

2011 NEWSLETTER



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Dear Clients and Friends of the Firm:

Year-end tax planning is especially challenging this year because of the uncertainty over whether Congress will enact sweeping tax reform that could have a major impact in 2012 and beyond. Even if there is no major tax legislation in the immediate future, Congress will have to address several thorny issues next year, including:

1. Revising the Alternative Minimum Tax (AMT) to avoid a drastic drop in post-2011 exemption amounts;
2. Deciding on the post-2012 expiration of the Bush-era income tax cuts (including the current rate schedules and low tax rates for long-term capital gains and qualified dividends); and
3. The expiration of favorable estate and gift tax rules for estates of decedents dying, gifts made or generation-skipping transfers made after December 31, 2012.

In addition, many provisions and credits are set to expire at the end of 2011 unless Congress renews them. This letter contains some planning ideas to consider before year-end. It's not too late to make some tax-saving moves for 2011.

What Remains the Same?

Federal income tax rates remain the same as they were in 2010. Federal income tax rates for 2011 are 10%, 15%, 25%, 28%, 33%, or 35%.

Long-term capital gains and qualifying dividends rates are the same as in 2010. The maximum rate for 2011 is 15%. For taxpayers in the 10% or 15% income tax brackets, the rate for 2011 is 0%.

IRA and Roth IRA contribution limits for 2011 are \$5,000 (\$6,000 if you are age 50 or older). IRA contributions may be deductible if you qualify under the Internal Revenue Service rules.

The contribution limit for 2011 for employer-sponsored retirement plans such as 401(k) or 403(b) plans is \$16,500 (\$22,000 if you are 50 or older). Pretax contributions to these types of plans are excludable from your taxable wages. Note that these limits increase by \$500 each in 2012.

Changes to Consider

AMT exemption amounts were increased last year, effectively reducing the impact of the AMT on many taxpayers. These increased amounts are scheduled to expire at the end of 2011. As of now, the AMT exemption amounts for 2012 are scheduled to be lower than for 2011 and are expected to affect many more middle-income taxpayers.

The making Work Pay credit was replaced with a payroll tax reduction of two percentage points to the employee's portion of Social Security tax. Most taxpayers will receive more from this payroll tax cut than they did with the Making Work Pay credit.

There are tax savings to be realized by taking advantage of tax breaks that are available for 2011 but may be gone for 2012 and beyond. These include, for individuals, the option to deduct sales and local sales and use taxes

instead of state and local income taxes; the above-the-line deduction for qualified higher education expenses; and tax-free distributions by those age 70 ½ or older from IRAs for charitable purposes. For businesses, tax breaks that are available through the end of this year but won't be around next year unless Congress acts include - 100% bonus first-year depreciation for most new machinery, equipment and software; and extraordinarily high \$500,000 expensing limitation (and within that dollar limit, \$250,000 of expensing for qualified real property); and the research tax credit.



Year-End Tax Planning Moves for Individuals

Postpone income until 2012 and accelerate deduction into 2011 to lower your tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2011 that are phased out over various levels of adjusted gross income. These include child tax credits, higher education tax credits, and the above-the-line deduction for higher education expenses and deductions for student loan interest. Postponing income may also be desirable for taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances.

Estimate your tax liability for 2011. Adjust your final quarterly voucher or your withholding to avoid underpayment penalties.

Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, and then buy back the same securities at least 31 days later.

Purchase qualified small business stock before the end of 2011. There is no tax on gain from the sale of stock if it is (1) purchased after September 27, 2010, and before January 1, 2012, and (2) held for more than five years. In addition, such sales won't cause AMT preference problems. To qualify for these breaks, the stock must be issued by a regular C corporation with total gross assets of \$50 million or less. A number of other technical requirements must be met as well.

Estimate the effect of any tax-planning moves on the AMT for 2011, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. Others are calculated in a more restrictive way for AMT purposes than for regular tax purposes. Thus, in some cases, deductions should not be accelerated.

Make gifts sheltered by the annual gift tax exclusion before the end of the year and save gift and estate taxes. You can give \$13,000 in 2011 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. Married couples may make combined tax-free gifts of \$26,000 to each recipient. Use of the lifetime estate and gift tax exclusion should be considered for larger gifts. Such transfers may save family income taxes where income-producing property is given to family members in lower tax brackets who are not subject to the kiddie tax.

Make IRA contributions for your nonworking spouse. For 2011, the maximum spousal IRA contribution is the lesser of \$5,000 or your combined earned income. You can add an additional \$1,000 if your spouse is over 50.

Accelerate big-ticket purchases into 2011 in order to ensure a deduction for sales tax. On those purchases if you elect to claim a state and local general sales tax deduction instead of a state and local income tax deduction. Unless Congress acts, this deduction won't be available after 2011.

If you are a homeowner, make energy-saving improvements to your residence. Such as putting in extra insulation or installing energy-saving windows or an energy-efficient heater or air conditioner. You may qualify for a tax credit if these improvements are made before 2012.

Increase the amount you set aside for next year in your employer's health flexible spending account if you set aside too little this year. Remember that you can no longer set aside amounts for tax-free reimbursements for over-the-counter drugs unless they are prescribed.

If you become eligible to make health savings account contributions in December 2011, make a full year's worth of deductible contributions for 2011.

If you expect to owe state and local income taxes. When you file your return next year, consider asking your employer to increase withholding of state and local taxes or pay estimated tax payments of state and local taxes to pull those payments into 2011 if doing so won't create an AMT problem.

Consider paying contested taxes. To be able to deduct them this year while continuing to contest them. Federal taxes do not apply; only state taxes are deductible.



Settle an insurance or damage claim. In order to maximize your casualty loss deduction this year. Keep in mind that casualty losses are subject to limitation. In addition, certain casualty losses can be deducted on the previous year's tax return.

Prepay eligible higher education expenses if doing so will increase your deduction for qualified higher education expenses for 2011. Generally, the deduction is allowed for qualified education expenses paid in 2011 in connection with enrollment at an institution of higher learning during 2011 or for an academic period beginning in 2011 or the first three months of 2012.

If you are 70 ½ or older and you have to take Required Minimum Distributions (RMD's) from your non-Roth IRA's make a qualified charitable donation with your RMD. For 2011, you can make a donation from your IRA directly to a qualified charity for as much as \$100,000 and exclude that amount from your taxable income and still have it satisfy your RMD requirements.

Take an eligible rollover distribution from a qualified retirement plan before the end of 2011 if you are facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2011. You can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be included in income tax for 2011, but the withheld tax will be applied pro rata over the full 2011 tax year to reduce previous underpayments of estimated tax.

Review support provided for relatives. Remember to take into account the financial support you provide to relatives. Potential tax breaks include dependency exemptions, head-of-household filing status, medical deductions, and the dependant care tax credit. Generally, you will need to provide over half of your relative's living expenses.

Year-End Tax Planning Moves for Businesses and Business Owners

Consider making expenditures that qualify for the Section 179 business property expensing option. For tax years beginning in 2011, the expensing limit is \$500,000 and the investment ceiling limit is \$2,000,000. In addition, a limited amount of expensing may be claimed for qualified real property. Unless Congress changes the rules, the dollar amount drops to \$139,000 for tax years beginning in 2012, the beginning of phase-out amount drops to \$560,000 and expensing won't be available for qualified real property.

Consider making expenditures for property that qualifies for the bonus first-year depreciation if bought and put into service in 2011. The 100% first-year write-off generally won't be available next year. Enterprises planning to purchase new depreciable property this year or next year should accelerate their buying plans to take advantage of the bonus depreciation if doing so makes sound business sense.

Obtain the Work Opportunity Tax Credit (WOTC) by hiring qualified workers (such as certain veterans). Under current law, the WOTC won't be available for workers hired after this year.

Make qualified research expenditures before the end of 2011 to claim the research credit. This credit won't be available after 2011 unless Congress extends it.

Make qualified expenditures to take advantage of tax credits for energy incentives. A number of tax credits for alcohol fuels and biodiesel/renewable diesel and for construction of energy-efficient homes and manufacture of energy-efficient appliances will expire after December 31, 2011, unless renewed by Congress.

If you are self-employed and have not already done so, **set up a self-employed retirement plan.**

Consider deferring a debt-cancellation event until 2012 and disposing of a passive activity to allow you to deduct suspended losses.

If you own an interest in a partnership or S corporation, **consider increasing your basis in the entity** so you can deduct a loss from it this year.



As we said at the beginning this letter is intended to give you a few ideas before the year-end. Please do not hesitate to contact us if you have any questions.

Many provisions within the new rules are broad-based and far reaching. Let us help you design a tax strategy to maximize your benefits.

Sincerely,

MONTANO & ASSOCIATES

Siegfried G. Montano, Jr., CPA



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