LISA A. SCARAZZO, CPA, PC
12904 HARBOR DRIVE
WOODBRIDGE, VA 22192

INTERNET: WWW.LASCPA.COM
(703) 690-4257
(703) 491-2794
FAX: (703) 492-6829
EMAIL: LISA.SCARAZZO@LASCPA.COM

# Annual Individual Tax Newsletter
# December 2012

**Changes for 2012:**

- NO First Time Home Buyer Credit.

**Changes for 2013:**

- IRA contributions increase by $500 - $5,500 if under 50 & $6,500 if over 50.
- Social Security taxes withheld on paychecks goes back up to 6.2% for all employees.
- Social Security taxable wage base goes up to $113,700.
- Medical Expenses - only medical expenses that are greater than 10% of the taxpayer's adjusted gross income will be deductible. If the taxpayer is 65 years or older, the limitation remains 7.5% of their adjusted gross income.
- Itemized Deductions will have limits & phase outs for high income earners.
- NEW TAXES

    +Additional Medicare tax of .9% for any individual that has wages of more than
    
    $125,000 if Married Filing Separately
    $200,000 if Single
    $250,000 if Married Filing Jointly
    
    +3.8% Additional tax for anyone with investment income & the following Adjusted Gross Income:
    
    $125,000 if Married Filing Separately
    $200,000 if Single
    $250,000 if Married Filing Jointly

**Foreign Reporting Issues:**

Taxpayers are required to report any cash accounts if the value is greater than $10,000 at any time during the year. A $10,000 civil penalty may be imposed on any person who fails to report foreign income on Form TD F90-22.1 and submits the form separately from the taxpayer's Form 1040. If you have foreign assets greater than $50,000 they must be reported on Form 8939 and submitted with Form 1040. This penalty could increase to $100,000 and jail time if it is a willful violation. You must let us know if you have any foreign income, off shore accounts, or foreign assets so they are reported properly.

**Capital Gains:**

The long term capital gains rate remains unchanged for the 2012 tax year: Zero for taxpayers in the lowest tax bracket. For those in the 15% tax bracket, their capital gains rate will be 10% and for all others the capital gains rate will be 15%. Be sure to review your capital gains and losses realized for this year. If you have net gains, take offsetting losses of equal value to make them tax free. You must actually sell the stock or fund by December 31st to take advantage of the losses. The maximum net allowable capital loss (after offsetting with gains) in one year is $3,000. If your net loss is greater than $3,000, the excess is carried forward to future tax years.

**Did you sell any stocks or mutual funds?** You will need to research your purchase price, the number of shares purchased, and the date of purchase. Start with your own records or contact your financial institution for the history of purchases. If this is not possible, the internet is a great resource – use http://www.bigcharts.com to research the basis (purchase price) of your shares. Don't forget that reinvested dividends are part of your costs. If we have to recreate your basis, there could be additional fees involved.

**Real Estate:**

**Foreclosures & Bankruptcy –** In general, if a taxpayer is forgiven or absolved of their debt (credit cards or mortgages), the debt becomes taxable income. The Mortgage Forgiveness Debt Relief Act will exclude debt forgiveness from taxable income up to certain limitations if the taxpayer's debt was a mortgage from their principal residence and the debt was used to buy, build, or improve their residence (home equity debt does not qualify) - this is available until December 31, 2013.

**Did you refinance this year?** Refinancing may increase your taxes. Paying a lower interest rate will decrease your mortgage interest write-off, which increases taxable income. Be sure to bring in your refinance settlement sheet for the preparation of your tax return. Any points paid at refinancing are considered to be mortgage interest and will be written off over the length of the loan using an amortization schedule. If you had a prior refinance with points, the remaining unamortized points can be taken as a deduction only if you have changed lenders.

**Home Equity Interest –** There are limits on the deductibility of home equity interest. A taxpayer may not deduct all of the interest if the principal amount of the home equity loan is greater than $100,000 if the money from the loan was used for a purpose other than to buy, build or improve a qualified home. Please let us know if you have a home equity loan, as there are other limitations to this deduction. If you used your loan proceeds to make improvements to your home this limitation may not apply.

**Rental Properties –** Owning a rental property that generates a loss will not give you a current-year tax break if your income is greater than $150,000 (less if married filing separately). Once your adjusted gross income reaches $100,000, your losses will begin to phase out as a current-year deduction. No losses are allowed in the current year if your adjusted gross income exceeds $150,000 unless you are in the business of real estate management. The disallowed losses will carry forward until the year that your income drops below $150,000, you sell the property or you have passive income. Please contact our office prior to signing any contracts if you intend on selling your rental so we can review the tax consequences.

**Sale of Personal Residence –** In general, if you have both lived in and owned your personal residence for 2 of the last 5 years and the gain is not larger than $500,000 (Married Filing Jointly) or $250,000 (Single), then there is no capital gains tax due on the sale. If you have been in the home less than 2 years, you may qualify for a reduced exclusion and still not be subject to the gains tax. The reduced exclusion is available for medical purposes, changing jobs, and unforeseen circumstances (such as death, divorce, multiple births, and disasters). Please let me know if you are selling your personal residence so we can review the tax consequences prior to signing any contracts.

**Military –** If you are an active member of the military, with the US Foreign Services, or employee of the US intelligence community you may have as many as 15 years instead of 5 to qualify for the primary residence exclusion.

**Retirement:**

**Converting a Traditional IRA to a Roth IRA –** Anyone can convert money they've already invested in a traditional IRA into a Roth IRA. This is a change from prior law where the IRA conversion was not allowed if your adjusted gross income was $100,000 or greater in the year you convert to a Roth. You will owe tax on whatever amount you have converted from the traditional IRA to the Roth IRA minus any amounts that were non-deductible contributions (these amounts must have been reported previously on Form 8606). After paying the tax on the conversion in the year of conversion, you will never pay any tax in retirement or when it is withdrawn. Please contact us before a planned conversion to discuss the tax implications.

**IRAs –** Putting money into a traditional individual retirement account (IRA) is a good idea but can be very tricky. If you are eligible to participate in a retirement plan with your employer or your income exceeds $92,000 (Married Filing Jointly) or $58,000 (Single) you are limited on how much is deductible. You may want to make the contribution anyway, but it will be necessary to track the non-deductible amounts on Form 8606. If the non-deductible amounts are not tracked, you could end up paying tax on the money twice. We are not able to help you track the non-deductible contributions unless you report the contribution amounts to us.

The Roth IRA remains very appealing because the distributions will not be taxed when withdrawn, as long as the money is in the account for at least 5 years and the taxpayer is age 59 ½ at the withdrawal date. You are not eligible to make a Roth contribution once your adjusted gross income exceeds $183,000 (Married Filing Jointly) or $125,000 (Single). If you have concerns about the taxation of a distribution or limits for contributions, please contact our office.

The maximum contribution amounts for both traditional IRAs and Roth IRAs are increasing for the 2013 year: $5,500 if you are under 50 years of age, plus an additional $1,000 if you are age 50 or older ($6,500).

**Retirement Contributions -** Contributing to a retirement account through your employer is always a great tax break. The income and earnings are non-taxable in the current year but become taxable upon withdrawal. Generally, there is a 10% penalty if the money is withdrawn before age 59 ½.

The maximum deferral for 401(k) and 403(b)s have increased for 2013:

| | Under the age of 50 | 50 or older by December 31 |
|---|---|---|
| 2012 year | **$17,000** | **$22,500** |
| 2013 year | **$17,500** | **$23,000** |

Check with your HR Department to increase your contribution amounts in January 2013. Please let us know if you decide to do an early withdrawal from a qualified retirement account prior to making the withdrawal. You will lose at least 30% and sometimes as much as 50% to taxes and penalties on any early withdrawal.

**Required Minimum Distributions (RMD) -** RMDs must be taken by December 31st to avoid a penalty. If you just turned 70 ½ during 2012, you can wait until April 1, 2013 to take your first distribution but then you will have to take two taxable distributions in 2013. We recommend taking the first RMD during the 2012 year and not doubling up income in a future year.

**Social Security Earnings –** If you are between the age of 62 and full retirement age (see the social security administration's website to calculate your full retirement age) and are drawing social security benefits, the maximum amount of earnings you can make in 2012 is $14,640 (increases to $15,120 for the 2013 year). The maximum amount that a taxpayer's wages can be taxed for social security purposes in 2012 is $110,100 (increases to $113,700 for the 2013 year).

If you are looking toward retirement, go to http://www.ssa.gov/retire to access the Social Security Retirement Planner, which will walk you through the retirement application process and offer information on issues to consider when applying for benefits. You will find online calculators to help you through the process of estimating future earnings based on past and present earnings.

## Credits & Deductions:

**Child Credit –** The maximum child credit for 2012 is $1,000 per child under the age of 17. This credit will not be available to some taxpayers due to their income level.

**Dependent Day Care Credit –** The maximum childcare expense used in this calculation for one child is $3,000 and for two or more children is $6,000.

**College tuition –** Qualified education expenses must be incurred during the year and does not include room and board. There are two available credits. The first is the American Opportunity Credit for 1st, 2nd, 3rd, and 4th year students who attend school at least half time (this credit covers tuition, fees, books, supplies & equipment). The second is the Lifetime Learning Credit which is available for any student (this credit is only available on tuition & fees). There are no limits to the number of years that the Lifetime Learning Credit can be claimed, and it is available to all individuals.

**Mileage Rates –** The standard business mileage rate for the 2012 year is 55.5 cents per mile. Mileage for charity and volunteer work remains at 14 cents per mile. Medical and moving mileage is 23.5 cents per mile. The standard mileage rate for 2013 is 56.5 cents per mile.

**Charity –** Taxpayers are required to have receipts, bank records, or written documentation for **all** charitable contributions. **No deductions for cash** contributions are allowed without receipts; therefore, you will need a receipt if you give cash, even cash offerings in church! Be sure to give us a copy of your receipts for any donations. The IRS is focusing on this deduction so be prepared to defend this deduction.

All non-cash items (clothing, household items, appliances, etc) must be in good condition or better for contributions made after 8/17/06. Written documentation is required to take this deduction and the IRS has been asking for this documentation in their examination process. Since we have no knowledge of the condition of the items you donate, it will be necessary for you to place a detailed description and value on the receipt for any donated items. **We cannot place a value on any blank**

**receipts we receive and you will receive no deduction**. Go to www.satruck.org for the Salvation Army Valuation Guide to value your donated goods. Valuations above $5,000 require an appraisal.

**Donating Vehicles –** If you give away a vehicle and the fair market value is greater than $500, you will need written documentation from the charity stating the amount the charity received when they resold your vehicle. You will only be allowed a deduction for the amount received in the sale and not the blue book value unless the charity is using the vehicle. The charity will send you a Form 1098-C.

**Donating Appreciated Stock to Charity –** As an example: If you purchased stock for $1.00 per share and the fair market value is now $10.00 per share and you held the stock for more than one year, you can avoid paying capital gains on the $9.00 increase in price by gifting it to a qualified charity. Not only that, you receive a charitable contribution deduction for the fair market value of $10.00 per share when you only had an out-of-pocket expense of $1.00 per share. This transaction must be well documented with a letter from the charitable organization and proof of the fair market value on the date that it was gifted. Remember: If you have stock that has declined in value, you should sell it first to take the tax loss and then give the cash from the sale to charity.

**Moving –** The moving deduction is available only if you have changed jobs and moved at least 50 miles. The new job and home must be more than 50 miles from the former job and home. Remember to always inform the IRS of a change of address. This can be done by completing Form 8822. The form can be found at the IRS Web site http://www.irs.gov.

**Other Tax Topics:**

**Increased Age to Kiddie Tax –** Any child under the age of 18 **and** your full-time college student (ages 18 to 23) who have unearned income (interest, dividends, and investment income) greater than $1,900 will be taxed at his or her parent's tax rate (the investment income goes up to $2,000 for the 2013 year). Please check with us if you are unsure whether your child needs to file an income tax return based on his or her earned or unearned income. It may seem odd, but it is possible that a newborn is required to file a return.

**CAUTION –** Check with your college age student to make sure they have not filed and claimed themselves on their own income tax return before you claim them as a dependent on your return. This not only impacts the dependency exemption but also the availability of education credits, so working with your college age students on obtaining the best overall tax advantage for the whole family is worthwhile.

**529 College Savings Plans** – Congress has made tax-free withdrawals from these accounts permanent and the financial aid formulas have been revamped to make these plans a better investment than a custodial account. In addition, there are credits available for Virginia residents who make 529 plan contributions.

**Inheritance –** In general, money and assets received through an inheritance are not taxable income. There is an exception for annuities and IRA accounts. If you have received a distribution from an IRA or annuity due to a death, you will most likely be taxed on the income on your individual income tax return. Please contact our office if you inherit an IRA or annuity so we can look at how this will affect your current tax liability.

**Estate Planning & Death of a Spouse -** The heirs of a descendent will pay taxes on the fair market value of the estate's assets that are greater than $5,250,000 (for the 2013 year). We recommend that a surviving spouse file Form 706 to take advantage of the "Portability" rules - This would allow a surviving spouse to elect to take advantage of the unused portion of the estate tax applicable exclusion amount of his or her deceased spouse and thereby providing the surviving spouse with a larger exclusion.

**Gifts –** Giving a gift to an individual or family member is not a tax deduction, but instead can cause the individual giving the gift to owe tax. The IRS has limits as to the amounts an individual can give before the taxpayer is required to file a gift tax return and possibly owe gift tax on the money. This amount is $13,000 for 2012. As a taxpayer, you can give up to $13,000 to any other individual before you are required to file a gift tax return. Keep track of gifts over $13,000, as they will reduce the taxpayer's unified estate credit.

**AMT –** Alternative Minimum Tax is a parallel tax system that is used to ensure high-income earners are not escaping taxation. More and more taxpayers are facing this parallel tax system. AMT requires adjustments to the regular taxable income for tax preference items, and this eliminates favorable deductions. The maximum alternative tax rate is 28%, but tax is recalculated at a higher taxable income amount, causing a higher tax bill than expected. If you are subjected to AMT, it will not benefit you to make your 4th quarter estimated state income tax payment by December 31st. Making this payment in 2012 is usually a good tax tip, but if you are subjected to AMT, state taxes are a disallowed deduction and will not reduce your IRS tax liability. **Important** - As of this printing, Congress has not extended expiring provisions on the income levels of those that may be subjected to this tax; therefore, many more taxpayers could be subjected to this higher tax rate.

**Charges to your Credit Card –** Deductible expenses, such as medical bills, charitable contributions, and business supply purchases, can be deductible if you charge them to your general use credit cards (Visa, Master Card, etc) before 12/31/12. This does not apply to charges made to a specific store credit card.

**Electronic Filing –** All eligible tax returns prepared in this office will be filed electronically for 2012. It will be necessary for the taxpayer to review and approve his or her tax return before we transmit the data electronically to the IRS and the state. We must receive a signed Form 8879 (The IRS e-filing form) and payment for the tax preparation services from the taxpayer before we submit the electronic tax data. We cannot guarantee timely filing if Form 8879 is received in our offices after April 8, 2013. *Please be sure to have all of your tax information to us before April 2, 2013 for timely processing. There will be a late processing fee for all information (including signed 8879 Forms) received by us after April 2, 2013.*

**2012 Questionnaire** – An 'Information Document Request' form will be sent to all clients at the beginning of January to assist them in gathering their tax data. This will provide our office current contact information for our database and assist in preparing accurate tax returns. Please be sure to list the current phone numbers (work, home and cell) and valid e-mail addresses. Also, it is important that you list the current dependents, especially once they reach college age so we know whether to include them on your return. Per IRS Circular 230, our firm is required to have proper documentation for tax preparation to ensure compliance or we will be subjected to preparer penalties; therefore, if your completed questionnaire is not included with your tax documents there will be an additional fee.

**Extensions** – The IRS needs valid numbers that are realistic when an extension is prepared or they can deny it.  The taxpayer would be subject to 'failure to file' and late penalties.  Contact our offices no later than April 2, 2013 if an extension is required.

**Consent to Release Data –** Due to new IRS rules regarding ethics and privacy, we will no longer be able to send copies of income tax returns to any third parties (mortgage companies or banks) without prior written consent from the taxpayer.  We are happy to provide copies directly to you in person or via e-mail or fax, but we cannot send to anyone else on your behalf without written consent.  Please visit my website at www.lascpa.com click on Information Center and Forms to download written consent in a pdf.  This form can be emailed or faxed to my office.

## Privacy Statement

Federal law requires that once a year I inform you of our Privacy Policy.  As you know, we collect certain personal information about you in order to prepare your tax returns.  The information is either provided by you or obtained by our office with your permission.  No personal information will ever be disclosed about you to anyone outside our firm except that which is already public by law or necessary to complete your work.

Should you become an inactive customer, we will continue to adhere to the policy regulations as written here.  The information you give us about your personal or business records is reserved only for our employees who need to know in order to service your account.  Procedural, physical, and electronic safeguards will be maintained in compliance with federal standards regarding your personal information.  We are committed to retaining your confidence and want to assure you that any information you give us remains safe and confidential.