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## The Importance of 2012 Year-End Tax Planning for Individuals

By [Erin N. Tuggle](#)

The end of 2012 may bring unexpected and adverse changes for many taxpayers due to the scheduled December 31, 2012, expiration of a number of tax cuts. Because most of these tax cuts have been in effect since 2001, many taxpayers have become accustomed to their existence and may not realize the effect that expiration may have on their personal tax bills. Although it is possible that Congress may act to extend a portion or all of these tax cuts, there is significant uncertainty surrounding whether such Congressional action will occur. In addition, new taxes and tax changes under The Patient Protection and Affordable Care Act (PPACA) will affect taxpayers beginning in 2013. As a result, taxpayers, with the assistance of their tax advisors, should undertake a careful review of their personal tax situation to take advantage of any year-end tax planning opportunities for 2012.

### Summary of Expiring Tax Incentives and New Taxes under the PPACA

**Higher Tax Rates.** One of the most publicized changes to the tax law after 2012 is the increase in individual income tax rates. Unless Congress acts to change the law, the individual income tax rates are scheduled to increase effective January 1, 2013, so that the highest income tax rate is increased from 35 percent to 39.6 percent (applicable for taxpayers with adjusted gross income over \$390,050). In addition, the current lowest income tax rate of 10 percent will expire and the lowest income tax rate will return to 15 percent. Other reduced tax rates, such as the favorable long-term capital gains rate and the qualified dividends tax rate (15 percent for taxpayers in the 25 percent bracket rate and above and zero percent for all other taxpayers), are also scheduled to end on December 31, 2012. As a result, the long-term capital gains rate would increase to 20 percent, and the qualified dividends income tax rate would again be subject to tax at ordinary income tax rates, which could be as high as 39.6 percent (and may be subject to the additional 3.8 percent Medicare contribution tax, discussed below). Also scheduled to expire is the 2 percent "payroll tax holiday" that has been in effect since January 2011, which reduced the Social Security tax rate from 6.2 percent to 4.2 percent.

**Revived Limitations and Expiring Incentives.** High income taxpayers will also be subject to revived limitations on their itemized deductions and their personal exemptions. The popular child tax credit, generally available for taxpayers in the lower and moderate income tax brackets, will be reduced by half. Further, some taxpayers may be liable for the alternative minimum tax (AMT) because of expiration of the AMT "patch." Relevant to business owners, the Section 179 deduction allows taxpayers an up-front deduction (up to \$139,000 for 2012) of the cost of certain business assets, rather than depreciating the cost over a number of years. In 2013, the maximum Section 179 deduction will be reduced to

\$25,000 in 2013, and computer software will no longer qualify as a Section 179 business asset. The "bonus depreciation" deduction will also disappear.

**New Taxes Under the PPACA.** Beginning in 2013, the PPACA will also affect individual taxpayers in several ways. The more significant changes involve two new taxes that will affect higher income taxpayers beginning January 1, 2013. The first new tax imposes an additional 0.9 percent Medicare tax on wages and self-employment income in excess of \$200,000 for single individuals and \$250,000 for married taxpayers. In addition, a new 3.8 percent Medicare contribution tax (sometimes referred to as the "new investment tax") will also apply to single individuals with a modified adjusted gross income (MAGI) in excess of \$200,000 and married taxpayers with MAGI in excess of \$250,000. For individuals subject to this tax, the amount of tax owed will be equal to 3.8 percent multiplied by the lesser of (1) the taxpayer's net investment income or (2) the amount by which the taxpayer's MAGI exceeds the \$200,000/\$250,000 thresholds. The 3.8 percent Medicare contribution tax also applies to trusts and estates, to the extent the estate or trust has undistributed investment income in excess of the amount at which the trust and estate is subject to the 39.6 percent income tax rate (\$11,650 for 2012).

### **Year End Planning Strategies**

**Review of Federal Withholding.** In light of the scheduled expiration of various tax incentives in 2012, and particularly the increased income tax rates scheduled for 2013 and new Medicare taxes, taxpayers should review their income tax withholding and consider whether additional withholding may be needed to avoid a surprise tax bill for 2013.

**Accelerating Income to 2012.** A traditional year-end tax planning technique has been to shift current income to a future tax year, to delay the income tax due on such income. However, due to the increased tax rates scheduled for 2013, a taxpayer may want to shift future income into the current tax year, to lower the overall tax rate applicable to such income. This may be especially relevant for long-term capital gains. Careful review should be made of this strategy, as a last-minute extension by Congress of the current tax incentives and current tax rates may cause such shifting of income to be unnecessary and actually accelerate the income tax due on such income.

**Harvesting Losses.** Taxpayers should also consider the traditional technique of harvesting losses, which involves selling assets which have a higher tax basis than their current fair market value, in order to offset current or future gains. Consideration must be given to whether an investment loss would be "short-term" or "long-term" loss. Therefore, taxpayers should consult with their tax advisors before implementing this strategy.

**Education Expenses.** One of the expiring tax incentives is a tax credit called the American Opportunity Tax Credit. Taxpayers should consider whether education expenses subject to the AOTC credit may be pre-paid in 2012 in order to qualify such expenses for the AOTC credit before its expiration.

**Section 179 Property.** If taxpayers are considering the purchase of Section 179 assets for their business, and computer software in particular, they should consider purchasing and placing those assets into service in 2012 to take advantage of the additional Section 179 deduction amount.

**Gifts.** Gift-giving is especially important for 2012. Without Congressional action, the lifetime gift tax exemption amount will drop from its current exemption of \$5.12 million to \$1 million on January 1, 2013, and the maximum gift tax rate will increase from its current rate of 35 percent to 55 percent. A number of planning opportunities may be available to taxpayers who desire to take advantage of the 2012 laws, which are the subject of a separate Jackson Walker Wealth Planning e-Alert, "Time is Running Out on Historic Estate Planning Opportunity," dated October 1, 2012. [Click here to read that e-Alert.](#)

**Charitable giving.** For many individuals, charitable giving is also a part of their year-end tax strategy. For high income taxpayers, the charitable deduction has been subject to reduction due to a limitation on certain itemized tax deductions, including the charitable deduction. This limitation has been subject to phase-out since 2006, and was eliminated entirely in 2010, 2011, and 2012. However, this limitation is scheduled to be revived in 2013. Therefore, if a taxpayer has been planning a significant charitable gift, the taxpayer should consider whether making such gift in 2012 rather than 2013 is best for their personal tax situation.

### **Summary**

Year-end tax planning is always an important undertaking, but it will be especially important for taxpayers for the 2012 tax year in light of changes scheduled for the 2013 tax year and beyond. Although competing Senate and House bills were passed in July 2012 which would extend many of the expiring tax cuts through 2013, it remains to be seen whether a compromise can be reached. Therefore, taxpayers should act now to take advantage of tax planning opportunities. Because each taxpayer's tax situation is unique, and because tax advisors will be very busy over the next several months, taxpayers should consult with their tax attorney or accountant soon, to determine what tax planning strategies are best and ensure there is sufficient time to implement such strategies.

If you have any questions regarding this article, please contact **Erin N. Tuggle** at 512.236.2065 or any member of the **Jackson Walker Wealth Planning and Transfer group**.

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