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American Taxpayer Relief Act of 2012

President Obama on January 2 signed the American Taxpayer Relief Act of 2012. The new law makes permanent Bush-era tax rates for individuals and couples with annual income of $400,000 and $450,000, respectively. The law also permanently indexes the alternative minimum tax for inflation, extends unemployment insurance benefits for one year and extends numerous business benefits. The following is a summary of the provisions applicable to individuals and small businesses included in the 157 page American Taxpayer Relief Act.

Tax Rates - For tax years beginning after 2012, the 10% rate has been made permanent. Thus income tax rates for individuals will stay at 10%, 15%, 25%, 28%, 33% and 35%, but with a 39.6% rate applying for income above the threshold of $450,000 for joint filers and surviving spouses; $425,000 for heads of household; $400,000 for single filers; and $225,000 for married filing separately. These dollar amounts are inflation-adjusted for tax years after 2013. The 2013 tax brackets are as follows:

	Single	HH	Joint	MS
10.0%	8,925	12,750	17,850	8,925
15.0%	36,250	48,600	72,500	36,250
25.0%	87,850	125,450	146,400	73,200
28.0%	183,250	203,150	223,050	111,525
33.0%	398,350	398,350	398,350	199,175
35.0%	400,000	425,000	450,000	225,000
39.6%				

Personal Exemption Phaseout (PEP) for High Income Earners – For tax years beginning after 2012, the Personal Exemption Phaseout (PEP), which had previously been suspended, is reinstated with a starting threshold for those with AGI of $300,000 for joint filers and a surviving spouse; $275,000 for heads of household; $250,000 for single filers; and $150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. These dollar amounts are inflation-adjusted for tax years after 2013.

Historical Exemption Phase Out - AGI Thresholds

Year	2008	2009	2010	2011	2012	2013*
Single	159,950	166,800	N/A	N/A	N/A	250,000
HH	199,950	208,500	N/A	N/A	N/A	275,000
Jt, SS	239,950	250,200	N/A	N/A	N/A	300,000
MS	119,975	125,100	N/A	N/A	N/A	150,000

* Inflation adjusted after 2013.

Itemized Deduction Phaseout - For tax years beginning after 2012, the "Pease" limitation on itemized deductions, which had previously been suspended, is reinstated with a starting threshold for those with AGI of $300,000 for joint filers and a surviving spouse, $275,000 for heads of household, $250,000 for single filers, and $150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. Thus, for taxpayers subject to the "Pease" limitation, the total amount of their itemized deductions is reduced by **3% of the amount by which the taxpayer's adjusted gross income (AGI) exceeds the threshold amount, with the reduction not to exceed 80%** of the otherwise allowable itemized deductions. These dollar amounts are inflation-adjusted for tax years after 2013. The following is a historic table listing the phase-out threshold values by year.

Tax Year	2008	2009	2010-12	2013*
Single	159,950	166,800	N/A	250,000
HH	159,950	166,800	N/A	275,000
Joint, SS	159,950	166,800	N/A	300,000
MS	79,975	83,400	N/A	150,000

** These amounts are inflation adjusted after 2013.*

Capital Gains and Dividends - For tax years beginning after 2012, the top rate for long-term capital gains and qualified dividends will permanently rise to 20% (up from 15%) for taxpayers with incomes exceeding $400,000 ($425,000 for head of household, $450,000 for married joint, and $225,000 for married separate taxpayers). For taxpayers whose ordinary income is generally taxed at a rate below 25%, long-term capital gains and qualified dividends will permanently be subject to a 0% rate. Taxpayers who are subject to a 25%-or-greater rate on ordinary income, but whose income levels fall below the thresholds listed above, will continue to be subject to a 15% rate on capital gains and dividends. The table below summarizes the capital gains rates in effect beginning with the 2013 tax year.

Ordinary Income Bracket	Long-Term
To the extent bracket is 10/% or 15%	0%
To the extent the bracket is 25%, 28%, 33% or 35%	15%
To the extent income exceeds 39.6% bracket threshold* (2013: $450K Joint, $425K HH, $400K Single, $225 MFS)	20%
Recaptured Sec 1250 Gain	25%
Qualified Small Business Stock - 50% of Gain	Max 28% (AMT Pref)
Collectibles	28%

Caution:
Capital gains are included in investment income and may be subject to the 3.8% surtax on net investment

** thresholds are subject to inflation adjustment after 2013*

Marriage Penalty Relief - The ATRA extends the marriage penalty relief for the standard deduction, the 15% bracket, and the EITC for taxable years beginning after December 31, 2012. For example, had this provision not been extended the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) would have been 167% (rather than 200%) of the standard deduction for single taxpayers.

Dependent Care Credit - The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) increased the amount of eligible expenses from $2,400 for one child and $4,800 for two or more children to $3,000 and $6,000, respectively and increased the applicable percentage from 30% to 35%. The Act permanently extends these increased amounts.

Adoption Credit – The Act permanently extends the increased adoption tax credit and the adoption assistance programs exclusion. Taxpayers that adopt children can receive a tax credit for qualified adoption expenses. A taxpayer may also exclude from income adoption expenses paid by an employer. The EGTRRA increased the credit from $5,000 ($6,000 for a special needs child) to $10,000, and provided a $10,000 income exclusion for employer-assistance programs, with both amounts inflation-adjusted. The Patient Protection and Affordable Care Act of 2010 extended these benefits to 2011 and made the credit refundable. The ATRA extends, for taxable years beginning after December 31, 2012, the increased adoption credit amount and the exclusion for employer-assistance programs as enacted in EGTRRA.

Employer Expenses for Child Care Assistance – The act permanently extends the credit for employer expenses for child care assistance. The EGTRRA provided employers with a credit of up to $150,000 for acquiring, constructing, rehabilitating or expanding property which is used for a child care facility. The ATRA extends this provision for taxable years beginning after December 31, 2012.

Child Credit – The Act permanently extends the 2001 modifications to the child tax credit. Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. The EGTRRA increased the credit from $500 to $1,000 and expanded refundability. The amount that may be claimed as a refund was 15% of earnings above $10,000. These rates become permanent.

However the refund provision (15% of earnings above $10,000) is temporarily set at 15% of earnings above $3,000 through 2017.

EITC *–Under prior law, working families with two or more children qualified for an earned income tax credit equal to 40% of the family's first $12,570 of earned income. The American Recovery and Reinvestment Act of* 2009 (ARRA) increased the earned income tax credit to 45% for families with three or more children and increased the beginning point of the phase-out range for all married couples filing a joint return (regardless of the number of children) to lessen the marriage penalty. The Act temporarily extends the third-child/45% credit rate and marriage penalty relief provisions through 2017.

Coverdell Accounts – The Act permanently extends the expanded Coverdell Accounts provisions which allow an annual $2,000 (was $500) contribution and includes elementary and secondary school expenses.

Employer-provided Educational Assistance – The Act permanently extends the expanded exclusion for employer-provided educational assistance. An employee may exclude from gross income up to $5,250 for income and employment tax purposes per year of employer-provided education assistance.

Student Loan Interest Deduction - The Act Permanently extends the expanded above-the-line deduction for student loan interest deduction for qualified education loans up to $2,500. It also makes permanent the elimination of the 60 month deduction limit and the increased income phase-out of $55,000 to $70,000 ($110,000 and $140,000 for joint filers).

Scholarship Exclusions – The Act permanently extends the exclusion from income of amounts received under certain scholarship programs. The National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program provide education awards to participants on the condition that the participants perform certain services. The EGTRRA allowed the scholarship exclusion to apply to these programs.

American Opportunity Tax Credit - Temporarily extends the American Opportunity Tax Credit. Created under the ARRA, the American Opportunity Tax Credit is available for up to $2,500 of the cost of tuition and related expenses paid during the taxable year. Under this tax credit, taxpayers receive a tax credit based on 100% of the first $2,000 of tuition and related expenses (including course materials) paid during the taxable year and 25% of the next $2,000 of tuition and related expenses paid during the taxable year. Forty percent of the credit is refundable. This tax credit is subject to a phase-out for taxpayers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly). The ATRA extends the American Opportunity Tax Credit for five additional years, through 2017.

Refund and Tax Credit Disregard for Means-Tested Programs – The Act permanently extends refund and tax credit disregard for means-tested programs. The receipt of a tax credit would put a substantial number of families over the income limits for these programs in the month that the tax refund is received.

Permanent AMT Patch - Without this change, effective in 2012, a taxpayer would have received an AMT exemption of $33,750 (individuals) and $45,000 (married filing jointly, and would not have been allowed nonrefundable personal credits to be used against the AMT. The ATRA increases the exemption amounts for 2012 to $50,600 (individuals) and $78,750 (married filing jointly) and indexes the exemption and phaseout amounts thereafter. The Act also allows the nonrefundable personal credits against the AMT. The changes are effective for taxable years beginning after December 31, 2011.

Gift & Estate Tax - The Act prevents steep increases in estate, gift and generation-skipping transfer (GST) tax that were slated to occur for individuals dying and gifts made after 2012 by permanently keeping the exemption level at $5,000,000 (as indexed for inflation). However, the Act also permanently increases the top estate and gift tax rate from 35% to 40%. The exemption amount for 2013 is $5.25 million.

Portability of Unused Estate Tax Exemption - The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (TRUIRJCA) allowed the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse for estates of decedents dying after December 31, 2010 and before December 31 2012. The ATRA makes permanent this provision and is effective for estates of decedents dying after December 31, 2012. CAUTION – A Form 706 (Estate Tax Return) must be timely filed to obtain the portability.

Gift & Estate Exemption Reunification - Prior to the EGTRRA, the estate and gift taxes were unified, creating a single graduated rate schedule for both. That single lifetime exemption could be used for gifts and/or bequests. The EGTRRA decoupled these systems. The TRUIRJCA reunified the estate and gift taxes. The ATRA permanently extends unification and is effective for gifts made after December 31, 2012.

Mortgage Debt Relief – A Principal Residence Acquisition Debt Relief Exclusion was established by the Mortgage Debt Relief Act of 2007 and provided a COD exclusion of $2 million ($1 million MFS) limited to acquisition debt. Equity debt is considered the first debt relieved. This exclusion is available even if the taxpayer is solvent. The 2012 Taxpayer Relief Act extends this exclusion for one year so that it applies to home mortgage debt discharged before 2014.

Teachers' Above-the-line Expense Deduction – The Act revives the deduction allowing up to $250 of a teacher's qualified classroom expenses for 2012 and extends it through 2013.

Mortgage Insurance Premiums as Qualified Residence Interest - Premiums for mortgage insurance contracts entered into after Dec. 31, 2006 on a qualified residence have been deductible as qualified residence interest. The ATRA extends the ability to deduct the cost of mortgage insurance on a qualified personal residence for two additional years, through 2013. The deduction is phased-out ratably by 10% for each $1,000 by which the taxpayer's AGI exceeds $100,000. Thus, the deduction is unavailable for a taxpayer with an AGI in excess of $110,000.

Tax Free Employer Mass Transit Benefits –The excludable employer-provided mass transit benefit is revived to $240 per month for 2012 and continues through 2013.

State & Local Sales Tax - The Act extends for two years the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes. The option to deduct State and local general sales taxes, which expired at the end of 2011, is revived for 2012 and continued through 2013.

Contributions of Capital Gain Real Property Made for Conservation Purposes - The special rule allowing a 50% (instead of 30%) of AGI limitation for contributions of conservation easement capital gain property and the 15 year carryover period if the conservation easement contribution exceeds the 50%

of AGI limitation, which expired at the end of 2011, is now revived for 2012 and continued through 2013.

Above-The-Line Tuition Deduction - The above-the-line deduction for qualified tuition and related expenses, which expired at the end of 2011, is now revived for 2012 and continued through 2013.

Tax-Free IRA to Charity Contributions - Tax-free distributions (up to $100,000) made by taxpayers over age 70.5 from individual retirement plans for charitable purposes, which expired at the end of 2011, is now revived for 2012 and continued through 2013.

Research Credit Reinstated and Liberalized - The research credit equals the sum of: (1) 20% of the excess (if any) of the qualified research expenses for the tax year over a base amount, (unless the taxpayer elected an alternative simplified research credit); (2) the university basic research credit (i.e., 20% of the basic research payments); (3) 20% of the taxpayer's expenditures on qualified energy research undertaken by an energy research consortium. Under pre-Act law, the research credit didn't apply for amounts paid or accrued after Dec. 31, 2011. The 2012 Taxpayer Relief Act retroactively extends the research credit for two years so that it applies for amounts paid or accrued before Jan. 1, 2014.

For tax years beginning after Dec. 31, 2011, the Act also liberalizes the research credit rules for persons that acquire the major portion of either a trade or business or a separate unit of a trade or business of another person. It also revises the rules for allocating the research credit among members of a controlled group or members of a group of commonly controlled trades or businesses.

Low-Income Housing Tax Credit - 9% Credit Rate Freeze for the Low-Income Housing Tax Credit Program. The low-income housing tax credit program provides a tax credit over a period of ten years after the housing facility is placed-in-service. The credit provided each year is determined by present-value formula based on the federal cost of borrowing. Over the past few years, as the federal cost of borrowing has declined, so has the amount of tax credits that can be used to build a LIHTC project. To deal with this, in 2008, Congress adjusted the formula and set a minimum credit amount of 9%, which is based on the original credit rate when the program was created and was effective for facilities placed-in-service before December 31, 2013. This ATRA extends the expiration date by changing the deadline to projects that have received an allocation before January 1, 2014.

Treatment of military basic housing allowances under low-income housing credit. The ATRA extends a provision whereby a member of the military's basic housing allowance is not considered income for purposes of calculating whether the individual qualifies as a low-income tenant for the low income housing tax credit program. The provision, which expired at the end of 2011, is continued for two additional years.

Indian Employment Credit Reinstated and Extended - The Indian employment credit for businesses is 20% of the excess, if any, of the sum of qualified wages and qualified employee health insurance costs (not in excess of $20,000 per employee) paid or incurred (other than paid under salary reduction arrangements) to qualified employees (enrolled Indian tribe members and their spouses who meet certain requirements) during the tax year, over the sum of these same costs paid or incurred in calendar year '93. The 2012 Taxpayer Relief Act retroactively extends the Indian employment credit for two years. It now applies to tax years beginning before Jan. 1, 2014.

New Markets Tax Credit Reinstated and Extended - The 2012 Taxpayer Relief Act retroactively extends the new markets tax credit two years, through 2013. It provides that a $3.5 billion cap applies for 2010, 2011, 2012, and 2013, but no amount can be carried over to any calendar year after 2018.

Differential Wage Payment Credit for Employers Reinstated and Extended - Eligible small business employers (less than an average of 50 employees during the year), with a written plan, that pay differential wage payments to qualified employees (been an employee during the 91-day period immediately preceding the period for which any differential wage payment is made) for periods that they are called to active duty with the U.S. uniformed services (for more than 30 days) that represent all or part of the wages that they would have otherwise received from the employer can claim a credit equal to 20% of up to $20,000 of differential pay made to an employee during the tax year. The 2012 Taxpayer Relief Act retroactively extends the credit for two years. It applies for differential wages paid through Dec. 31, 2013.

Work Opportunity Tax Credit Extended - The work opportunity tax credit (WOTC) allows employers who hire members of certain targeted groups to get a credit against income tax of a percentage of first-year wages up to $6,000 per employee ($3,000 for qualified summer youth employees). Where the employee is a long-term family assistance (LTFA) recipient, the WOTC is a percentage of first and second year wages, up to $10,000 per employee. Generally, the percentage of qualifying wages is 40% of first-year wages; it's 25% for employees who have completed at least 120 hours, but less than 400 hours of service for the employer. For LTFA recipients, it includes an additional 50% of qualified second-year wages.

The maximum WOTC for hiring a qualifying veteran generally is $6,000. However, it can be as high as $12,000, $14,000, or $24,000, depending on factors such as whether the veteran has a service-connected disability, the period of his or her unemployment before being hired, and when that period of unemployment occurred relative to the WOTC-eligible hiring date.

The 2012 Taxpayer Relief Act retroactively extends the WOTC so that it applies to eligible veterans *and* nonveterans who begin work for the employer before Jan. 1, 2014. Thus, the Act grants a two-year lease on life for the WOTC for eligible nonveterans, and a one-year lease on life for the WOTC for qualifying veterans.

7-Year Write-off for Motorsport Racing Track Facilities Reinstated and Extended - The 2012 Taxpayer Relief Act retroactively extends the 7-year straight line cost recovery period for motorsports entertainment complexes for two years. The quick write-off applies to qualifying motorsports entertainment complexes placed in service through Dec. 31, 2013.

Business Property on Indian Reservations – The accelerated depreciation for business property on an Indian reservation is retroactively extended through 2013.

Contributions of Food Iinventory - The Act extends for two years (through 2013) the provision allowing businesses to claim an enhanced deduction for the contribution of food inventory.

Section 179 Expensing Increased for 2012 and 2013 – Under prior law the Section 179 expensing cap for 2012 was $139,000 and dropped to $25,000 in 2013. The 2012 Taxpayer Relief Act extends 2011 caps to both 2012 and 2013. Thus for both years the cap will be $500,000 with a $2,000,000 investment ceiling. The Act also provides that:

Off-the-shelf computer software is expensing-eligible property if placed in service in a tax year beginning before 2014 (a one-year extension).

For tax years beginning before 2014 (also a one-year extension), an expensing election or specification of property to be expensed may be revoked without IRS's consent. But, if such an election is revoked, it can't be reelected.

For any tax year beginning in 2010, 2011, 2012, or 2013 (a two-year extension) up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) is eligible for expensing.

For tax years beginning after 2013, the maximum expensing amount is scheduled to drop to $25,000 and the investment-based phaseout amount is scheduled to drop to $200,000.

	2008-9	2010-13	2014
Cap	250,000	500,000	25,000
MS Cap	125,000	250,000	12,500
Investment Limit	800,000	2 Million	200,000

Special Expensing Rules for Certain Film and Television Productions - The Act extends for two years, through 2013, the provision that allows film and television producers to expense the first $15 million of production costs incurred in the United States ($20 million if the costs are incurred in economically depressed areas in the United States).

Qualified Small Business Stock Exclusion – Normally 50% of the gain from QSBS is excluded from taxation (but is an AMT preference). Under prior law the 50% was increased to 100% for the exclusion of gain on certain small business stock acquired after Sept. 27, 2010 and before Jan. 1, 2012. The 2012 Taxpayer Relief Act retroactively extends this provision for two years, through 2013.

CAUTION – For California (CA) purposes the requirement that 80% of the business be conducted in CA to benefit from the CA exclusion and reinvestment was recently found to be discriminatory and all exclusions or reinvestments since 2009 have been invalidated. The FTB will be sending out tax due notices to affected taxpayers.

S Corporation Charity Basis Adjustment Provision Extended – Prior to the Pension Protection Act of 2006 (PPA) shareholders made their pro-rata ownership basis adjustment based upon the **FMV** of property donated to charity. PPA temporarily changed that to the **adjusted basis** of the property for tax years beginning before Jan. 1, 2010. The provision was later extended to years beginning before Jan. 1, 2012. The 2012 Taxpayer Relief Act retroactively extends the PPA rule for two years so that it applies for contributions made in tax years beginning before Jan. 1, 2014.

Reduction in S Corporation Recognition Period for Built-in Gains Tax - If a taxable corporation converts into an S corporation, the conversion is not a taxable event. However, following such a conversion, an S corporation must hold its assets for a certain period in order to avoid a tax on any built-in gains that existed at the time of the conversion. The American Recovery and Reinvestment Act reduced that period from 10 years to 7 years for sales of assets in 2009 and 2010. The Small Business Jobs Act reduced that period to 5 years for sales of assets in 2011. The ATRA of 2012 extends the reduced 5-year holding period for sales occurring in 2012 and 2013. In addition, this Act clarifies rules for carryforwards and installment sales.

Empowerment Zone Tax Incentives - The Act extends for two years the designation of certain economically depressed census tracts as Empowerment Zones. Businesses and individual residents within Empowerment Zones are eligible for special tax incentives.

Bonus First-Year Depreciation Extended for One Year – Under prior law, a bonus first-year depreciation was 50% of the adjusted basis of qualified property acquired and placed in service after Dec. 31, 2011, and before Jan. 1, 2013 (before Jan. 1, 2014 for certain longer-lived and transportation property). Bonus depreciation applies for both regular tax and AMT purposes, but is not allowed for purposes of computing earnings and profits. A taxpayer may elect out of additional first-year depreciation for any class of property for any tax year. The 2012 Taxpayer Relief Act extends 50% first-year bonus depreciation so that it applies to qualified property acquired and placed in service before Jan. 1, 2014 (before Jan. 1, 2015 for certain longer-lived and transportation property).

First-Year Depreciation Cap for 2013 Autos and Trucks Boosted by $8,000 – As a result of the one-year extension of the 50% bonus depreciation the yet-to-be determined luxury auto dollar limits for 2013 are increased $8,000 when the bonus depreciation is used.

15-Year Writeoff for Qualified Leasehold and Retail Improvements and Restaurant Property Reinstated and Extended - The 2012 Taxpayer Relief Act retroactively extends for two years the inclusion of qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property in the 15-year MACRS class. Such property qualifies for 15-year recovery if it is placed in service before Jan. 1, 2014.

Energy-efficient Improvements to Existing Homes - The nonbusiness energy property credit under Code Sec. 25C for energy-efficient existing homes is retroactively extended for two years through 2013. A taxpayer can claim a 10% credit on the cost of: (1) qualified energy efficiency improvements, and (2) residential energy property expenditures, with a lifetime credit limit of $500 ($200 for windows and skylights).

Alternative Fuel Vehicle Refueling Property Credit - The alternative fuel vehicle refueling property credit under Code Sec. 30C is retroactively extended for two years through 2013 so that taxpayers can claim a 30% credit for qualified alternative fuel vehicle refueling property placed in service through Dec. 31, 2013, subject to the $30,000 and $1,000 thresholds.

Plug-in Electric Vehicles Credit - The credit for 2- or 3-wheeled plug-in electric vehicles under Code Sec. 30D is modified and retroactively extended for two years through 2013.

Credit for Energy-efficient New Homes - The credit for energy-efficient new homes under Code Sec. 45L is retroactively extended for two years through 2013.

Pension Provision Roth Transfers - For transfers after Dec. 31, 2012, in tax years ending after that date, plan provisions in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution under Code Sec. 408A(e).

Roth Conversions for Retirement Plans - Under current law, a deferral plan under section 401(k) (including the Thrift Savings Plan), 403(b) or 457(b) governmental plan can have Roth accounts that allow participants to save on a Roth basis. That is, they can make after-tax contributions to the plan and all the principal and earnings are tax-free when distributed. Plans can currently allow participants to convert their pre-tax accounts to Roth accounts, but only with respect to money they have a right to take out of the plan, usually because they have reached age 59½ or separated from service. The ATRA allows any amount in a non-Roth account to be converted to a Roth account in the same plan, whether or not the amount is distributable. The amount converted would be subject to regular income tax.

Please call this office with any concerns you may have related to how these new tax laws may impact your tax situation.

Direct Deposit Puts Your Money in Your Pocket...Faster

Don’t wait around for a paper check. Have your federal (and state, if applicable) tax refund deposited directly into your bank account. Selecting Direct Deposit is a secure and convenient way to get your money into your pocket more rapidly.

- **Security—**Eliminates any possibility of a check being lost in the mail. Thousands of checks are returned to the IRS by the US Post Office every year as undeliverable mail. Direct Deposit eliminates the possibility of you not receiving your check, or of your refund check being stolen from your mailbox.
- **Convenient—**The money goes directly into your bank account. You won’t have to make a special trip to the bank to deposit the money yourself.

- **Easy—**Simply provide this office with your bank routing number and account number when we prepare your return and you'll receive your refund far more quickly than you would by check.
- **Multiple Options—**You also have the option of electronically directing your refund to multiple accounts. With the "split refund" option, taxpayers can divide their refunds among up to three checking or savings accounts and three different U.S. financial institutions. A word of caution—some financial institutions do not allow a joint refund to be deposited into an individual account. Check with your bank or other financial institution to make sure your direct deposit will be accepted.
- **Deposit Can't Be to a Third Party's Bank Account**—To protect taxpayers from scammers, direct deposit tax refunds can only be deposited into an account or accounts owned by the taxpayer. Therefore, only provide your own account information and not account information belonging to a third party.

For more information regarding direct deposit of your tax refund and the split refund option, we would be happy to discuss your options with you at your tax appointment.

Don't Forget to Report Those Foreign Financial Assets!

Don't overlook the requirement for any individual who holds any interest in a "specified foreign financial asset" during the tax year to complete and attach Form 8938 to his or her income tax return if a certain reporting threshold is met. The reporting threshold varies, depending on whether or not the individual lives in the U.S. and files a joint return with his or her spouse. For example, an individual who is not married and does not live abroad will need to file Form 8938 for 2012 if the total value of his or her specified foreign financial assets amounts to more than $50,000 as of December 31, 2012 or more than $75,000 at any time during 2012. For married taxpayers filing a joint return and living in the U.S., the threshold amounts are twice as high. The thresholds are also higher for taxpayers residing abroad.

Specified foreign financial assets include financial accounts maintained by foreign financial institutions and other investment assets not held in accounts maintained by financial institutions, such as stock or securities issued by non-U.S. persons, financial instruments or contracts with issuers or counterparties that are non-U.S. persons, and interests in certain foreign entities. However, no disclosure is required for interests that are held in a custodial account with a U.S. financial institution.

The penalty for failing to report specified foreign financial assets for a tax year is $10,000. However, if this failure continues for more than 90 days after the day on which the IRS mails notice of the failure to the individual, there are additional penalties of $10,000 for each 30-day period (or fraction of the 30-day period) during which the failure continues after the expiration of the 90-day period, with a maximum penalty of $50,000.

To the extent that the IRS determines the individual to have an interest in one or more foreign financial assets but fails to provide enough information to enable the IRS to determine the aggregate value of those assets, the aggregate value of those assets will be presumed to have exceeded $50,000 (or other applicable reporting threshold amount) for purposes of assessing the penalty.

No penalty will be imposed if the failure to file the 8938 is due to reasonable cause and not due to willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.

In addition, if it is shown that the individual failed to report the income from the foreign financial account on his or her income tax return, a 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset.

If you have questions related to this issue or are uncertain as to whether you are required to file Form 8938, please give this office a call in order to discuss your particular situation.

Prepared for the New Surtax?

As part of Obama Care, we have a new tax beginning in 2013. The official name of this tax is the "Unearned Income Medicare Contribution Tax," and even though the name implies it is a contribution, don't get the idea you deduct it as a charitable contribution. It is, in actuality, a surtax levied on the net investment income of higher-income taxpayers.

The surtax is 3.8% on the lesser of your net investment income or the excess of your modified adjusted gross income (MAGI) over a threshold based on your filing status. MAGI is your regular AGI increased by income excluded for working out of the country; net investment income is your investment income reduced by investment expenses.

The filing status threshold amounts are:

- $250,000 for married taxpayers filing jointly and surviving spouses.
- $125,000 for married taxpayers filing separately.
- $200,000 for single and head of household filers.

Example *– A single taxpayer has net investment income of $100,000 and MAGI of $220,000. The taxpayer would pay a Medicare contribution tax only on the $20,000 amount by which his MAGI exceeds his threshold amount of $200,000, because that is less than his net investment income of $100,000. Thus, the taxpayer's Medicare contribution tax would be $760 ($20,000 × 3.8%).*

Investment income includes:

- Interest, dividends, annuities (but not distributions from IRAs or qualified retirement plans), and royalties,
- Rents (other than derived from a trade or business),
- Capital gains (other than derived from a trade or business),
- Home sale gain in excess of the allowable home gain exclusion,
- Your child's investment income in excess of the excludable threshold if, when eligible, you elect to include your child's investment income on your return,
- Trade or business income that is a Sec. 469 passive activity with respect to the taxpayer, and
- Trade or business income with respect to trading financial instruments or commodities.

Planning Note: for surtax purposes, gross income doesn't include interest on tax-exempt bonds. Thus, one can avoid the net investment income surtax by investing in tax-exempt bonds.

Investment expenses include:

- Investment interest expense,
- Investment advisory and brokerage fees,
- Expenses related to rental and royalty income, and
- State and local income taxes properly allocable to items included in Net Investment Income.

Do you think you will never get hit with this tax because your income is way under the threshold amounts? Don't be so sure. When you sell your home, the gain is a capital gain, and to the extent that the gain is not excludable using the home gain exclusion, it will add to your income, and possibly push you above the taxation thresholds. And, since capital gains are investment income, you might be in for a surprise. The same holds true for gains from selling stock and a second home. So when planning to sell a capital asset, be sure to consider the impact of this new surtax.

The surtax also applies to undistributed net investment income of trusts and estates, and there are special rules applying to the sale of partnership and Sub-S Corporation interests.

If this surtax will apply to you in 2013, you may need to increase your income tax withholding or estimated tax payments to cover the additional tax so you can avoid or minimize an underpayment of estimated tax penalty when you file your 2013 return.

If you have questions about this new tax or wish to do some related tax planning, please give this office a call.

Revising Your W-4? Seek Professional Advice.

This time of the year, many employers will request from their employees updated W-4 forms (and the equivalent state form for those who live in a state with income tax). The W-4 form allows you to specify your filing status and the number of dependent exemptions to be used for figuring the amount of income tax to be withheld from your pay. Even though the IRS provides an on-line W-4 calculator, it is generally suitable for the more simple returns and may not be appropriate in all cases since it does not take into account all income adjustments, credits, and deductions available. Be careful when completing the W-4 form because errors can create some significant financial problems.

This is where a frequent error occurs. Let's say that you are married and have two dependents. On your tax return, you claim four exemptions. The natural thing for you to do would be to claim "married" and four exemptions on the W-4. However, for W-4 purposes, the exemption for the taxpayer and spouse are automatically built into the married rates, and only two exemptions need to be claimed. The result, of course, is that you would end up claiming more exemptions than you actually have, which can result in under-withholding if the standard deduction is used.

It is common practice and acceptable for taxpayers to claim additional exemptions when they have excessive withholding. The withholding tables do not account for large itemized deductions or other situations that might reduce their taxable income. It's also quite common for taxpayers to increase their exemptions to provide more take-home pay from their payroll checks. In doing so, they are essentially borrowing tax money from the government, which they will have to repay, along with possible penalties and interest, when they file their return next year. That might seem like a good idea now, but it could lead to an unexpected tax liability at tax time. This is where a professional tax projection can more accurately establish appropriate withholding amounts.

Determining the appropriate number of exemptions to claim on the W-4 can be tricky if you have other substantial income on which no tax is withheld or when both spouses of a married couple are employed. The guidance of a tax professional also may be beneficial in these cases to help figure the W-4 withholding allowances and to analyze how the withholding amount may affect the need for estimated tax installment payments.

If you feel you need assistance in establishing your withholding amount, please give this office a call.

What to Do If You Are Missing a W-2

Have you received all of your W-2s? These documents are essential for completing individual tax returns. You should receive a Form W-2, Wage and Tax Statement, from all of your employers each year. Employers have until January 31st to provide or send you a 2012 W-2 earnings statement, either electronically or in paper form. If you have not received your W-2, follow these steps:

1. Contact Your Tax Preparer—And let him or her know that you are missing a W-2. If your appointment is in the near future, your preparer will advise you whether to keep the appointment or change it to another time. Generally, when a W-2 or 1099 is missing, it is best to keep the appointment so that everything else for the return can be completed. You can then mail the missing document to the office or drop it off at a later date. That way, your return can be finished as soon as the W-2 or 1099 is available, which will speed up your refund, if you are receiving one.

2. Contact Your Employer—Contact your employer to inquire if and when the W-2 was mailed. If it was mailed, it may have been returned to the employer due to an incorrect or incomplete address. After contacting the employer, allow a reasonable amount of time for the employer to resend or re-issue the W-2.

3. Contact the IRS—If you still have not received your W-2 by February 15, you can contact the IRS for assistance at 800-829-1040. However, we recommend that you hold off from contacting the IRS until you are <u>certain</u> that you will not be receiving a W-2 from the employer. If and when you do call the IRS, have the following information at hand:

- Employer's name, address, city, and state, including zip code;
- Your name, address, city, state, zip code, and Social Security number; and
- An estimate of the wages you earned, the federal income tax withheld, and the period in which you worked for that employer. The estimate should be based on year-to-date information from your final pay stub or leave-and-earnings statement, if possible. This office can assist you with making the estimate.

4. File Your Return—Even if you don't receive a W-2, you are still required to file your tax return or to request a filing extension by April 15.

- <u>If you anticipate that you will ultimately receive the missing W-2</u>, this office can estimate your 2012 tax liability and file extensions for you. If you have a substantial refund coming, you may opt to have this office prepare a substitute W-2, enabling you to file without the W-2. Refunds for returns, including substitute W-2s, can be delayed significantly while the IRS verifies the W-2 information.
- <u>If you don't anticipate receiving the missing W-2</u>, then this office can prepare a substitute W-2, enabling you to file your 2012 tax return.

If a substitute W-2 is used and it is later determined that the information used to prepare the substitute W-2 was in error, an amended return may need to be prepared for you to be able to file.

Please call this office if you have questions or need assistance.

Use QuickBooks' Tools -- and Common Sense Procedures -- To Prevent Financial Fraud

You work hard for your money. Strong internal controls can keep it from disappearing unnecessarily.

You trust your employees or you wouldn't have hired them. That's what everyone says as they watch a valued staff member being hauled off in handcuffs. But I trusted him.

Whether your accounting tasks are done on one PC or you have multiple users working on different screens, it's critical that you make use of all that QuickBooks offers in terms of internal controls. You'll also need to establish some common-sense rules.

First Stop: Audit

Trail An audit trail is a very large report that displays every addition, deletion and modification of every transaction. In older versions of QuickBooks you could turn it on and off, but it's permanently on now.

Because of its size, you'll probably have to use QuickBooks' filtering tools to zero in on the user and/or date(s) you're looking for. Go to **Reports | Accountant & Taxes | Audit Trail**. Click **Customize Report | Filters** to set up your search.

Your audit trail won't alert you when someone tries to enter a prohibited area, and it won't detect changes to lists. Setting up permissions will help **(Company | Set Up Users and Passwords | Set Up Users)**, but you need more than that.

Figure 1: Be especially careful when granting user access to areas that contain customer, vendor and employee information.

Run the Right Reports

Other QuickBooks features can help prevent fraud. Review these reports regularly:

- **Closing Date Exception**. Why were those changes necessary?
- **Voided/Deleted Transactions**. Is there supporting documentation? Should you be reviewing these daily?
- **Expenses by Vendor Detail**. Look for irregularities, especially multiple payments made to a vendor in a short period of time.
- **Check registers.** Use the **Balance Sheet** for this. Go to **Reports | Company & Financial | Balance Sheet Standard** and customize the report for the correct period and – if necessary – for specific customers, vendors and/or jobs.

Adhere to Best Practices

You undoubtedly implement financial best practices in your personal life. You reconcile your accounts. You don't give your online banking password to anyone. And you glance through your recently-posted transactions on your financial institutions' websites.

If your company is large enough that you have multiple accounting employees, you probably can't be as hands-on as you are at home. But you can still set up internal control procedures.

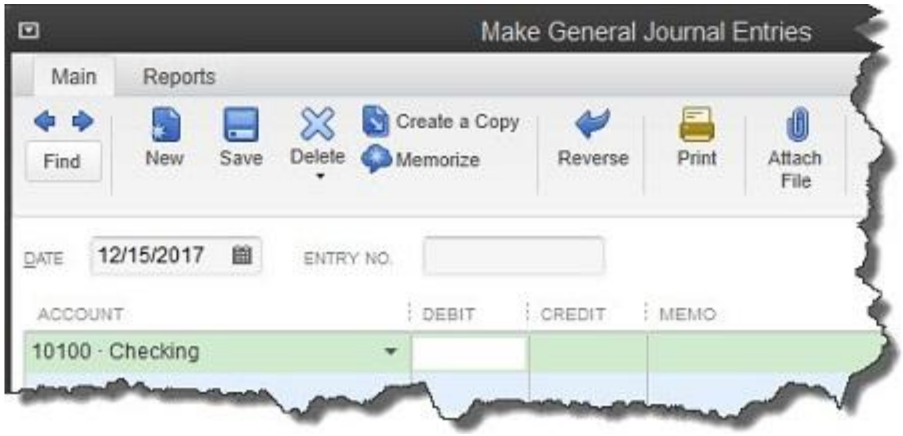

Figure 2: Debit? Credit? Reverse the transaction? No one should be making General Journal entries but you.

It's easy to err here; talk to us before using this feature. For example, if your company has grown to the point where you're removed from the daily workflow, you may still want to have approval rights for some procedures, like bank balance adjustments, refunds and credits, printed checks (you should still be signing them), timesheets and expense reports.

It goes without saying that you should password-protect your QuickBooks company file and change the password regularly, even – and especially – if you're the entire accounting department. And protect yourself from external fraud. We can do a review of your security procedures and make suggestions.

Reinforce the rules

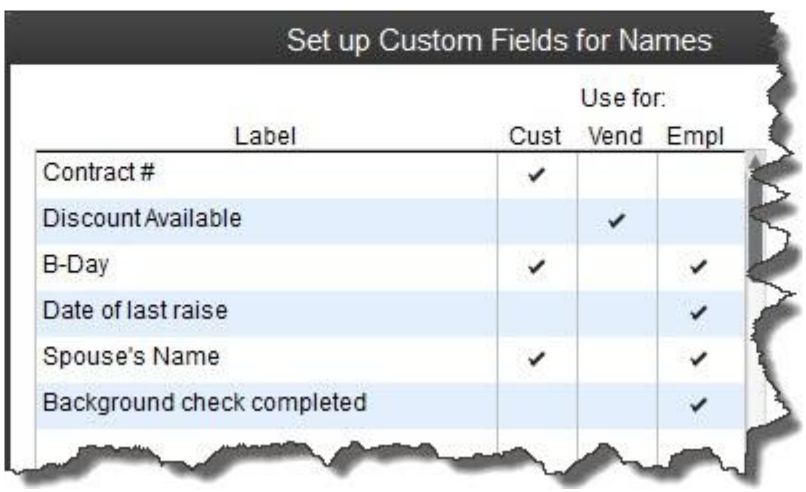

Figure 3: Anyone in your company who has access to accounting data should have a background check.

Know who your employees are (consider running background checks) and, if you can, rotate the duties assigned to accounting staff. If you have only one person managing all of your bookkeeping work, conduct an even more thorough background search: credit, references, criminal activity, etc.

Finally, make sure that all employees understand the definition and consequences of fraud. Let them know about the steps being taken to prevent it, but do some unannounced auditing on your own. Include a session on fraud in orientation and get current staff up to speed. Explain that this is necessary for their protection, too. Make it easy to report fraud anonymously, with no fear of repercussions.

This may seem like a lot of extra tasks in your workday, but imagine the time you'll lose tracking down fraudulent activity if it occurs. So spend a fraction of that time upfront.

If you have questions on this subject, or anything else Accounting or QuickBooks related, give us a call or email. We're here to be your partner.