Rinehart Wealth Management
Greater Trust

October Newsletter: Tax Update and Opportunities

On August 2nd, our congressional leaders finally pulled together and resolved the debt ceiling crisis in the nick of time. What they failed to do, however, was take bold steps to reduce the national debt or overhaul the American tax code. The debt deal established a "super committee" that has been charged with preparing a deficit reduction proposal by Thanksgiving. While this proposal could recommend increasing taxes and closing loopholes, it is unlikely that Congress will approve a tax hike before the 2012 elections.

Because of the current political environment, the future of our tax code is once again uncertain. The Tax Relief Act of 2010, passed in late December, extended the Bush tax cuts through 2012. Unless Congress extends the legislation again, tax rates for high income taxpayers will increase on January 1st, 2013. With this in mind, we encourage you to review your finances in light of the current tax law and start planning for the possibility of higher rates in the future.

<u>Tax Planning Opportunities</u>:

- The 2% reduction in FICA tax that we've enjoyed this year is currently scheduled to expire on December 31st, 2011; but Congress may vote to extend this provision into 2012. Make sure that you're taking advantage of this windfall while it's still available, by**saving a bit more of your paycheck** for retirement.

- If your teenager or college student worked this summer, **encourage him or her to make a Roth IRA contribution**. The maximum 2011 contribution is the lessor of $5,000 or the child's total taxable compensation for the year. While there is no current tax deduction, the Roth is a tax-free account that will kick-start your child's retirement fund. Roth IRA funds may also be withdrawn free of penalty when purchasing a first home. Consider this a good opportunity to teach your young adult about saving for the future.

- If you converted a traditional IRA to a Roth during 2010 **you still have time to re-characterize**, or undo, the conversion. This may be appropriate if your Roth account balances have declined since the conversion, or if your financial situation has changed and you are no longer able to pay the associated taxes. In order to re-characterize you must file an amended tax return by October 17th, 2011.

- Beginning in 2013, a 3.8% Medicare surtax will apply to single filers with income over $200k, or married filers with income over $250k. For these high-income taxpayers, the surtax is levied on the smaller of net investment income or the excess of their total income over the threshold amounts. If you fall into the high-income category, you may wish to **accelerate any large upcoming taxable events** into 2012 if possible. Although the tax event itself may not be subject to the surtax, it could push your overall income above the threshold and subject your investment income to the surtax.

- Also in 2013, the Medicare payroll tax will increase for high-income taxpayers as defined above. Where possible, you may wish to minimize payroll taxes by **accelerating bonuses or other compensation** into 2012.

- If you haven't already done so, please **send a copy of your 2010 federal and state tax returns** to your Financial Advisor. Your tax return provides a snapshot of your general tax situation and contains data that helps us manage your accounts. For example, your income and withholding levels tell us whether we should withhold tax from your IRA distribution, and Schedule D shows the amount of prior year capital losses that are available to offset current year gains.

How Rinehart Wealth Management Can Help:

- As we head into the fourth quarter, we will **start reviewing portfolios for opportunities to take tax losses** on assets that have underperformed. These harvested losses can be used to offset current or future capital gains.

- On the flip side, we will also **look for opportunities to sell assets that have performed well** over the past few years and reinvest the proceeds elsewhere. One of the lessons that we have learned from the past few years of economic turbulence is to take investment gains when we have them. If you are reluctant to sell because of the tax impact, try to keep your investment goals in perspective. Also remember that current capital gains rates are the lowest they've been in almost 80 years, and perhaps the lowest we will see in our lifetimes.

- We look for opportunities to reduce portfolio expenses and **increase the tax efficiency of your portfolio** by using Exchange Traded Funds (ETFs) and individual stocks where practical. Not only are ETFs less expensive than mutual funds, they generally do not produce capital gain distributions.

- While **planning for the Alternative Minimum Tax (AMT)** has become increasingly difficult, there are certain types of investments that may minimize the impact of this tax. If you are subject to AMT, please make sure that your Financial Advisor is aware of your situation.

- Starting in 2011, brokerage firms are required to begin reporting cost basis information on 1099 forms. This new requirement will eventually make it easier for taxpayers to report gains and losses without digging through years of trade confirmations. It will also make it easier for the IRS to match the gains/losses reported on tax returns against the 1099 data they receive from brokers. Rest assured that we have been working with our custodians for many months **to ensure that cost basis information is correctly reflected** on your 1099s.

While we attempt to take your individual tax situation into account, we believe that the decision to sell capital assets should be primarily based on economic fundamentals as well as your investment goals. For this reason we urge you to not let tax considerations override prudent investment recommendations. If you are particularly tax-sensitive and have specific concerns that you would like us to consider, please talk to your Financial Advisor.

Regards,

Marilyn Spencer, CFP®, Enrolled Agent

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