

2011/12 Tax Guide

Financial Fitness Special Edition

■ A KFMR publication designed to help businesses and individuals improve their financial position.

■ Special Edition

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It's Not Too Late to Make Major Gifts

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Few people need to worry about federal estate tax or the federal gift tax in today's environment. For deaths in 2011, everyone has a lifetime gift and estate tax exemption of \$5 million, which means being able to leave or give away up to \$5 million without owing any federal estate tax. Married couples can leave or give away up to \$10 million. For 2012 deaths, the individual lifetime exemption amount is increasing to \$5.12 million per person.

For people who think their estate might owe estate tax, one way to avoid or reduce the tax bill is to give away property during their lifetime. Even for those who aren't concerned about estate taxes, gifts offer intangible benefits such as getting to see recipients enjoy the gifts.

In 2011 and 2012, any individual can make an unlimited number of \$13,000 gifts of cash or other property completely tax-free. This is known as the annual exclusion and this rule is pretty straightforward. For example, if you give \$20,000 to someone, \$13,000 of the amount is exempt from gift tax, but the remaining \$7,000 is charged against the lifetime amount. Couples can combine their annual exclusions, meaning that they can give away property worth \$26,000 per year, per recipient using a technique known as gift-splitting. Even if only one spouse makes a gift, it can be considered to have been made by both spouses, if they both consent.

All gifts that are made to a spouse are tax-free, as long as he or she is a U.S. citizen. If a spouse isn't a citizen, the limit on tax-free gifts is \$136,000 in 2011 and \$139,000 in 2012.

To make the most of the annual exemption, bear in mind that it is based on a calendar year. If a year is missed, one can't go back and claim that year's exemption amount. Spreading a large gift over two or more years can have a better result. For example, if you give your child \$20,000 on December 17 and do not or cannot gift-split with your spouse, \$7,000 of the gift is charged against the lifetime amount and a Gift Tax Return will need to be filed by April 15 of the following year. But if you give your daughter \$10,000 in December and wait to hand over the other \$10,000 until January 1, both gifts qualify for the annual exclusion.

The \$5 million lifetime gift and estate tax exemption came about as a result of the tax changes that were passed in December 2010. The increase in the

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FATCA – Offshore Reporting Developments

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The IRS and Treasury have made a lot of progress in the last five years addressing tax evasion through the use of offshore accounts. Their newest tool is the Foreign Account Tax Compliance Act (“FATCA”). This act was part of the Hiring Incentives to Restore Employment Act (HIRE Act, P.L. 111-47) which was enacted on March 18, 2010.

A Bit of History

US taxpayers have been hiding income and assets overseas for years. The IRS has had little success in pursuing these individuals because overseas financial institutions were generally not required to report income to the IRS. Also, bank secrecy laws in local jurisdictions precluded some foreign financial institutions from providing information to taxing authorities. For decades, these jurisdictions were attractive havens for individuals wanting to hide money from spouses, business partners or the IRS.

The IRS had a bit of success in the late 90s and early 2000s with some John Doe summons and the Qualified Intermediary program; however, the 2008 UBS scandal changed the game. A UBS private banker, named Bradley Birkenfeld, came forward under the IRS’s whistleblower program in 2007 and details of UBS’s tactics for helping US taxpayers evade US tax became the stuff of legend. The Department of Justice pursued UBS on several fronts and in February 2009 UBS agreed to a deferred prosecution agreement of the criminal charges, a fine of \$780 million and, most importantly, the disclosure of an unknown number of accounts. This prompted the IRS to conduct a Voluntary Disclosure program in 2009 which motivated US taxpayers with offshore accounts to come forward and avoid criminal prosecution in exchange for hefty penalty and interest. The program netted 14,700 disclosures and ended in October 2009. Even though the program was successful, the IRS realized that they must do better at preventing US taxpayers from hiding income offshore.

FATCA is Born

The FATCA legislation affects two fronts: (1) increased foreign financial institution reporting and (2) increased individual disclosure.

For foreign financial institutions, the new law forces them to report material US ownership or accept a 30% withholding on a broad category of payments, and is

applicable to payments made after 12/31/2012. Foreign financial institutions that do not want to enter into agreements with the IRS will have their own receipts subject to the 30% withholding from participating foreign financial institutions. The rules regarding the registration, procedures and administration are still in process and are outside the scope of this article; however, the intent is to make it more difficult to hide assets offshore. The long term goal is to have substantially all financial institutions that want access to US capital participating in the system.

For individuals, the HIRE Act added §6038D to the Internal Revenue Code. This new section requires individuals holding specified foreign financial assets with an aggregate value exceeding \$50,000 for a tax year to attach to their return specific required information for each asset. For calendar year taxpayers, the vast majority of individuals, 2011 is the first reporting year. The definition of a specified foreign financial asset is broad, and some of the information required overlaps with other foreign bank account reporting. Reporting is done on Form 8938, which at this time is still in draft form. The penalties for failure to report specified foreign financial assets are steep and the statute of limitations may be extended in certain circumstances.

As mentioned above, the regulations are still evolving regarding the new law. However, the IRS has more weapons in its arsenal to pursue US taxpayers who attempt to avoid tax by moving money offshore.

Pennsylvania Act 32 Update

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The mandatory requirement of all employers who maintain a work site in PA to withhold earned income tax on behalf of all employees begins with the first payroll of 2012. Remember that the withholding is based on the greater of the resident Earned Income Tax (“EIT”) rate where the employee lives and the non-resident rate where they are employed.

In order to meet the Act 32 requirements employers should:

1. Register their businesses with their tax collection district.
2. Fill out the Residency Certification Form. This form must be filled out by the employer and employee and signed by the employee. The employer retains this form for their records.
3. Send withheld taxes for all employees to the appropriate tax collector on a timely basis.
4. Complete and submit the Annual Withholding Reconciliation Form to the appropriate tax collector within 30 days of the close of each calendar year.

The Department of Community and Economic Development’s web site (www.newpa.com) provides details on all requirements for employers and employees. If necessary, you can call 866-GO-NEWPA for additional assistance.

Working together and completing the necessary requirements will make the conversion process easier for all involved.

Additional information can be found by visiting KFMR’s Summer 2011 Financial Fitness (<http://kfmr.com/financial-fitness/summer-2011>).

Key Benefit Plan Limits for 2011

Maximum Annual Benefit for Defined Benefit Plan	
2012: \$200,000	2011: \$195,000
Maximum Annual Contribution for Defined Contribution Plan	
2012: \$50,000	2011: \$49,000
Highly Compensated Employee Definition (In General)	
2012: \$115,000	2011: \$110,000
SEP Compensation Minimum Amount	
2012: \$550	2011: \$550
SEP Nondiscrimination Compensation Amount	
2012: \$250,000	2011: \$245,000
401(k) Maximum Compensation Amount	
2012: \$250,000	2011: \$245,000
401(k) Maximum Exclusion (Deferrals/In General)	
2012: \$17,000	2011: \$16,500
IRA Deduction Limit (In General)	
2012: \$5,000	2011: \$5,000
SIMPLE Contribution Limit	
2012: \$11,500	2011: \$11,500
Catch-up Contributions (50 years of age and older)	
<i>Traditional and Roth IRAs</i>	
2012: \$1,000	2011: \$1,000
<i>SIMPLEs</i>	
2012: \$2,500	2011: \$2,500
<i>401(k), 403(b) and 457 Plans</i>	
2012: \$5,500	2011: \$5,500
Qualified Transportation Fringe Benefits	
<i>Commuter Highway Vehicle and Transit Pass</i>	
2012: \$125	2011: \$230
<i>Qualified Parking</i>	
2012: \$240	2011: \$230
Adoption Assistance Programs	
<i>Excludible Amount</i>	
2012: \$12,650	2011: \$13,360
<i>Phase Out Income Thresholds</i>	
<i>Phase Out Begins</i>	
2012: \$189,710	2011: \$185,210
<i>Phase Out Complete</i>	
2012: \$229,710	2011: \$225,210
Long-term Care Premiums Under Section 213	
<i>Age 40 or Less</i>	
2012: \$350	2011: \$340
<i>Age 41 to 50</i>	
2012: \$660	2011: \$640
<i>Age 51 to 60</i>	
2012: \$1,310	2011: \$1,270
<i>Age 61 to 70</i>	
2012: \$3,500	2011: \$3,390
<i>Age 71 or Older</i>	
2012: \$4,370	2011: \$4,240

Tax Notices

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Are you one of the millions of taxpayers that have received a tax notice in your mailbox? If so, first – CALM DOWN, and then read below for some helpful tips.

- Not all notices are bad news. Open the envelope and read over the details of the notice, do not ignore the notice.
- The worst thing you could do is to ignore a notice. Ignoring the notice will not make it go away. In most cases, the situation will deteriorate and prevent a potential “easy fix.” If payment is due, ignoring the notice could result in payroll garnishments or bank levies.
- Make note of the instructions included in the notice. Sometimes the notices do not require any response; other notices will provide a due date for your response with the required information.
- If the notice requires a response, the recommended procedure is to write a letter and include copies of any information that is relevant to the notice. Ensure that you keep a copy of all of the information that you send for your own records. You may also want to consider sending the information via certified mail to record that your information was received.
- Ask for an extension if the notice provides a due date and you cannot respond, for any reason, by the date provided. Most agencies will offer additional time for your response, but you must confirm that an extension is permissible.
- Review the details of the notice and compare the details to your records to determine if you agree with the changes presented in the notice.
- You may want to consider asking for assistance from a professional. A tax advisor or tax lawyer may be better at navigating the challenges that come with some notices. Depending on the situation, paying a profession may actually save you money.

Tax Updates for 2011 and/or 2012

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To understand the changes to the 2011 and/or 2012 tax code, one must review the changes that occurred in December 2010 with the passing of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, “2010 Tax Relief Act,” which extended more than 400 benefits that were created in the Bush-era under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) or the Jobs and Growth Tax Relief Act of 2003 (JGTRA). Most of the benefits were extended two years, but there are some that will expire at the end of 2011.

Scheduled to expire at the end of December 31, 2011

- 100% bonus depreciation switches to 50% for 2012 and expires totally for 2013. Bonus depreciation only applies to new assets.
- Code Sec. 179 expensing of up to \$500,000 with capital addition limitation of \$2,000,000. This will revert back to \$125,000/\$500,000
- Small Gain Business Stock Exclusion
- Highest exemption amounts for taxpayers subject to AMT.
- Tuition and fees deduction.
- Classroom expense deductions.
- Charitable contributions from the Required Minimum Distribution (RMD) of an IRA.
- Deduction of state and local sales taxes in place of state and local income taxes.
- Payroll Tax:
The 2010 Tax Relief Act created a tax cut for more than 155 million workers by reducing the employee share of the Social Security tax from 6.2% to 4.2% for wages up to \$106,800. As of today, the house and senate have not passed any extension of this payroll tax cut.

Scheduled to expire at the end of December 31, 2012

- Reversion of individual income tax rates to 2001 levels:
 - Income tax rate pre 2001 – 15% to 39.6%,
 - Current income tax rates – 10% to 35%
- Favorable tax rate on capital gains income – currently 0% and 15% and without an extension will be 10% and 20% for 2013.
- Dividend income rates – 15% currently back to ordinary income rates for 2013.

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1099 Reporting

Part of the Patient Protection and Affordable Care Act was going to require businesses to report payments to corporations in excess of \$600 on Form 1099-MISC. This has been repealed with Section 9006 of the Act.

Education Credits

- American Opportunity Tax Credit (“AOTC”) – extended thru December 31, 2012:

This is an enhancement on the Hope Credit and is for tax years beginning after December 31, 2008 and before January 1, 2013. The AOTC has increased income limitations of \$80,000 single and \$160,000 for joint. AOTC completely phases out for single individuals with modified AGI of \$90,000 and \$180,000 for married couples filing jointly.

The credit can be as much as \$2,500 with up to 40% of it being a refundable credit if the taxpayer’s tax liability is insufficient to offset the nonrefundable credit amount.

- Student Loan Interest Deduction – extended thru December 31, 2012:

After 2012 student loan interest will be deductible only if paid during the first 60 months, whether or not consecutive, that interest payments are required.

Average Itemized Deductions (Data based on Preliminary 2008 IRS Statistics)

The chart below provides the averages only for planning purposes and does not represent a suggested itemized deduction. In the event of an audit, itemized deductions may be investigated.

Adjusted Gross Income	Medical Expenses	Taxes	Interest	Charitable Contributions
\$15,000 to \$30,000	\$7,074	\$3,147	\$9,245	\$2,024
\$30,001 to \$50,000	\$6,153	\$3,830	\$9,055	\$2,189
\$50,001 to \$100,000	\$7,102	\$6,050	\$10,659	\$2,693
\$100,001 to \$200,000	\$9,269	\$10,798	\$13,734	\$3,757
\$200,001 to \$250,000	\$21,554	\$18,164	\$18,570	\$5,895
\$250,001 or more	\$37,143	\$50,267	\$27,865	\$20,930

Individual Income Tax Rates 2011

Married Filing Jointly or Qualifying Widow(er)	Single	Head of Household	Married Filing Separately	Tax Rate
\$0 to \$17,000	\$0 to \$8,500	\$0 to \$12,150	\$0 to \$8,500	10%
\$17,001 to \$69,000	\$8,501 to \$34,500	\$12,151 to \$46,250	\$8,501 to \$34,500	15%
\$69,001 to \$139,350	\$34,501 to \$83,600	\$46,251 to \$119,400	\$34,501 to \$69,675	25%
\$139,351 to \$212,300	\$83,601 to \$174,400	\$119,401 to \$193,350	\$69,676 to \$106,150	28%
\$212,301 to \$379,150	\$174,401 to \$379,150	\$193,351 to \$379,150	\$106,151 to \$189,575	33%
\$379,151 or more	\$379,151 or more	\$379,151 or more	\$189,576 or more	35%

Accounting Standards Updates

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The Financial Accounting Standards Board (FASB) issues multiple Accounting Standard Updates (ASU) every year. Below are summaries of important updates that may affect the financial reporting for your business.

Testing Goodwill for Impairment (ASU 2011-08)

The cost and complexity of performing the two-step goodwill impairment test has proved burdensome to some entities. The FASB has issued this update to simplify the impairment testing for goodwill. Entities will now be able to assess qualitative factors to determine whether impairment may exist. The entity will only be required to calculate the fair value of a reporting unit if it determined that it is more likely than not that the entity's fair value is less than its carrying value. The amendment is effective for periods ending after December 15, 2011. A related update (ASU 2010-28) addresses testing for goodwill impairment when the carrying value of a reporting unit is zero or negative. Entities may no longer assume that impairment does not exist due simply to the fact that the fair value of such a reporting unit is likely greater than zero, as qualitative indications of impairment may still exist. An entity should evaluate whether it is more likely than not that goodwill is impaired, and perform step two of the goodwill impairment test, if applicable. This amendment is also effective for periods ending after December 15, 2011.

Health Care Entities (ASU 2011-07)

In an effort to improve the transparency of a health care entity's net patient service revenue, and improve the comparability between these types of entities, the FASB has issued this update which changes the presentation of the provision for bad debts. Previously, the provision for bad debts would be included in the income statement as an operating expense. The new presentation will show the provision for bad debts as a direct reduction of patient service revenue. In addition, an enhanced disclosure concerning a health care entity's revenue recognition and bad debt accounting policies will be required. For nonpublic entities, the new presentation and disclosure requirements are effective for periods ending after December 15, 2012, with early adoption permitted.

Other Comprehensive Income (ASU 2011-05)

Currently, U.S. Generally Accepted Accounting Principles allows three methods for presenting other comprehensive income (OCI) in the financial statements: an entity may disclose (1) total comprehensive income (i.e. net income and OCI) as one continuous statement; (2) two separate, but consecutive statements; or (3) OCI as a part of the statement of changes in stockholders' equity. This amendment eliminates option three. In addition, reclassifications of items between OCI and net income will be required to be presented on the face of the financial statements. For nonpublic entities, these requirements are effective for periods ending after December 15, 2012, with early adoption permitted.

Putting Together Your Tax Information: The "Short List" for Businesses and Individuals

For smooth and thorough preparation of your tax returns, collect the following information for your accountant — and please be careful not to throw away any tax documents you get in the mail!

Businesses

- Year-end bank reconciliations.
- Year-end bank statements.
- Physical inventory records with costing, if applicable.
- W-3, W-2s and 940
- Year-end commercial loan statements.
- Invoices for new equipment purchases made during the year.
- Loan documents for new loans.
- List of bad debt write-offs.
- Broker statements, if the business has investments.

Individuals

- W-2s
- 1099s as follows:
 1. 1099-B, Proceeds from sale of stock.
 2. 1099-INT, Interest income.
 3. 1099-R, Pension distributions.
 4. 1099-G, Unemployment compensation.
 5. 1099-DIV, Dividend income.
 6. 1098, Mortgage interest expense.
- K-1s from other businesses.
- Contributions — cash and non-cash.
- Tax estimates — federal, state and local.
- Child/day care information.
- Medical expenses as follows:
 1. Health insurance premiums.
 2. Payments to doctors, dentists & hospitals.
 3. Prescription drug expenses.
- Miscellaneous deductions as follows:
 1. Safe deposit box fees.
 2. Investment expenses.
 3. Unreimbursed business expenses.
- Changes that occurred during the year, i.e., new baby, change in marital status, or purchase of new home.
- Settlement sheets from purchases and/or sales of property.

2012 Wage and Tax Facts Quick Reference Guide

FEDERAL

Minimum Wage
Effective 7/24/09..... \$7.25

Minimum Cash Wage
Tipped Employee \$2.13

Maximum Tip Credit
Effective 7/24/09..... \$5.12

Youth Sub-Minimum Wage
First 90 Days of Employment \$4.25

FICA (Social Security)
Maximum Taxable Earnings \$106,800
Employee/Employer Deduction 6.20%*
Self-Employment Tax 12.40%

*Employee Social Security deduction may remain at the 2011 level of 4.2%, or lower, depending upon future Congressional legislation. The employer deduction will remain at 6.2%.

FICA (Medicare)
Maximum Taxable Earnings No Limit
Employee/Employer Deduction 1.45%
Self-Employment Tax 2.90%

Supplemental Wage Bonus
Rate (Flat Rate Method)
Under \$1 million 25%
Over \$1 million 35%

FUTA (Employer-paid)
Maximum 2012 Taxable Earnings \$7,000
Percent of Taxable Wages 6.00%
Maximum Credit 5.10%
Normal Net Tax 0.09%**

**20 states, including PA, were affected by the reduction of the FUTA credit due to amounts borrowed from the federal government.

Mileage Reimbursement Rate
2011 Split: Jan. to June = \$0.51 | July to Dec. = \$0.55
2012 \$0.55

PENNSYLVANIA

ALL EMPLOYERS

Minimum Wage
Effective 7/24/09..... \$7.25

Note: Training wages for PA employees may no longer be reduced beneath minimum wage.

Minimum Cash Wage
Tipped Employee \$2.83

Note: Employee must receive more than \$30/month in tips.

State Income Tax
Wage Withholding..... 3.07%

Unemployment Insurance
Maximum 2012 Taxable Earnings \$8,000
Employee 2012 Deduction 0.08%

Note: Maximum taxable employee earnings are unlimited.

SOCIAL SECURITY

Early Retirement Age \$14,640/yr.***
(\$1,220/mo)***

Note: One dollar in benefits will be withheld for every \$2 in earnings above the limit.

Full Retirement Age \$38,880/yr.***
(\$3,240/mo)***

Note: Applies only to earnings for months prior to attaining full retirement. One dollar in benefits will be withheld for every \$3 in earnings above the limit.

There is no limit on earnings beginning the month an individual attains full retirement age.

***Social Security beneficiaries will receive a 3.6% COLA for 2012.



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amount from the existing \$3.5 million (along with the top estate tax rate of 35% - down from 45%) that was in effect in 2009 was a total surprise to the entire estate and gift planning professional community. Conventional wisdom, at the time, assumed that the rules that were in effect in 2009 would continue.

This has created an unprecedented opportunity for certain individuals to make major gifts to younger generations and remove from their estates future growth, which is the single most important benefit of gifting. This strategy has the effect of reducing an estate and the resulting estate tax.

Remember, however, that an ambitious program of gift-giving is not for everyone. Parting with assets can make people feel vulnerable or fearful that they will someday be without money that they need. If this is the case, major gifting may not be appropriate.

One reason that planned gift-giving has gained in popularity is that people are living much longer. People that wait until they die to transfer wealth to their heirs may be transferring assets to family members that are nearing old age themselves. Providing financial help may be more useful when they are younger.

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