September 2011

Tax Notes and Perspectives

KING & OLIASON

INSIDE THIS ISSUE:

2010 Tax Act Provisions Continue to Impact 2011

The 2010 Tax Relief Act extended expiring tax breaks and provides new tax breaks in 2011. For 2011 and 2012:

- Individual tax rates remain the same, with a top rate of 35%.
- The top tax rate on qualified dividends and long-term capital gains remains at 15%.
- Regardless of the amount of your adjusted gross income, you will not lose part of your personal exemptions or overall itemized deductions.
- The American Opportunity Education Tax Credit is extended, allowing up to $2,500 per year for each of the first four years of a student's post secondary education. This credit begins phasing out when income reaches $80,000 for single filers and $160,000 for joint filers.

In 2011:

- If you itemize deductions, you continue to have the option of claiming either state and local *income* taxes or state and local *sales* taxes. You can't claim both.
- Personal exemptions and standard deductions will rise due to inflation. The value of each personal and dependent exemption, available to most taxpayers, is $3,700, up $50 from 2010. The standard deduction for married filing jointly is $11,600 and $5,800 for singles .
- The 2% payroll tax cut translates into more take home pay. The Social Security tax rate is 4.2% for employees and 10.4% for self-employed individuals.

For Business Owners:

If you are considering asset purchases or leasehold improvements, the following tax breaks are of note:

- 100% bonus depreciation is allowed for new property placed in service before January 1, 2012.
- A 15-year recovery period for qualified leasehold improvements is extended through 2011, making them eligible for 100% bonus depreciation.
- The Section 179 deduction limit allows businesses to deduct up to $500,000 of assets purchased during the year. The allowed 179 deduction phases out once the business's purchases exceed $2 million for the year. The Section 179 limit for 2012 is $125,000.

Foreign Account Reporting

Any United States person who has a financial interest in or signature authority over any foreign financial accounts must file an FBAR (report of foreign bank and financial accounts) if the aggregate value of the accounts exceeds $10,000 at any time during a calendar year. An individual may have signature authority over a financial account in their role as an employee, board member, trustee, executor, etc.

The FBAR is not filed with your federal income tax return. The separate form is due June 30th following the calendar year being reported. An extension of time to file your federal income tax return does not extend the due date for filing the FBAR. *(continued on Page 3)*

TAX PLANNING FOR 2013 CHANGES

A change in tax rates is scheduled to take effect beginning January 1, 2013, including an increase in capital gains rates, an increase in ordinary rates, and new Medicare taxes on high income taxpayers.

- The top tax rate on most long-term capital gains is scheduled to increase from 15% to 20%.
- The top ordinary rate is scheduled to increase from 35% to 39.6% and the top qualified dividend rate from 15% to 39.6%.
- However, the Obama administration has proposed that the 15% long-term capital gains rate be permanently extended for middle-class taxpayers. The administration has also proposed applying a top ordinary tax rate of 20% on qualified dividends beginning in 2013.

Taxpayers with adjusted gross income over $200,000 ($250,000 for joint returns) will be subject to a new 3.8% Medicare surtax on net investment income. Net investment income includes gains from the sale of investment property, interest, dividends, royalties, and rents.

Employees will be required to pay an additional .09% Medicare tax on wages above $200,000 ($250,000 for joint returns). Self-employed persons will also pay an additional .09% on earnings over those thresholds.

In light of these changes, you may want to consider recognizing capital gains or other income in 2011 and 2012 while rates are still low. Investment moves should not be made solely to realize current low tax rates. However, if you are planning to sell in the near future, here are a few tax planning strategies to consider:

- Consider selling appreciated securities held for more than a year. If you think a security will continue to appreciate, you can immediately buy it back. This will step up your tax basis to the current value at a low 15% tax cost. Only gains beyond the new purchase price will be taxed at the anticipated higher rate.
- On the flip side, consider waiting until 2013 to sell securities at a loss so that the losses will offset higher taxed long-term gains.
- Installment sales may be used to limit the amount of net investment income in any one year, as well as manage your adjusted gross income so as to avoid exceeding the Medicare surtax income thresholds. If an installment sale is used, the capital gain is spread over a period of years. If you sell an asset prior to 2013, the potential advantage of a lower capital gains tax rate and no Medicare surtax should be considered in evaluating any transaction.
- Closely held corporations should consider paying dividends before 2013 to lock in the current top qualified dividend rate of 15% at the shareholder level.

Please contact us if you have any questions or would like our assistance with planning.

GIFT AND ESTATE PLANNING TIPS

Gifting is a good way to reduce your taxable estate and is an important element of your estate plan.

Congress has enacted temporary changes that increase the amount of tax free gifts you can make during your lifetime. The 2010 Tax Relief Act reinstated the estate tax and increased the exemption amount from $1,000,000 to $5,000,000 for 2011 and 2012. Congress once again unified the estate and lifetime gift tax exemption, which means that not only will you be able to exclude $5,000,000 from your taxable estate, that same exclusion can instead be used during your lifetime to make large gifts without current gift tax consequences.

If you previously used your $1,000,000 lifetime gift tax exemption, you may gift an additional $4,000,000 without paying gift tax. This increased exemption is scheduled to expire after 2012, when it will revert to the lower exemption amount of $1,000,000.

If you plan on transferring significant assets to your children or grandchildren, you should consider taking advantage of this limited opportunity in 2011 or 2012.

The annual gift tax exclusion remains at $13,000 per person for 2011. This means you can still make gifts of up to $13,000 each year to individuals without affecting your lifetime gift tax exemption.

Note that you can also avoid gift tax if you make tuition payments on behalf of another individual directly to the educational organization or if you pay medical expenses on behalf of another directly to a medical care provider. These exclusions are available in addition to the $13,000 annual gift tax exclusion.

FOREIGN ACCOUNT REPORTING (CONTINUED FROM PAGE 1)

In fact, the filing date of the FBAR may not be extended. A person who fails to file may be subject to civil penalties of up to $100,000 and/or criminal penalties.

In early 2011, the Treasury Department amended the FBAR regulations to help clarify the reporting requirements. Not only are US individuals required to file but also US corporations, partnerships, trusts, estates and LLC's.
Accounts to be reported include: bank accounts, brokerage accounts, insurance policies with a cash value, shares in a mutual fund, and some retirement accounts. Accounts not currently required to be reported include: hedge funds and private equity funds.

The Foreign Account Tax Compliance Act (FATCA)

FATCA was enacted in 2010 to combat tax evasion by US persons holding investments in offshore accounts. Beginning in 2011, US persons (individuals, partnerships, corporations, trusts and estates) holding foreign financial assets with an aggregate value exceeding $50,000 must report those assets on a new form that must be attached to the taxpayer's income tax return. This is in addition to the FBAR reporting noted above. In 2013, foreign financial institutions will be required to report owner identification and account information directly to the IRS for financial accounts held by U.S. taxpayers.

TEACHING FINANCIAL CONCEPTS TO CHILDREN AND YOUNG ADULTS

According to Capital One, "Fifty-four percent of parents rated their teenager's knowledge of money management as either "good" or "excellent," but seventy-eight percent of the children of those respondents rated their own knowledge of money management as merely average or even poor." Even if you think your child has a grasp of financial skills, they may not feel the same level of confidence.

Online resources for financial education abound. Since most young adults spend a considerable amount of time online, use of such resources, along with a follow-up discussion with mom or dad, may be an effective way to teach financial management skills.

Consider having your child take a personal finance class in high school or college. The Washington Department of Financial Institutions and Bellevue College have developed six online courses to teach the core financial education needed to get through life : http://bellevuecollege.edu/financialeducation/curriculum.htm There is no cost to this course when used for educational purposes.

A popular site such as Yahoo! Finance has tools for calculating "How Much Am I Spending?" or "What Is My Current Net Worth?"

There are a number of personal software and budgeting programs available. These programs automatically download account information and offer a variety of reports and graphs to show both spending and asset balances. One widely used program is Intuit's "Quicken" (www.quicken.com). Intuit also has free online personal finance software called "Mint" (www.mint.com). If your child has their own checking account or credit card, it may be fun to track a few months of transactions and create a report or graph to see where the money came from and where it went. This may offer an opportunity to discuss saving and spending habits together.

Specially targeted books are available to help teach money management concepts. One that we like for young adults is Standard & Poor's "Guide to Understanding Personal Finance". King & Oliason is pleased to offer a complimentary copy to our young clients. Please contact us if you would like one.

There are also companies that provide personalized financial education for kids and teens. One company that has been recommended by a client is Jessica Andrews, Inc. www.jessicaandrewsinc.com .

(King & Oliason does not specifically endorse the resources mentioned in this article; they are included as examples and a starting point for your own research.)

Issues facing today's trustee

Friends and family members who take on the role of trustee are often unaware of the full extent of their fiduciary responsibilities and the potential liabilities involved. The business of being a trustee is much more involved than the filing of an annual tax return and making distributions to beneficiaries.

The duty of undivided loyalty is the cornerstone of the trust relationship. A trustee must act solely in the best interest of the beneficiary and avoid the appearance of actions to the contrary. A trustee must not allow personal interests or personal objectives to influence his/her behavior.

Under the Prudent Investor Rule, which governs the investment of trust assets, the trustee is required to formulate an investment strategy designed to meet the trust's objectives, taking into consideration the portfolio's total expected return and all the relevant facts and circumstances. The trustee also needs to maintain ample documentation to show compliance with the Prudent Investor Rule.

Lastly, communication plays a vital role in the fiduciary relationship. Trustees should maintain continuous dialogue with beneficiaries and always keep them informed. Washington State has enacted a new Trust Act, effective January 1, 2012, which clarifies notification requirements for trusts created after the effective date.

The bottom line is that trustees should make educated, reasoned decisions based on careful consideration of all the facts and circumstances. Any course of action should be well documented to help protect a trustee from liability. Professional advisors familiar with fiduciary obligations and expertise in fulfilling those responsibilities can be helpful in managing the role of the trustee.

Deducting long-term care expenses

Qualified long-term care expenses, such as skilled nursing care, can be deducted as medical expenses. Because long-term care can be quite costly, the potential tax deduction may be significant. If you pay long-term care costs for your parent, and provide more than half of their overall support, you may be able to include those costs along with your own when determining your medical deduction. Long-term care expenses, along with all other medical expenses, can only be deducted to the extent they exceed 7.5% of your adjusted gross income.

Some guidelines to help determine if you or a relative might be eligible to deduct long-term care costs include the following:

- To qualify, the necessary services must be prescribed by a licensed health care practitioner such as a physician, registered nurse, or licensed social worker, for a chronically ill individual.
- To qualify as chronically ill, an individual must require significant assistance to perform at least two activities of daily living (ADLs) such as eating, bathing, dressing, using the bathroom, transferring (walking) or require ongoing supervision due to severe cognitive impairment.

If an individual's long-term care meets these requirements, the costs are allowed as deductible medical expenses, whether provided in-home, in a nursing home or in an assisted living facility. In-home care need not be provided by a nurse or other health care professional, however care provided by a spouse or relative of the chronically ill individual usually does not qualify as a deductible expense.

E-filing update

The transition to electronically filing tax returns has gone well. We thank you for your assistance in making the process go smoothly and appreciate your patience.

We are continuing to refine our procedures and our communications to make sure the instructions are clear and easy for everyone to follow. We encountered some problems exchanging .pdf files with clients who use Mac computers. For those of you using this platform, let us know who you are and we will work to ensure a smooth exchange of electronic files in the future.

Going forward, King & Oliason will expand e-filing options to include more partnership and corporate tax returns.

WHY WAS MY RETURN SELECTED FOR AUDIT?

When returns are filed, they are compared against "norms" for similar returns. Computer programs give returns numeric scores. Scores rate the "potential for change" and the "potential for unreported income" based on IRS experience with similar returns. IRS personnel then screen returns that are identified, selecting some for audit and identifying the items on these returns that warrant further review.

The number of returns being audited more than doubled from 2000 to 2009. High income taxpayers are the most likely to face scrutiny. Individual taxpayers with income up to $200,000 had a 1% audit risk in 2009, while taxpayers with income over $1 million faced a 6% audit risk.

Following is a list of specific situations that may make a return more likely to be selected for examination:

- Payer reports, such as Form W-2 and Form 1099, do not match the income reported on the tax return
- A partnership you are a partner in is selected for audit
- Filing a Schedule C (Profit or Loss from Business) with your 1040
- Including a home office deduction on your return
- Failure to file a return by the due date (or the extended due date)
- High income taxpayers

Being selected for audit does not mean that your return is incorrect and it will not necessarily result in paying additional taxes. Be sure to maintain the documentation to support your income and expenses in case your return is selected for audit.

ELECTRONIC FEDERAL TAX PAYMENT SYSTEM

The Electronic Federal Tax Payment System (EFTPS) is a free service that allows you to make federal tax payments online or by phone 24 hours a day, seven days a week. All federal taxes can be paid using EFTPS.

Beginning January 1, 2011, corporations and private foundations are required to use the Electronic Federal Tax Payment System (EFTPS) to make federal tax deposits, as the paper coupon system is no longer maintained by the Treasury Department. Individuals may find paying electronically is a more convenient method of making tax payments.

EFTPS is secure and easy to use. Payments can be scheduled up to 120 days in advance for businesses and up to 365 days in advance for individuals, but must be scheduled for payment at least one calendar day prior to the tax due date. EFTPS will automatically make your payment on the date you select, assuming there are available funds in your account.

There is an immediate acknowledgement that the taxpayer's payment has been scheduled, and there is an acknowledgment when the payment is received. Scheduled payments can be changed or cancelled up to 2 business days in advance of the scheduled payment date.

To enroll, or for more information, visit www.eftps.gov If you would like to have King & Oliason enroll you or your organization on your behalf, please contact us. For corporations and private foundations, we encourage you to complete the enrollment process as soon as possible, so that you are ready to make any upcoming tax payments.

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Our Mission:

To serve clients in the Pacific Northwest who value exceptional and ethical management of their complex tax situations.

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Learn more about the range of tax consulting services we offer, our people, and our firm. Use the links to access tax forms, financial information, past newsletters, and more.

King & Oliason news

As many of you know, Karol King is retiring (see article below). ***Rick Starkenburg*** was promoted to partner this year and has taken on Karol's responsibilities. Rick joined the firm in 2008, as principal in the High Net Worth Group. His nearly twenty years of experience in income tax compliance and consulting encompasses work for individuals, trusts, partnerships, corporations and private foundations. He has special expertise in planning for wealth transfer, estates and trusts, charitable giving, formation and operation of family limited liability companies and valuation issues.

Norma Oliason will continue in the role of founding partner and is looking forward to many more years with the firm. Norma continues to focus on estate and gift tax planning, including assisting clients with wealth transfer strategies and philanthropic planning. She serves as an officer of the Icicle Fund, a larger charitable organization, and is very active as a volunteer and fundraiser for Seattle Public Schools.

A Note from Karol:

"My decision to retire is certainly bittersweet. I have wonderful clients, most of whom I have had the pleasure of working with for many years and exceptional co-workers who are like family to me. It's a difficult decision, but after 30 years in public accounting, this is a good time for me to move on and explore other areas of interest completely unrelated to accounting.

One thing I know for sure is that I am leaving everyone in very good hands with Rick taking over as partner. His breadth of experience and easy-going manner will serve my clients well. The plan going forward is that I will continue to provide consulting services in a limited capacity, so I won't say goodbye. Thanks so much for a wonderful working relationship. I look forward to keeping in touch." *Karol*

King & Oliason congratulates Andrea Kristof, CPA on becoming a certified QuickBooks™ ProAdvisor. Our staff regularly assist clients with their QuickBooks™ questions. In addition to her own increased technical knowledge of the software, this certification allows Andrea access to technical support at no additional cost so she can research complex problems that clients might be having. She also has access to training tools that can help clients learn more efficiently and discounts on products if clients are interested in upgrading.

King and Oliason continues to grow. We are pleased to welcome ***Randy Zhu,*** CPA, to our tax professional staff. Randy has a B.A. in Accounting from the University of Washington and a M.S. in Taxation from Golden Gate University. He worked for a public accounting firm in Bellevue before joining us in March. He enjoys outdoor activities in the Pacific Northwest and likes to travel. Randy spends some of his free time volunteering for Food Lifeline and Habitat for Humanity.