

Income Taxes . . .

Planning for One of Life's Two "Certainties"

“T is the season (yes, already!) to be thinking about and planning for income taxes. As the filing deadline draws near (April 17 for federal and state tax returns) here are some helpful ideas to consider, courtesy of Diana L. Veid, CPA:

• **The 401k “double whammy”** - Many individuals have had to take a loan against their 401k for one reason or another, be it college costs, unexpected medical expenses, or to stave off foreclosure. In this period of great economic uncertainty, job layoffs are a grim reality. Once you’ve taken out a loan against your 401k and become unemployed (which means you no longer have the ability to continue to repay your loan via payroll deduction), your loan is treated as an early distribution and deemed taxable as ordinary income. And, to add insult to injury, that “ordinary” income is subject to a 10 percent penalty if you are younger than 59 ½, meaning you will owe additional income tax, plus, possibly, a penalty, at a time when you can least afford it.

Before taking a loan against your 401k, be sure to explore other options such as a 0-percent-interest credit card, debt-consolidation loan, or re-financing if you have sufficient equity in your home, as interest rates continue to be at historical lows.

• **To file joint or separate?** - Ohio is known as a “progressive tax state,” meaning the higher your income, the higher the tax rate on all of your income. For dual-income couples at similar income levels, be sure to run the numbers both ways (filing joint and filing separate) to see which option generates the lowest overall tax liability. Know that even if filing separate results in a slightly higher federal tax liability, it may be more than offset by state income tax savings.

You must file consistently for federal and state purposes. Once you determine your filing method, you must stay

with your election because it can't be amended. Beware of any federal credits you may be eligible for if filing joint that aren't available if filing separately. Also note that filing separately severely limits the amount you can contribute to a Roth IRA. The IRS does not want to deal with two returns when one will suffice.

• **To AMT or not to AMT?** (That is the question!) – Every return runs through two tax “systems” for which every tax payer must pay the higher of the two:

- 1) Regular tax rates
- 2) AMT or Alternative Minimum Tax – a flat rate of 26 or 28 percent

AMT was created by Congress in 1969 to ensure the extremely wealthy paid their “fair share.” The problem is the AMT exemption has never really been adjusted for inflation. Rather, the AMT personal exemption has been adjusted on a yearly basis as a “band-aid” approach -- the higher your income, the less your exemption. As a result, middle-class and upper-middle-class taxpayers (those with annual incomes above \$150,000 or \$175,000) are adversely affected by AMT. The primary difference between the two is certain “preference” items; for example, state, local, and real estate taxes are added to your income and subject to tax. So while some may characterize it as good tax planning to pay your real estate tax bill or fourth quarter estimate prior to year end, there may be no benefit in doing so if you are subject to AMT. Likewise, there may be no tax benefit to owning a second home if real estate taxes are non-deductible. Many other “preference” items exist, but these are just a few of the most common.

For a year in which you know your income will be higher (via bonus, exercise of incentive stock options, etc.) consult with your tax advisor to consider if you will be subject to AMT. Note that the impact is greater for residents with higher state and local taxes.

• **Little uncertainty for 2012** – Thanks to an extension of the Bush tax cuts through 2012, there won't be a repeat of last year's tax-rate uncertainty because Congress has legislated tax rates through 2012. However, if Congress remains divided and no action is taken, tax rates will automatically increase in 2013 courtesy of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), also referred to as the Bush tax cuts, which will expire at the end of this year. Therefore, if you have the option to defer bonus or other income to 2013, you may instead choose to do that in 2012.

Diana comments, “As a CPA, it is important to have communication throughout the year with your clients. Often it is not **what** you do but **how** you do it that has the greatest impact on taxes.”

With a background in corporate finance, Kathleen transitioned to the personal side in 1995. She specializes in the efficient accumulation and preservation of family wealth. With solid technical skills in wealth accumulation, business transfer, estate planning and insurance, Kathleen helps clients by focusing on the Purposeful Planning - a values-based approach.



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