

STERLING FINANCIAL GROUP

YEAR-END TAX PLANNING LETTER 2011

INDIVIDUAL TAX PLANNING

Charitable Donations

Normally, you can deduct the full amount of your cash contributions to charity, as long as you obtain the proper substantiation. Furthermore, you may be able to deduct the fair-market value of donated property that has appreciated in value if you have owned the property longer than one year.

Year-end action: Complete donations before January 1, 2012, to increase your deduction for 2011. If you make a charitable gift by credit card and the charge is posted by December 31, 2011, it is currently deductible, even if you actually pay off the charge in 2012.

Tip: Deductions for donations of used clothing and other household items are generally available only if those items are in “good condition.”

Donation from an IRA: If you are over 70 ½ and taking Required Minimum Distributions from an IRA, you may be able to donate your IRA withdrawal to a qualified charity of your choice. For 2011 only you may be able to donate up to \$100,000 tax free from an IRA. This withdrawal from IRA/donation to charity will not be treated as taxable income by the IRS. Withdrawals from IRAs typically are taxable income. This may be especially attractive to you if you are required to take a minimum distribution, don’t need the income, and were planning on donating to a charity anyways. Note that such a donation must be made directly to the charity from the IRA.

Alternative Minimum Tax

The alternative minimum tax (AMT) is triggered if a special calculation involving certain “tax preference items,” technical adjustments and a special exemption amount exceeds your regular income tax liability. The AMT rate is 26% on AMT income up to \$175,000; 28% above \$175,000. The exemption amounts for 2011, increased slightly from 2010, are as follows:

Joint filers	\$74,450
Single filers	\$48,450
Marrieds filing separately	\$37,225

Year-end action: Have an estimate made of your AMT liability for 2011. If warranted, you might shift tax preference items to 2012 to avoid or reduce expected AMT liability for this year.

Tip: The exemption amounts are reduced for high-income taxpayers. The reduction is equal to 25 cents for each dollar of AMT income above \$150,000 for joint filers; \$112,500 for single filers; and \$75,000 for marrieds filing separately. These thresholds are not adjusted annually.

Residential Energy Credit

The tax law provides a 10% tax credit, up to a maximum of \$500, for certain energy-saving installations in the home. The list of qualified expenses ranges from insulation to energy-efficient central air conditioning units and furnaces. Previously, a maximum credit of \$1,500 was allowed for 2009 and 2010.

Year-end action: Make energy-saving improvements before January 1, 2012. Unless this tax break is extended again by Congress, it will expire on December 31, 2011.

Tip: The maximum \$500 credit must be reduced by any credits claimed under the prior rules in 2009 and 2010.

Estimated Tax Payments

If you do not pay enough income tax through quarterly installments or income tax withholding, you may be assessed an “estimated tax penalty.” But no penalty applies if payments equal at least 90% of your current liability or 100% of the prior year’s tax liability. The 100% threshold is increased to 110% if your adjusted gross income (AGI) for last year exceeded \$150,000.

Year-end action: Qualify under either one of these safe harbor rules. Typically, it is easier to meet the requirement based on the prior year’s tax liability.

Tip: If you are employed and increase withholding after clearing the Social Security wage base (\$106,800 for 2011), there will be little or no reduction in your take-home pay.

Miscellaneous Tax Benefits

*The tax law allows you to deduct annual unreimbursed medical expenses only in excess of 7.5% of your AGI for 2011 (scheduled to increase to 10% in 2013). If you are close to the 7.5% mark or already over it, schedule non-emergency medical and dental visits before the end of the year.

*For 2011, you can generally claim a dependency exemption of \$3,700 for a child younger than age 19 or a full-time student younger than age 24 if you provide more than 50% of the child’s support. To secure an exemption in 2011 for a child, make sure your support clears the 50% mark this year.

*Miscellaneous expenses are deductible only to the extent that the annual total exceeds 2% of your AGI. When it is warranted, pay qualified expenses (e.g., tax assistance fees) before the end of the year to maximize your deduction for 2011.

*Under the “kiddie tax,” investment income in excess of \$1,900 received in 2011 by a child younger than age 19 or a full-time student younger than age 24 is generally taxed at the top tax rate of the parents. Try to minimize or avoid the kiddie tax through tax-deferred or tax-free investments.

*Depending on your situation, you might pay state and local taxes due on January 1, 2012, in December to increase your deduction for 2011.

*If you are a parent of a child in college, you may claim a tuition deduction or one of two higher education credits for qualified expenses paid in 2011. However, these tax benefits are phased out for high-income taxpayers.

FINANCIAL TAX PLANNING

Securities Sales

Tax-smart investors can use capital losses from securities sales to offset capital gains and vice versa. A capital loss in 2011 may offset capital gains plus up to \$3,000 of ordinary income. Any remainder is carried over to next year. Under current law, the maximum tax rate on long-term capital gains (i.e., on assets owned for more than a year) is 15% and 0% for certain low-income taxpayers.

Year-end action: When it makes sense, “harvest” losses from securities sales before 2012 to avoid tax if you are currently showing a net capital gain. Conversely, if you are showing a net capital loss, capital gains realized before 2012 are effectively tax-free up to the amount of the loss.

Tip: The 15% and 0% maximum tax rates for long-term capital gains are scheduled to increase to 20% and 10%, respectively, in 2013. But this may be changed by future legislation.

Required Minimum Distributions

As a general rule, you must receive “required minimum distributions” (RMDs) from qualified retirement plans and IRAs once you have reached age 70½. The amount of the distribution is based on special life expectancy tables.

Year-end action: Make sure you take the RMD before January 1, 2012. If you fail to do so, you may be assessed a penalty equal to 50% of the required amount.

Tip: If you are still working and not a 5%-or-more owner of the employer, you can postpone RMDs from the employer’s qualified plan until retirement, but not for any IRAs.

Estate and Gift Taxes

During the last decade, the top estate-tax rate gradually decreased from 55% to 45% while the estate-tax exemption increased from \$1 million to \$3.5 million, before the estate tax was generally repealed for 2010. Now a generous estate-tax exemption of \$5 million, with a top estate-tax rate of 35%, is available through 2012. The chart below summarizes the recent progression.

Tax year	Top estate-tax rate	Estate-tax exemption
2009	45%	\$3.5 million
2010	Repealed	Not applicable
2011	35%	\$5 million

Year-end action: Review your estate plan with a professional adviser. Frequently, it will make sense to reduce your taxable estate with lifetime gifts to family members. The annual gift-tax exclusion allows you to give each recipient up to \$13,000 in 2011 without paying any gift tax (\$26,000 for joint gifts by a married couple).

Tip: The gift-tax exclusion applies annually. Therefore, you can give the maximum tax-free gift to someone in December 2011 and give the maximum to the same person in January 2012.

Miscellaneous Tax Benefits

*Under the “wash sale rule,” you cannot deduct a loss on securities sales if you acquire substantially identical securities within 30 days. The simplest way to avoid this result is to wait at least 31 days before you repurchase the same or similar securities.

*Maximize deductions for vacation home rentals. Generally, you may claim a loss only if your personal use does not exceed the greater of 10% of the time the home is rented out or 14 days. However, you may qualify for loss deductions if you are an “active participant” in the rental activity. This tax break is phased out for high-income taxpayers.

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if major tax reform provisions are enacted before the end of the year.

Finally, remember that the letter is intended only as a general guideline. Your personal circumstances will likely require greater examination. We will be glad to schedule a meeting with you to provide assistance with your tax-planning needs.

This year-end planning letter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered. IRS Circular 230 requires us to inform you that the information contained in this letter is not intended or written to be used for the purpose of avoiding any penalties that may be imposed under federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. Before any action is taken based on this information, it is essential that competent, individual, professional advice be obtained.