TAX MATTERS - 2011

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YEAR-END TAX PLANNING 1
ENERGY CREDITS 4
ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS 4
STOCK OPTIONS 4
FORM 1099 FILING REQUIREMENTS 5
DEPENDENTS 6
DEDUCTIBILITY OF INTEREST PAID 6
COSIGNING VS. A LOAN GUARANTEE 7
CHARITABLE CONTRIBUTIONS 8
SALE OF PRINCIPAL RESIDENCE 9
DEPRECIATION 9
INTERNAL REVENUE SERVICE MILEAGE RATE ALLOWANCES 10
HEALTH INSURANCE 10
TAX EXEMPT INTEREST REPORTING 11
HOUSEHOLD EMPLOYERS 11
INDEPENDENT CONTRACTOR VS. EMPLOYEE 11
INVESTMENT CONSIDERATIONS 12
RETIREMENT PLAN ISSUES 13
ESTATE PLANNING 16
SOCIAL SECURITY INFORMATION 17
LONG-TERM CARE INSURANCE POLICIES 18
DISABILITY INSURANCE 18
EDUCATION PLANNING 19
DISASTER VICTIMS 20
MAILING OF TAX RELATED DOCUMENTS 20
ALERT 21
A FEW NOTES ABOUT OUR FIRM 22
- FINANCIAL PLANNING 22
- NOTARY PUBLIC SERVICES 22

TAX MATTERS – 2011

There was no significant tax legislation enacted in 2011. However, you can expect taxes will be a central issue as we head into a presidential election year in 2012.

Once again the income tax filing season is near and we want to bring some matters to your attention which should be considered in connection with your tax returns for the year ending December 31, 2011 and your tax planning in general. Please contact us if you need to discuss any of these in more detail.

YEAR-END TAX PLANNING

Conventional year-end tax planning includes the deferral of income into 2012 and the acceleration of deductions into 2011.

Due to this and other complexities in the tax law created by the Alternative Minimum Tax, please contact us to discuss this strategy prior to implementation.

Some specific methods of tax planning are:

> ALTERNATIVE MINIMUM TAX (AMT) - Philosophically, the Alternative Minimum Tax (AMT) was designed to prevent high-income taxpayers from utilizing too many tax benefits. However, under current law more and more taxpayers are finding themselves subject to the AMT.
>
> The AMT patch continues the indexing of the AMT exemption amounts for inflation through 2011. Hopefully, in 2012, Congress will explore a permanent solution to this issue since the AMT exemption amounts for individuals are scheduled to revert back to pre-2001 amounts in 2012.
>
> Additional planning might be in order with respect to private activity municipal bond interest, large passive losses, etc.
>
> Moreover, the *acceleration* of ordinary income into 2011 might be worthwhile so as to take advantage of the 26% or 28% tax rate if the AMT is already invoked.

Please contact us to discuss these items in more detail as the AMT is an extremely complex area.

BUNCHING OF CERTAIN ITEMIZED DEDUCTIONS – There are thresholds in the tax law which may affect you adversely, but potentially two which you may be able to overcome. First, medical expenses are deductible only to the extent they exceed 7.5% of your adjusted gross income. Second, certain "miscellaneous" itemized deductions (just about all other itemized deductions which do not fall into the medical, interest, taxes and charitable contribution categories) are deductible only to the extent that their aggregate exceeds 2% of adjusted gross income.

Since the calculation of the non-deductible portion of each of these items is made annually on a cash method, it follows that the threshold amounts might be able to be overcome by "bunching" expenditures into alternate years.

STATE SALES TAX DEDUCTION – The choice of deducting either state and local income taxes or state and local sales taxes for those taxpayers who itemize deductions is scheduled to expire after 2011. For the year 2011, this may be particularly beneficial for those living in states that do not impose an income tax. The deductible sales tax amount would be the greater of the amount determined by accumulating receipts or using tables provided by the IRS. Sales tax paid on vehicles and boats would be added to the table amount up to the general sales tax rate. Please contact us to discuss your particular situation. Please note that this deduction could be limited or eliminated due to the AMT.

CAPITAL GAINS – It may be advantageous for an individual in a federal income tax bracket higher than 15% to gift capital gain property to someone in the 10% or 15% tax bracket and, assuming the property has been held for at least one year, have the long-term gain on the sale taxed at 0% instead of 15% in the year 2011. Please contact us to discuss this since special rules exist for gifts to children.

CHARITABLE GIFTS OF APPRECIATED PROPERTY – Donating appreciated securities instead of cash continues to be very appealing. Here is an example: If you own 100 shares of Microsoft currently worth $2,500 with a basis of $1,000, and you gift the 100 shares and then buy the same stock with the cash that you would have contributed, you will have accomplished your charitable gifting while removing $1,500 of appreciation without paying capital gains tax or changing your portfolio.

DISPOSITION OF “PASSIVE ACTIVITIES” – The disposition of certain “passive activities” investments on or before December 31, 2011 could make current year and certain carryover losses deductible. Contact us, however, since this is a very complex issue.

MUTUAL FUNDS – If you are contemplating investing in or selling a mutual fund before the end of 2011, you should contact the fund or your broker to determine if and when it will be making its annual distribution of capital gains. If you invest in a fund prior to the distribution or sell a fund after the distribution you will owe income tax on the distribution while at the same time the share price will be decreased as a result of the distribution. This means that the value of your investment in the fund or proceeds from the sale of the fund will be the same but you will owe income tax on the distribution. However, if the investment is in a tax-deferred account such as an IRA there is no reason to wait since there are no current tax consequences of the distribution.

SECURITY TRANSACTIONS – You may want to recognize a loss on a security this year while maintaining your investment position. In order for the loss to be deductible, you must avoid the “wash sale” rules. These rules state that if you buy substantially identical securities during the period beginning 30 days before and ending 30 days after the date of the sale that resulted in the loss, you are precluded from recognizing the loss and your basis in the newly purchased stock is equal to your basis in the old stock, thus deferring the recognition of the loss. There may be a benefit to selling bonds upon which you would realize a loss and investing the proceeds immediately in similar but not identical obligations. Please contact us to discuss your particular situation.

ENERGY CREDITS

The tax credit for homeowners who make qualified energy efficiency improvements and residential energy property expenditures to their existing homes was modified and extended for one year and is set to expire after 2011. The credit is 10% of those qualified expenditures limited to a lifetime maximum credit of $500. The $500 amount must be reduced by the aggregate amount of previously allowed credits the homeowner received in 2006, 2007, 2009 and 2010. The tax credit of 30% of the cost of qualified residential alternative energy equipment is available to homeowners through December 31, 2016. The annual maximum limits applicable to the residential alternative energy credit are eliminated for solar hot water heaters, wind turbine property, and geothermal heat pumps effective for tax years through 2016. Please contact us for more specific guidance in this area.

ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

The repeal of the limitation of itemized deductions and personal exemptions for taxpayers whose AGI exceeds specified amounts was extended for two years. As a result, the itemized deduction and personal exemption phase-out will not apply to tax years beginning in 2011 and 2012.

STOCK OPTIONS

Stock options are a popular method of compensating differing levels of employees, from top executives to administrative employees. The two main types of stock options are Incentive Stock Options (ISOs) and Non-Qualified Options (NQOs). The decision on when to exercise the options and when to sell the underlying stock have many far reaching implications for both regular and AMT purposes. We can provide you with expert guidance on these matters.

The Internal Revenue Service announced it will not impose employment taxes such as Social Security, Medicare, and unemployment on income from incentive stock options and employee stock-purchase plans.

The end of each year is a good time to review the holding period of ISOs that have been exercised. In order to receive long-term capital gain treatment on the sale of shares received under an ISO the shares may not be sold before the later of two years from the date of the grant of the option, or one year from the date of exercise of the option.

More of our clients are exploring the use of a "covered call" strategy to produce income in this sideways stock market environment.

Simply stated, your broker will write a call option contract (one contract equals options for 100 shares) for a third party to purchase stock that you already own, for a certain period of time at a price, usually higher than the current price of the stock. If the price of the stock reaches or exceeds the "call price" then you will likely have to sell the stock for the call price.

A simplistic example would be if you own 100 shares of Cisco selling at $18/share your broker could write a call option contract for a third party to buy your Cisco stock at $22/share at any time during the next three months. The third party might pay you $1 per contract so that you would get $100 at the time that the call option contract was sold. If the stock never reaches $22, at the end of three months the call option expires and you keep the $100 and you still own the 100 shares. If the stock reaches $25/share you will likely get "called out" and have to sell the stock to a third party for $22/share. In that case you still keep the $100 and you made $4 per share ($22-18) in three months.

The downside to this strategy is that you are limiting your upside potential.

From an income tax standpoint, if your options expire, the $100 is a short term capital gain. If you get called out on the option the $100 is part of the sale price of the stock and is a long or short term capital gain or loss depending on the holding period of the underlying stock.

If you have large capital loss carryforwards, you can shelter some or all of this income for federal income tax purposes.

Please contact us or your broker for further details.

FORM 1099 FILING REQUIREMENTS

Requirements exist for the filing of various Form 1099 information returns which are used to report certain payments by persons engaged in a trade or business made in the course of such trade or business. These payments include, but are not limited to, rents, services, interest and retirement plan distributions. Failure to file these forms may result in the assessment of penalties. Please contact us to discuss your specific situation.

Gross proceeds information reporting is required for all payments made to attorneys in the course of a trade or business. This reporting is required on Form 1099-MISC. The present exemption from reporting for payments made to corporations does <u>not</u> apply to

payments made to incorporated law firms. Payments to law firms are payments to attorneys and, therefore, are subject to this reporting. Attorneys are required to promptly provide their taxpayer identification numbers to persons required to file these information reports. Please contact us to discuss this reporting requirement.

DEPENDENTS

The law requires that any person born before December 1, 2011 with respect to whom you claim a dependency exemption on your 2011 income tax return must have a Social Security number. If he or she does not, certain penalties will be assessed. If you find that you will be required to apply for a Social Security number for someone under these circumstances (or any other circumstances, for that matter) you need only call our office and we will provide you with assistance.

In 2011, unearned income of a child under the age of 18 or under the age of 24 for full time students in excess of $1,900 is taxed to the child at the parent's marginal tax rate. In 2011, if the child's gross income is less than $9,500, derived entirely from interest and dividends and the child has not made independent estimated tax payments, the parent can include the child's income in the parent's own return.

DEDUCTIBILITY OF INTEREST PAID

The severe restrictions on the deductibility of interest paid (other than home mortgage interest) continue to be a problem. A technique known as "tracing" is employed to segregate interest which is to be deductible from that which is not. Generally, the ultimate use of the proceeds of borrowed money will determine the characterization (and thus, the deductibility) of the interest paid on such borrowing.

The following course of action must be followed to deal with this problem:

> When you provide us with the information necessary for the preparation of your tax returns for the year 2011, it will be essential that you provide us with information about any loans which you received during 2011 (to the extent that you have not previously furnished this information to us) including the use of the proceeds of the loans, the amount of interest paid thereon and any collateral given. We urge you to tend to this part of the compilation process as soon as practicable rather than waiting for the regular gathering of your general tax return data since the task will, in many cases, be time consuming and tedious in its own right!

Further, you may be well advised to contact us regarding the possible restructuring of such loans to obtain a more favorable tax treatment of the interest paid.

Caution should be given to tax advice received from "non-tax experts" as to the deductibility of specific types of interest paid, i.e. margin interest, home equity interest, etc.

Please keep in mind there are different limitations on the deductibility of interest paid on home equity indebtedness and acquisition indebtedness.

Points paid on the first refinancing of the mortgage on your principal residence are deductible ratably over the term of the new loan. If you refinance again, you can deduct the balance of the points remaining from the previous refinancing. The IRS says that if you refinance with the **same lender** the remaining points on the original refinancing can only be deducted over the term of the new loan. Please contact us to discuss this further.

COSIGNING VS. A LOAN GUARANTEE

Many people agree to cosign loans for friends or relatives. They do this as a favor, a vote of confidence or because they just can't say no. Unfortunately, they often find that they've bitten off more than they intended to chew.

The cosigner of a loan agrees to be responsible for its repayment along with the borrower. While a lender will generally seek repayment from the debtor first, it can go after the cosigner at any time. On the other hand, where a loan is *guaranteed*, the lender can usually go after the guarantor only after the principal debtor has actually defaulted.
Finance companies report that most cosigners end up paying off the loans they've cosigned – along with late charges and legal fees. Not only is this an unwanted out-of-pocket expense, but it can also be an undeserved blot on the cosigner's credit record.

Generally, it is better to guarantee a loan than to cosign it. However, if you're willing to cosign a loan, at least seek the lender's agreement to refrain from collecting from you until the borrower actually defaults, and try to limit your liability to the unpaid principal at the time of default. Then stay on top of the borrower's financial situation to help avoid a default (for example, have the lender notify you whenever a payment is late). At least you can preserve your credit rating by nipping payment problems in the bud.

Please contact your attorney regarding this, as laws vary from state to state.

CHARITABLE CONTRIBUTIONS

For individual contributions of $250 or more made during 2011 written acknowledgement must be obtained from the charitable organization by the due date (including extensions) of the tax return for the year in which the contribution is made. A cancelled check is not sufficient to satisfy the substantiation requirement. The charitable organization may provide the acknowledgement via e-mail.

A deduction for contributions made in cash or by check, regardless of the amount, will not be allowed unless you have a bank record or receipt, letter, or other written communication from the charitable organization containing the name of the charitable organization, the date the contribution was made and the amount of the contribution.

The deduction for a donation of an automobile to a qualified charity is generally limited to the vehicle's selling price when the charity sells it. There are exceptions to this rule, which would allow the deduction of the fair market value, including the use of the automobile by the charity for charitable purposes. The charity must provide a Form 1098-C to the donor within 30 days after the date the vehicle is sold which will indicate the selling price of the vehicle or certify that an exception to the general rule applies. This form must be attached to the donor's tax return.

Donations of clothing and household items will not be deductible unless the items are in "good" or better condition. The IRS does not define good condition but the intent may be to deny a deduction for any item that has minimal monetary value. An exception applies for a donated item that is not in good condition but is worth more than $500 as long as a qualified appraisal is received at the time of the donation.

The option for owners of IRAs who are 70 ½ or older to distribute from their IRAs up to $100,000 per year directly to qualified charities was extended to the year 2011. The distributions would not be included in income nor would they be deductible as charitable contributions. In addition, this may possibly reduce the federal income tax owed on Social Security benefits as well as reducing the AGI threshold for determining the deductibility of medical expenses and miscellaneous itemized deductions. The distributions must be done as a direct transfer to the charity. Please contact us to discuss this further to determine whether this would be beneficial to you.

SALE OF PRINCIPAL RESIDENCE

For federal purposes an individual can exclude from income up to $250,000 of gain realized from the sale of a principal residence. The exclusion is doubled to $500,000 for married persons filing jointly. There is an unlimited exclusion for Pennsylvania purposes. To be eligible for the exclusion, the individual must have owned and occupied the residence as a principal residence for at least two of the five years before the sale. If an individual does not satisfy the two year ownership or use requirement because of a change in employment, health, or "unforeseen circumstances" such as death, divorce or multiple births from the same pregnancy, the maximum allowable exclusion may be prorated, not the realized gain. With proper planning, a certain portion of the gain from the sale of a vacation home that is converted to a principal residence can qualify for this exclusion. In determining the gain, be aware that the basis of the property may need to be adjusted depending upon certain factors such as the death of a spouse/co-owner.

The Internal Revenue Service privately ruled that divorced or separated spouses will each be able to exclude up to $250,000 of gain on the sale of a jointly owned residence if either spouse has used the home as a principal residence for two of the previous five years before the sale. To utilize this, the spouse who lived in the residence must have been granted the use of the property under a court decree.

Points charged by a lender and paid by the seller of a principal residence are treated as having been paid by the buyer and, as a result, are deductible by the buyer. However, in computing the buyer's basis the purchase price of the principal residence must be reduced by the payment of the points.

DEPRECIATION

Qualified property placed in service before January 1, 2012 continues to be eligible for 100% bonus depreciation. For qualified property placed in service after December 31, 2011, the bonus depreciation rate is scheduled to drop to 50%. Please contact us for more specific details.

The maximum dollar amount that may be deducted under I.R.C. Section 179 for qualifying property placed in service in the year 2011 is $500,000. The deduction is reduced by the amount by which the cost of qualified property placed in service exceeds $2,000,000. These amounts are scheduled to be reduced significantly in 2012.

The maximum Section 179 expense for larger SUVs purchased for use in a trade or business in 2011 is $25,000. This covers SUVs with gross vehicle weights in excess of 6,000 pounds.

With respect to automobiles and light trucks or vans purchased for use in a trade or business there are limitations in the amount of depreciation that may be deducted annually. These rules apply to vehicles that have a gross vehicle weight of 6,000 pounds or less. However, light trucks or vans that have been modified in such a way that the opportunities for personal use are limited are not subject to those limitations.

INTERNAL REVENUE SERVICE MILEAGE RATE ALLOWANCES

The optional standard rate for the business use of an automobile is 51 cents per mile through June 30, 2011 and 55.5 cents per mile for the final six months of 2011. This rate is used as an alternative to deducting the actual automobile expenses. It is also used to determine the reimbursement for employees who use their personal automobile for business purposes.

The standard rate for use of your automobile for medical purposes or for computing deductible moving expenses is 19 cents per mile through June 30, 2011 and 23.5 cents per mile for the final six months of 2011.

The standard rate for use of your automobile for charitable purposes is currently 14 cents per mile.

HEALTH INSURANCE

The new health insurance legislation was signed into law in 2010 creating new employer and individual responsibilities, taxes and incentives for health insurance coverage including broadening the Medicare tax base for higher income taxpayers, increasing the medical deduction threshold and establishing a small employer health insurance tax credit. Certain tax provisions took effect in 2010 while other changes are not scheduled to take effect until 2013, 2014 or 2018. Please contact us to discuss this in more detail.

Subject to certain limitations a self-employed individual's above-the-line deduction for health insurance costs is 100% of eligible expenses. Medicare Part B and Part D premiums are included in health insurance costs for this purpose. Also, for the year 2011, that same deduction can be used to reduce self-employment income in computing the self-employment tax.

TAX EXEMPT INTEREST REPORTING

The law requires that any person who is required to file an income tax return must report on such return the amount of tax exempt interest received or accrued during the taxable year. Moreover, the law pertaining to the AMT requires a separate listing of interest income on all “nonessential function municipal bonds” which the taxpayer holds, if they were issued after August 7, 1986.

Your securities broker should be able to tell you which of your bonds represent “nonessential function municipal bonds”.

Thus, we will need such listing, if applicable, for the complete preparation of your tax returns.

HOUSEHOLD EMPLOYERS

Anyone who employs household workers may need to apply for an Employer Identification Number (EIN) (separate and distinct from a social security number) with the Internal Revenue Service. Please call us and we will be happy to provide this service for you or direct you to the proper website.

In addition, individuals who employ only household workers are able to report social security tax, federal unemployment tax and any agreed upon federal income tax withholding annually on their own U.S. Individual Income Tax Return and pay those amounts in a lump sum. If you currently employ household workers or are contemplating hiring household workers, please contact us to discuss this in more detail.

The new Pennsylvania law that requires employers to withhold local earned income tax from their employees' wages does <u>not</u> apply to household workers.

INDEPENDENT CONTRACTOR VS. EMPLOYEE

Owing to the complexity of the tax laws dealing with the distinctions between independent contractors and employees we ask that you notify us before entering into arrangements where there may be questions as to independent contractor or employee status.

INVESTMENT CONSIDERATIONS

Although an individual's investment philosophy should not be dictated exclusively by income tax considerations we offer the following points:

1. Tax exempt investments such as municipal bonds may have a greater after-tax yield than a taxable investment such as a corporate bond. Be aware, though, that interest from certain municipal bonds could trigger or increase the AMT.

   With respect to private activity municipal bond interest you may be able to realize a higher rate of return without any adverse AMT consequences.

2. As a result of a maximum 15% tax rate for most long-term capital gains and for dividends paid by domestic corporations and qualified foreign corporations it is an appropriate time to examine the allocation of your current investments between taxable accounts and tax deferred accounts. Due to the disparities between this 15% tax rate and higher ordinary income tax rates, one school of thought suggests that investments paying qualified dividends or generating long-term capital gains be held in taxable accounts while investments earning interest income or instruments generating short-term capital gains be held in tax deferred accounts. It should be noted, however, that the reduction in tax rates for long-term capital gains and dividends is currently scheduled to expire at the end of 2012.

3. Certain financial planning strategies, such as annuities, may convert capital gain income into ordinary income. The tax deferral aspect will offset this to at least some extent, but careful consideration should be given to this before any long-term commitments are made. Insurance features and expenses of the annuities should also be examined.

4. If you purchased a zero-coupon bond and it is not held in a tax-deferred account such as an IRA, you must include the accrued interest in your taxable income on an annual basis. This is true even though the interest is not paid to you until the bond reaches maturity. As a result, current taxable income is not reduced by investing in a zero-coupon bond.

Any changes in investment philosophy must consider risks associated with volatility of capital and transaction costs. You should discuss these ideas with your investment advisor since each individual's situation is unique.

In any case, one's ultimate asset allocation must be determined by several factors, with arguably the most important being the comfort level of the individual investor with respect to risk tolerance. No one can put a price on one's ability to sleep at night!

The importance of fund expenses is significant for almost any investment in mutual funds be they stock, bond, cash reserves, etc. Due to compounding, a 1% difference in expense ratios can mean thousands, if not tens of thousands of dollars or more, over the life of an investment. Since all funds are required to disclose their expense ratios this is a very simple factor to incorporate into your investment decision.

RETIREMENT PLAN ISSUES

Many different rules and options are applicable with respect to retirement plan distributions. These can be summarized by the saying there are potentially penalties on distributions that are "too soon, too late, or too little". Please contact us to discuss any of the following that may apply to you.

Certain pension distributions or, more importantly, rollovers, could be subject to a mandatory 20% federal withholding tax rate unless specific rules are followed. Please contact us to discuss this prior to making any arrangements for the distribution or transfer of funds.

The maximum elective deferral for an employee to a 401(k) plan is $16,500 for the year 2011 and $17,000 for the year 2012. The maximum for individuals at least 50 years of age is $22,000 for the year 2011 and $22,500 for the year 2012. Self-employed individuals can potentially contribute higher amounts.

Businesses can now offer Roth 401(k) plans. Rules for these plans are similar to those for Roth IRAs. Contributions are made with after tax dollars and, thus, do not reduce taxable income. Distributions, including earnings, are tax free as long as certain

conditions are met. Unlike Roth IRAs, no income limitations apply to contributions to Roth 401(k)s. However, contributions must satisfy nondiscrimination rules which may limit the amounts that upper income individuals can contribute. Distributions from Roth 401(k)s will generally have to be made upon reaching the age of 70 ½, unlike Roth IRAs, which do not require mandatory distributions.

The maximum contribution to IRAs is $5,000 for the years 2011 and 2012. The maximum contribution for individuals at least 50 years of age is $6,000 for the years 2011 and 2012.

It may be more beneficial to make contributions to a Roth IRA instead of a regular IRA. The Roth IRA will not yield current tax deductions but distributions can be tax-free. Generally speaking if your tax bracket will be the same or higher upon retirement the Roth IRA may be more advantageous. However, even if your tax bracket will be lower upon retirement and you have 15 to 20 years until retirement the Roth IRA may still be better.

There are adjusted gross income limitations which may reduce or eliminate the ability to utilize a regular IRA or a Roth IRA.

In addition, you can convert all, or part, of your regular IRA to a Roth IRA regardless of the amount of your adjusted gross income. You will have to pay federal income taxes on previous tax deductible contributions plus all of the IRA's earnings. Whether this is advantageous is dependent upon certain factors including the tax bracket you are in and the source of funds used to pay the additional income tax. This could be beneficial for individuals, especially children, who have been contributing to their IRA and will be in a low tax bracket for the next few years. After converting, future distributions from the Roth IRA will be tax-free, provided the account has been open for five years and certain other criteria are met. This could be especially beneficial if one's tax bracket is at least as high when taking distributions as it is upon conversion. Even if you do not currently have an IRA and are not eligible to make deductible contributions it may be beneficial to contribute to a non-deductible IRA for the year 2011 and then convert it to a Roth IRA in 2011. The tax treatment of the rollover will differ depending upon whether the regular IRA has been funded with deductible or non-deductible contributions.

A conversion from a regular IRA to a Roth IRA could also be beneficial for a taxpayer who incurs a Net Operating Loss (NOL) in a given year. An NOL presents an opportunity to make the conversion tax-free.

Non-spousal beneficiaries may transfer inherited assets from certain employer sponsored retirement plans directly to an inherited IRA. This allows the beneficiary to spread out future distributions over his/her lifetime.

In addition to the exceptions to the 10% tax on early distributions from qualified retirement plans, distributions from a traditional IRA prior to the age of 59-1/2 will not be subject to the 10% tax if the amounts are used to pay for qualified higher education expenses, or to pay up to the first $10,000 of qualified first-time home buying expenses. Individuals under the age of 59-1/2 who pay medical expenses with funds withdrawn from an IRA or other retirement plan are generally not subject to the 10% penalty for early distributions. However, a Tax Court Decision found that the distributions would be subject to the penalty if the medical expenses were not paid in the year the withdrawals were made.

Individuals who have retirement plan assets invested in illiquid assets such as limited partnerships, tangible assets, etc may have some difficulty when they are required to begin taking distributions. Determining the fair market value (FMV) of limited partnership interests in your IRA can prove to be particularly difficult. This can pose a problem when one must begin taking required distributions upon reaching the age of 70-1/2. In order to calculate the correct required distribution an accurate FMV of all retirement accounts is necessary. If an incorrect FMV is used for a partnership interest it would result in an incorrect distribution. Severe penalties can be assessed when required distributions are less than they should be. The Internal Revenue Service requires IRA custodians to report the fair market value of investments they hold. It is not enough for the custodian to indicate "NA" (not available) or by listing the purchase price. However, many do not comply with the rules since they are not strictly enforced. If you hold limited partnership interests in your IRA please contact us for guidance.

If your retirement account includes shares of your employer's stock it may be to your advantage to have that stock distributed directly to you instead of rolling it into your Individual Retirement Account. If this applies to you please contact us before any distributions or rollovers are made.

We cannot stress enough how important it is that the named beneficiaries of your retirement plans be kept current. Changes in marital status, death of a spouse, birth of children or grandchildren, etc. are all events that should prompt a review of your particular circumstances.

One type of retirement plan is a "Defined Benefit Keogh Plan". As one could infer from the name the contributions to the plan are computed with a targeted *benefit* in mind. The number of taxpayers who could benefit from this type of plan has greatly increased. Generally, anyone over 45 years of age who has net income from self-employment with few or no employees should discuss this possibility with us.

Example:

A sixty-five-year-old individual has net income from self-employment of $245,000 and has no employees. His estimated retirement age is seventy. The taxpayer would be

able to contribute and deduct the entire $245,000 to the defined *benefit* Keogh as opposed to approximately $49,000 ($54,500 if at least 50 years of age) to a defined *contribution* plan.

If this is of interest to you for the 2011 tax year, please contact us immediately, as the Defined Benefit plan must be established by December 31, 2011.

ESTATE PLANNING

The estate tax was retroactively revived for 2010 with a 5 million exemption and a 35% top tax rate. The exemption and tax rates are scheduled to remain the same through 2012. Without further legislation, the exemption would fall to 1 million and the top tax rate would increase to 55% which was the law in effect before 2001. Reports indicate that is unlikely to happen and that the current rules will be extended.

Along with the return of the estate tax was an increase in the lifetime gift tax exemption from 1 million to 5 million for 2011 and 2012. Enough emphasis cannot be placed on the enormous long-term ramifications of proper estate planning techniques such as taking advantage of the $13,000 per donee yearly gift exclusion. This gifting, which is usually, but not limited to, gifts to heirs can dramatically increase the amount of accumulated lifetime wealth that is transferred gift and estate tax free. Family gifting is just one of the many techniques used to maximize wealth transfer. Married individuals should pay particular attention to the titling of their assets in order to maximize the benefit of each individual's lifetime estate exemption.

Many wills/estate plans contain language that provide for beneficiaries other than the surviving spouse to receive an amount equal to the available lifetime exemption with the remainder of the estate going to the surviving spouse. This language should be reviewed to ensure that beneficiaries other than your surviving spouse do not receive more than you intended and, depending upon the size of your estate, unknowingly leave your surviving spouse with nothing.

Certain legitimate arrangements such as family limited partnerships, irrevocable life insurance trusts, credit shelter trusts and charitable remainder trusts can be effective estate planning vehicles. They basically transfer assets from the grantor to a trust for the benefit of a beneficiary. However, the Internal Revenue Service is aggressively pursuing arrangements referred to as "abusive trusts". These are trusts that are formed for no other purpose than to shield income and assets of a taxpayer from the government. Legitimate trusts adhere to established principles of tax law which places the responsibility for taxes on property on the person or entity that controls the property. Be extremely cautious of anyone who claims that you can maintain control of your assets in a trust while not paying tax on income from the trust.

The IRS has given its approval to the use of an intentionally defective grantor trust. The grantor is taxed on the income from the trust since he retains minor control over the trust. However, the control is not enough to include the trust assets in the grantor's estate in the majority of cases. Nor is the payment of income tax by the grantor considered to be a gift to the beneficiaries.

The unlimited marital deduction, which allows you to leave your assets to your husband or wife without paying any federal estate tax, does not apply to spouses who are not United States citizens.

There is a time limit on the Internal Revenue Service's ability to question the value of non-monetary gifts. However, the three year statute of limitations only begins to run once a proper gift tax return is filed. As a result, it may be wise to file gift tax returns for non-monetary gifts such as jewelry, real estate or art where a valuation might be questioned even if the value reported is under the annual exclusion amount. If you have any questions about this please contact us.

Owing to the complexities of estate planning we urge you to contact your estate attorney to ensure that your planning is appropriate. If you do not have an attorney to handle your estate planning, we would be happy to recommend one to you.

SOCIAL SECURITY INFORMATION

What's the best age to begin collecting Social Security benefits? Many factors need to be considered before answering this question. If you are approaching the time when you will be eligible for social security please contact us so we can explain the various options and help determine what is best for you.

There is no earnings limit for individuals beginning with the month in which they reach normal retirement age. This means that social security benefits will not be reduced for those individuals regardless of how much earned income they receive after reaching that age. However, benefits will be reduced for social security recipients who have not reached normal retirement age and received earned income above certain levels. Normal retirement age is determined by your year at birth.

Under current Social Security law, normal retirement age is 66 for those individuals who turn 62 in the year 2011. Full benefit retirement age will be gradually increased to age 67 for those born in 1960 and later.

The ultimate benefits which people will receive from the Social Security system are based largely upon the recipients' earnings during their working years. The government

keeps track of such earnings as they are reported on tax returns and information statements (Forms W-2, etc.). In prior years you received statements annually from the SSA that you could review to determine if your earnings have been recorded correctly. The SSA suspended mailings of those statements in 2011 but is currently considering resuming the mailings as well as making them available online. Hopefully, this will occur early in 2012.

If you have any questions regarding social security please contact us or access the social security website at ssa.gov.

LONG-TERM CARE INSURANCE POLICIES

Statistics indicate that a significant portion of the population will require long-term care during their lifetime. As a result, consideration should be given to the merits of purchasing a long-term care insurance policy to cover some, or all, of the anticipated costs. The decision to purchase a policy depends on one's own particular financial situation. Please contact us to discuss this further.

Current law provides for the treatment of eligible long-term care insurance premiums as medical expenses as long as the policies meet the federal eligibility standards. However, certain states have eligibility standards that are more permissive than the federal standards. This issue should be discussed with your insurance professional. The portion of the premiums that may be deductible as medical expenses is determined by the age of the policy owner.

Eligible premiums for both long-term care policies currently in effect and long-term care policies issued before December 31, 1996 will be treated as medical expenses even if the policies do not meet the federal standards.

DISABILITY INSURANCE

The Internal Revenue Code states that long-term disability benefits received by an employee under company-sponsored disability plans **are tax free only if the employee paid the premiums with after tax dollars.** Otherwise, the benefit payments are fully taxable. If you would like more information about this please contact our office.

EDUCATION PLANNING

Prepaid tuition plans and college savings plans (Code Section 529 Plans) provide parents, grandparents, etc. with the ability to prepay their children's, grandchildren's, etc. future tuition costs while, at the same time, retaining control over distribution decisions and the power to revoke the account, even though the account's value is shifted from the owner's estate to the beneficiary's. Contributions to these plans are considered gifts qualifying for the annual gift tax exclusion. A special election allows the contribution to be treated as if it were made over five years. This provision would enable a $65,000 ($130,000 for a married couple) contribution per donee (subject to state limits) to be covered by 5 years of annual exclusions. Generally, there are no income limitations or age restrictions in determining who is eligible to use these plans. Typically, distributions made from these plans are excludable from gross income to the extent that the distributions are used to pay for qualified higher education expenses. If you are interested in exploring this area please contact us, or, you may visit certain popular websites such as savingforcollege.com and tap529.com.

Pennsylvania residents are allowed a deduction on their Pennsylvania income tax return for contributions to Section 529 Plans sponsored by any state. The maximum deduction is $13,000 per contributor, per child. In addition, Pennsylvania no longer taxes the earnings from out-of-state 529 Plans.

The annual limit on contributions to Coverdell Education Savings Accounts (formerly called an "education IRA") is $2,000. The definition of qualified education expenses that may be paid tax-free from an education IRA includes elementary and secondary school expenses.

Tuition payments made directly to a "qualifying educational organization" by an individual on behalf of another individual are excluded from gift tax implications. This unlimited exclusion is in addition to the annual exclusion allowed for gifts. Also, a private letter ruling by the Internal Revenue Service stated that multi-year prepayments of tuition for the taxpayer's grandchildren would not be considered a gift. It stated that all payments would be "nonrefundable" and, once paid, would become the school's "sole property". Although the ruling only applies to the particular circumstances addressed in the ruling it does offer the IRS's current thinking on the subject. This might be an option for elderly or ill individuals to consider if they are concerned about surviving their grandchildren's years of schooling.

The Internal Revenue Code provides for penalty-free (but not tax-free) distributions from non-education IRAs to pay for higher education expenses. We would caution you to explore other options for financing education expenses before taking any distributions from your IRA. These options include paying the expenses from personal non-

retirement plan assets or a home equity loan. If you would like to discuss this area in more detail please contact us.

Various strategies exist which may facilitate the funding of future college education costs. Some of the more notable are zero coupon bonds, U.S. Savings Bonds, growth stocks and mutual funds and transfers under "The Uniform Gift to Minors Act". There may be "kiddie tax" implications so we would urge you to contact us regarding your specific situation.

DISASTER VICTIMS

If you incurred losses in 2011 from certain disasters you may be able to claim a casualty loss deduction. Please contact us to discuss this further.

MAILING OF TAX RELATED DOCUMENTS

An Appeals Court decision points out the importance of obtaining proof of filing for any tax related documents. A couple filed their return shortly before the statute of limitation period expired without proof of filing. The return reflected a refund due. A few months later they contacted the IRS about the refund and were told that their return had not been received. Since the statute had expired by then, the IRS denied the refund. The Court held that the taxpayer has to prove that the return was mailed on time.

Receipts for documents delivered by private delivery services constitute proof of timely filing so long as the delivery service meets certain criteria as established by the Internal Revenue Service. Please contact our office if you have a question about a particular delivery service. The rule stating that impressions (stamps) made by postage meters are <u>not acceptable proof of timely mailing by the Internal Revenue Service and other taxing agencies</u> remains unchanged.

Thus, we recommend that postage meters **NOT** be used in posting tax returns.

Our first choice is hand delivery to the taxing agency with a written acknowledgement obtained from the recipient of the document.

Our second choice is U.S. Postal Service certified mail, return receipt requested.

Our third choice is a designated private delivery service with appropriate documentation.

ALERT

Beware of scamsters preying on taxpayers who have not received their refunds. They send bogus e-mails attempting to obtain financial information that can be used to access their accounts. If you are trying to find out information about your refund go to the IRS website at irs.gov and use the “Where’s My Refund?” feature.

A FEW NOTES ABOUT OUR FIRM

FINANCIAL PLANNING

We offer both general and specific financial planning. In the general sense, we coordinate income tax, investment, estate, retirement and risk management (insurance) planning. In the specific sense, we can help you establish a plan based upon certain specific goals. Examples include retirement planning and the effects of different levels of living expenses and rates of returns on invested assets, education planning for children and maximizing funding of tax deferred vehicles in conjunction with other goals. Although we do not offer advice on specific investments, we do have access to Internet and other electronic and paper research which many clients have found to be very useful in researching an investment or product.

If you are interested in communicating with our firm via E-mail we have included for your convenience the following list of addresses for those individuals you would most likely need to contact:

Artie DeSisto	-	desisto@djspc.com
Jim Jones	-	jones@djspc.com
Christine Miron	-	miron@djspc.com
Don Schneeberger	-	schnee@djspc.com
Bill Shaw	-	shaw@djspc.com

NOTARY PUBLIC SERVICES

A member of our staff is a notary public. If you are ever in need of these services please contact us and we will be happy to make the necessary arrangements.