth IRAs don't require you to take distributions during your lifetime. So you can let the entire balance grow tax-free over your lifetime for the benefit of your heirs.

But Roth IRAs are subject to the same low annual contribution limit as traditional IRAs (see Chart 5), and your Roth IRA limit is reduced by any traditional IRA contributions you make for the year. An income-based phaseout may also reduce or eliminate your ability to contribute.

2. Roth conversions. If you have a traditional IRA, consider whether you might benefit from converting all or a portion of it to a Roth IRA. A conversion can allow you to turn tax-*deferred* future growth

CHART 5 Retirement plan contribution limits for 2012

	Limit for taxpayers under age 50	Limit for taxpayers age 50 and older
Traditional and Roth IRAs	$ 5,000	$ 6,000
401(k)s, 403(b)s, 457s and SARSEPs[1]	$17,000	$22,500
SIMPLEs	$11,500	$14,000

[1] *Includes Roth versions where applicable.*

Note: *Other factors may further limit your maximum contribution.*

into tax-*free* growth and take advantage of a Roth IRA's estate planning benefits.

There's no longer an income-based limit on who can convert to a Roth IRA. But the converted amount is taxable in the year of the conversion. Whether a conversion makes sense for you depends on factors such as your age, whether you can afford to pay the tax on the conversion, your tax bracket now and expected tax bracket in retirement, and whether you'll need the IRA funds in retirement.

3. "Back door" Roth IRAs. If the income-based phaseout prevents you from making Roth IRA contributions and you *don't* have a traditional IRA, consider setting up a traditional account and making a nondeductible contribution to it. You can then wait until the transaction clears and convert the traditional account to a Roth account. The only tax due will be on any growth in the account between the time you made the contribution and the date of conversion.

4. Roth 401(k), Roth 403(b), and Roth 457 plans. If the plan allows it, you may designate some or all of your contributions as Roth contributions. (Any employer match will be made to a traditional plan.) No income-based phaseout applies, so even high-income taxpayers can contribute.

Early withdrawals

If you're facing financial challenges, it may be tempting to make withdrawals from your retirement plans. But generally this should be a last resort. With a few exceptions, distributions made before age 59½ are subject to a 10% penalty on top of any income tax that ordinarily would be due on a withdrawal. This means that you can lose a substantial amount to taxes and penalties. Additionally, you'll lose the potential tax-deferred future growth on the amount you've withdrawn.

If you must make an early withdrawal and you have a Roth account, you may be better off withdrawing from that. You can withdraw up to your contribution amount free of tax and penalty. Another option, if your employer-sponsored plan allows it, is to take a plan loan. You'll have to pay it back with interest and make regular principal payments, but you won't be subject to current taxes or penalties.

Early distribution rules are also important to be aware of if you change jobs or retire and receive a lump-sum distribution from your employer's retirement plan. To avoid the early-withdrawal penalty and other negative income tax consequences, request a direct rollover from your old plan to your new plan or IRA.

Otherwise, you'll need to make an indirect rollover within 60 days to avoid tax and potential penalties. ***Warning:*** The check you receive from your old plan may be net of 20% federal income tax withholding. If you don't roll over the gross amount (making up for the withheld amount with other funds), you'll be subject to income tax — and potentially the 10% penalty — on the difference.

Required minimum distributions

After you reach age 70½, you must take annual required minimum distributions (RMDs) from your IRAs (except Roth IRAs) and, generally, from your defined contribution plans. If you don't comply, you can owe a penalty equal to 50% of the amount you should have withdrawn but didn't. You can avoid the RMD rule for a Roth 401(k), Roth 403(b) or Roth 457 plan by rolling the funds into a Roth IRA.

So, should you take distributions between ages 59½ and 70½, or take more than the RMD after age 70½? Distributions in any year your tax bracket is low may be beneficial. But also consider the lost future tax-deferred growth and, if applicable, whether the distribution could: 1) cause your Social Security payments to become taxable, 2) increase income-based Medicare premiums and prescription drug charges, or 3) affect other deductions or credits with income-based limits.

If you've inherited a retirement plan, consult your tax advisor regarding the applicable distribution rules. ◗

CASE STUDY I

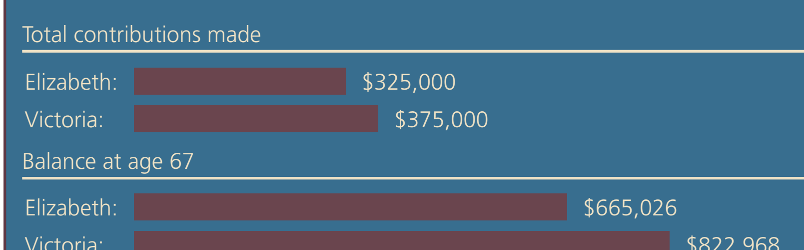
Contributing a little more now can result in a substantially larger nest egg

When Elizabeth is age 42, she starts a new job and decides to contribute $10,000 of her salary annually to her employer's traditional 401(k) plan. After 10 years, she increases her contributions to $15,000 per year.

Victoria is also 42, and she starts contributing to her employer's traditional 401(k) plan on the same day. But she decides to immediately defer $15,000 of her salary annually. Remember, the contributions are before tax. So if Victoria is in the 28% tax bracket, her extra $5,000 per year contribution is costing her only $3,600 — or $300 per month. (And that doesn't even take into account any state tax savings.)

Elizabeth and Victoria both enjoy a 6% rate of return and maintain their annual contributions for 25 years, until they retire at age 67. At retirement, Victoria's plan has $157,942 more than Elizabeth's, even though she contributed only $50,000 more.

As you can see, making additional contributions now that cost you only a few hundred dollars more per month can result in a substantially larger nest egg at retirement than if you wait to increase your contributions.



Note: *This example doesn't consider employer matching. It's for illustrative purposes only and isn't a guarantee of future results.*

Why estate planning continues to be a challenge

Estate planning is never easy. You must address your own mortality while determining the best strategies to ensure that your assets will be distributed according to your wishes and that your loved ones will be provided for after you're gone. You also must consider how loved ones will react to your estate planning decisions, which may be difficult if, for example, a family business is involved or you wish to provide more to certain family members. But estate planning may be especially challenging this year because of uncertainty about whether favorable exemptions and rates will be allowed to expire in 2013 as scheduled.

Estate tax

The current estate tax exemption is at an all-time high, and the top estate tax rate remains low. But the favorable exemption and rate will be in effect only through 2012 unless Congress extends them. (See Chart 6.)

Also set to expire is exemption "portability" between spouses: If part (or all) of one spouse's estate tax exemption is unused at death, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. Making this election is simple and provides flexibility if proper planning hasn't been done before the first spouse's death.

But the election is available only to the estates of spouses who've died in 2011 or 2012, unless Congress extends it. Also, exemption portability doesn't protect future growth on assets from estate tax as effectively as applying the exemption to a credit shelter trust does.

So married couples should still consider making asset transfers and setting up trusts to ensure they take full advantage of both spouses' exemptions. Transfers to your spouse — during life or at death — are tax-free under the marital deduction (assuming he or she is a U.S. citizen).

Gift tax

The gift tax follows the estate tax exemption and top rate for 2012. (See Chart 6.) Any gift tax exemption used during life reduces the estate tax exemption available at death.

You can exclude certain gifts of up to $13,000 per recipient each year ($26,000 per recipient if your spouse elects to split the gift with you or you're giving community property) without using up any of your gift tax exemption.

GST tax

The generation-skipping transfer tax generally applies to transfers (both during life and at death) made to people more than one generation below you, such as your grandchildren. This is in addition to any gift or estate tax due. The GST tax also follows the estate tax exemption and top rate for 2012. (See Chart 6.)

Warning: Exemption portability between spouses doesn't apply to the GST tax exemption.

CHART 6 Transfer tax exemptions and highest rates

Year	Estate tax exemption[1]	Gift tax exemption	GST tax exemption	Highest estate and gift tax rates and GST tax rate
2011	$ 5 million	$ 5 million	$ 5 million	35%
2012	$ 5.12 million	$ 5.12 million	$ 5.12 million	35%
2013[2]	$ 1 million	$ 1 million	$ 1 million[3]	55%[4]

[1] Less any gift tax exemption already used during life.
[2] Assuming legislation isn't signed into law extending current levels or making other changes. Contact your tax advisor for the latest information.
[3] Indexed for inflation.
[4] The benefits of the graduated gift and estate tax rates and exemptions are phased out for gifts and estates over $10 million.

State taxes

Many states now impose estate tax at a lower threshold than the federal government does. To avoid unexpected tax liability or other unintended consequences, it's critical to consider state law. Consult a tax advisor with expertise on your particular state.

Tax-smart giving

Giving away assets now will help reduce the size of your taxable estate and may be especially beneficial this year. (See Case Study II.) Here are some additional strategies for tax-smart giving:

Choose gifts wisely. Consider both estate and income tax consequences and the economic aspects of any gifts you'd like to make:

- To minimize *estate tax*, gift property with the greatest future appreciation potential.
- To minimize *your beneficiary's income tax*, gift property that hasn't already appreciated significantly since you've owned it.
- To minimize *your own income tax*, don't gift property that's declined in value. Instead, sell the property so you can take the tax loss and then gift the sale proceeds.

Plan gifts to grandchildren carefully. Annual exclusion gifts are generally exempt from the GST tax, so they also help you preserve your GST tax exemption for other transfers. For gifts that don't qualify for the exclusion to be tax-free, you generally must apply both your GST tax exemption and your gift tax exemption.

Gift interests in your business. If you own a business, you can leverage your gift tax exclusions and exemption by gifting ownership interests, which may be eligible for valuation discounts. So, for example, if the discounts total 30%, in 2012 you can gift an ownership interest equal to as much as $18,571 tax-free because the discounted value doesn't exceed the $13,000 annual exclusion. ***Warning:*** The IRS may challenge the calculation; a professional valuation is strongly recommended.

CASE STUDY II

2012 may be the year to make large gifts

Bill, a widower, has an estate of $8 million, so he has substantial estate tax exposure. In 2012 he's already given $13,000 to each of his chosen beneficiaries. He doesn't feel comfortable giving away another $5.12 million of assets to use up his entire lifetime gift tax exemption. But he would like to take *some* advantage of the high exemption currently available in case it's not extended beyond 2012.

So he gives away an additional $3 million of assets, which also will be removed from his taxable estate — assuming there's no "clawback." (Some people fear that, if the estate tax exemption shrinks, taxable lifetime gifts in excess of the exemption amount in the year of death may be "clawed back" into the deceased's estate and subject to estate tax. But many experts argue that this is unlikely.)

By making the taxable gift, Bill also removes any future appreciation on the gifted assets from his estate. If the assets increase in value by 50% before his death, the gift will essentially have removed an additional $1.5 million from his estate. This amount escapes estate tax (even if the $3 million gift is clawed back into his estate).

Note: *This example is for illustrative purposes only and isn't a guarantee of future results. It doesn't consider state taxes, which can arise even when there's no federal liability.*

Gift FLP interests. Another way to potentially benefit from valuation discounts is to set up a family limited partnership. You fund the FLP and then gift limited partnership interests. ***Warning:*** The IRS scrutinizes FLPs, so be sure to set up and operate yours properly.

Pay tuition and medical expenses. You may pay these expenses without the payment being treated as a taxable gift to the student or patient, as long as the payment is made directly to the provider.

Make gifts to charity. Donations to qualified charities aren't subject to gift taxes and may provide an income tax deduction. (See page 2.)

Trusts

Trusts can provide significant tax savings while preserving some control over what happens to the transferred assets. You may want to consider these:

- A *credit shelter (or bypass) trust* can help minimize estate tax by taking advantage of both spouses' estate tax exemptions.
- A *qualified terminable interest property (QTIP) trust* can benefit first a surviving spouse and then children from a prior marriage.
- A *qualified personal residence trust* (QPRT) allows you to give your home to your children today — removing it from your taxable estate at a reduced tax cost (provided you survive the trust's term) — while you retain the right to live in it for a certain period.
- A *grantor-retained annuity trust* (GRAT) works similarly to a QPRT but allows you to transfer other assets; you receive payments from the trust for a certain period.

Finally, a GST — or "dynasty" — trust can help you leverage both your gift and GST tax exemptions, and it can be an excellent way to potentially lock in the currently high exemptions.

Insurance

Along with protecting your family's financial future, life insurance can be used to pay estate taxes, equalize assets passing to children who aren't involved in a family business, or pass leveraged funds to heirs free of estate tax. Proceeds are generally income-tax-free to the beneficiary. And with proper planning, you can ensure proceeds aren't included in your taxable estate.

CHART 7 2012 individual income tax rate schedules

Tax rate	Regular tax brackets			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
10%	$ 0 – $ 8,700	$ 0 – $ 12,400	$ 0 – $ 17,400	$ 0 – $ 8,700
15%	$ 8,701 – $ 35,350	$ 12,401 – $ 47,350	$ 17,401 – $ 70,700	$ 8,701 – $ 35,350
25%	$ 35,351 – $ 85,650	$ 47,351 – $122,300	$ 70,701 – $142,700	$ 35,351 – $ 71,350
28%	$ 85,651 – $178,650	$122,301 – $198,050	$142,701 – $217,450	$ 71,351 – $108,725
33%	$178,651 – $388,350	$198,051 – $388,350	$217,451 – $388,350	$108,726 – $194,175
35%	Over $388,350	Over $388,350	Over $388,350	Over $194,175
Tax rate	**AMT brackets**			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
26%	$ 0 – $175,000	$ 0 – $175,000	$ 0 – $175,000	$ 0 – $ 87,500
28%	Over $175,000	Over $175,000	Over $175,000	Over $ 87,500
	AMT exemption			
	Single	Head of household	Married filing jointly or surviving spouse	Married filing separately
Amount	$ 33,750	$ 33,750	$ 45,000	$ 22,500
Phaseout[1]	$112,500 – $247,500	$112,500 – $247,500	$150,000 – $330,000	$ 75,000 – $165,000

[1] *The alternative minimum tax (AMT) income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.*

Note: *An AMT patch might be signed into law that would increase the exemptions and expand the phaseout ranges. Consult your tax advisor for the latest information, as well as for AMT rates and exemptions for children subject to the kiddie tax.*

CHART 8 2012 corporate income tax rate schedule

Tax rate	Tax bracket
15%	$ 0 – $ 50,000
25%	$ 50,001 – $ 75,000
34%	$ 75,001 – $ 100,000
39%	$ 100,001 – $ 335,000
34%	$ 335,001 – $10,000,000
35%	$10,000,001 – $15,000,000
38%	$15,000,001 – $18,333,333
35%	Over $18,333,333

Note: *Personal service corporations are taxed at a flat 35% rate.*