



Zhang CPA Group LLC

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2012 Year-End Tax Planning

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NEWSLETTER
JANUARY 2013

2012 Year-End Tax Planning

Year-end tax planning in 2012 is one of the most challenging in recent memory. There are many changes in tax, such as income tax rates, capital gains/dividends, Medicare tax rate, alternative minimum tax, education, estate & gift tax, business planning, and health care, etc.

Individual Planning

Several unique tax-rates-factors make 2012 year-end tax planning complicated. 1) Planning must account for the possibility of the expiring Bush-era income tax rates to move in one of four directions. 2) The same four scenarios must be considered in connection with sun-setting Bush-era rates on capital gains and dividends. 3) Investors in the higher tax brackets must plan for the 3.8% Medicare contribution tax on investment income that starts in 2013. 4) High-income wage earners must also contend with 0.9% additional Medicare tax that starts in 2013. 5) The 2012 payroll tax holiday is scheduled to expire after December 31, 2012.



3.8% Medicare Contribution Tax

One of the most important new changes for year-end tax planning in 2012 is the 3.8% “unearned income Medicare contribution” tax on higher-income individuals, estates and trusts. It will take effect on 1/1/2013 immediately. The Medicare surtax also will apply to capital gains from the disposition of property. It will not apply to income derived from a trade or business, or from the sale of property used in a trade or business. For individuals, it apply to the lesser of the taxpayer’s NII or the amount of “modified” AGI.

Specified Thresholds

The new AGI thresholds are:

- \$250,000 for married taxpayers filing jointly or a surviving spouse;
- \$125,000 for married taxpayers filing separately; and
- \$200,000 for single and head of household taxpayers.

Estates and Trusts

For an estate or trust, the Medicare surtax applies to the lesser of undistributed net investment income for the year, or the amount of AGI that exceeds the dollar amount at which the higher tax rate bracket begins for estates and trusts (estimated at \$11,950 for 2013).

Net Investment Income

NII for purposes of the 3.8% Medicare surtax includes:

- 1) Gross Income from interest, dividends, annuities, royalties, and rents, provided this income is not derived in the ordinary course of an active trade or business;
- 2) Gross income from a trade or business that is a passive activity;
- 3) Gross income from a trade or business of trading in financial instruments or commodities; and
- 4) Net gain from the disposition of property, other than property held in an active trade or business.

Exclusions from Tax

The 3.8% Medicare surtax does not apply to nonresident aliens, corporations, trusts whose interests all are devoted





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ed to charitable purposes, charitable trusts under Code Sec. 501, and charitable remainder trusts under Code Sec. 664.

Additional 0.9% Medicare Tax

Effective Jan. 1, 2013, higher income individuals will be subject to an additional 0.9% HI (Medicare) Tax.



End of Payroll Tax Holiday?

For the past two years, the employer-share of OASDI taxes has been reduced from 6.2% to 4.2%. Under current law, the reduction is scheduled to expire after December 31, 2012. On January 1, 2013, the employee-share of OASDI taxes will revert to 6.2%; effectively increasing payroll taxes across-the-board.

Personal Exemption/Itemized Deduction Phaseouts

Effective Jan. 1, 2013, higher income taxpayers may be subject to the return of the personal exemption phaseout (PEP) and the so-called Pease limitation on itemized deductions. PEP and the Pease limitation could return for the 2013 tax year, which would be reflected on returns filed in 2014. Return of the Pease limitation on itemized deductions would reduce itemized deductions by the lesser of : 1) 3% of the amount of the taxpayer's AGI in excess of a threshold inflation-adjusted amount projected for 2013 to be \$178,150 (\$89,075 for a married individual filing separately), or 2) 80% of the itemized deductions otherwise allowable for the tax year.

Child Tax Credit

Taxpayers who claim the child tax credit need to plan for its scheduled reduction after 2012. The child tax credit, at \$1,000 per eligible child for 2012, will be \$500 per eligible child, effective Jan. 1, 2013.

State and Local Sales Tax Deduction

Before 2012, qualified taxpayers could deduct state and local general sales taxes in lieu of deducting state and local income taxes. Unless extended, the deduction for state and local general sales taxes will not be available for the tax year 2012 and beyond.

Work Opportunity Tax Credit

Under current law, the WOTC is not available for 2012 except for the target group applicable to qualified veterans. The WOTC for qualified veterans can be as high as \$9,600.

Itemized Deduction for Medicare Expense

After Dec. 31, 2012, taxpayers who itemize deductions may claim an itemized deduction for qualified unreimbursed medical expenses to the extent the expenses exceed 10% of AGI.

Student Loan Interest Deduction

Individual taxpayers with MAGI below \$75,000 (\$150,000 for married couples filing a joint return) may be eligible to deduct interest paid on qualified



education loans up to a maximum deduction of \$2,500, subject to income phase out rules. The enhanced treatment for the student loan interest deduction is scheduled to expire after 2012.

If you have any questions, please don't hesitate to call. We are at your service.