FINANCIAL PLANNING IN AN UNCERTAIN TAX LANDSCAPE

Understanding today's tax environment // Strategies for 2012 // Planning for 2013

RAYMOND JAMES®

KEY TAKEAWAYS

Without further changes by Congress, tax rates are scheduled to increase significantly starting in 2013.

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You have until December 31 to take advantage of today's low tax-rate environment and reposition assets for a potentially higher tax landscape starting in 2013.

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This paper includes numerous 2012 and 2013 tax planning tips for income, investing, estate planning and charitable giving that you may wish to discuss with your financial advisor.

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It is important not to make drastic changes to your financial plan until more clarity is given to pending legislation. Rather, careful planning and selective action should be taken to properly position assets and react accordingly as the situation evolves.

INTRODUCTION

To say the tax landscape in America will likely transform in 2013 may be a bit of an understatement. There are numerous changes scheduled for year-end, including scheduled budget cuts resulting from last year's debt ceiling negotiations, the expiration of the Bush-era tax cuts on income and investment gains, the reduction of the lifetime gift and estate tax exclusion limits, and the implementation of new taxes created by recent healthcare reform.

Given that it's a presidential election year – and a particularly heated one at that – there's no way to predict what will happen with taxes in the future. There's only one thing of which we can be fairly certain: The tax landscape will change to some degree starting in 2013.

The timing of these changes makes today's favorable tax environment potentially all the more advantageous for positioning your wealth for the future. The key is to assess your options as soon as possible so you can take advantage in case the lower rates expire. As it is highly unlikely that there will be any changes in tax legislation before this year's elections, this is an important time to consult with your financial and tax advisors to help position your finances to keep more of your money and develop a plan to react to potential changes when they occur.

To give you more insight into tax planning strategies for 2012 and 2013, the following is an overview of scheduled changes to the tax code and strategies you may want to consider.

INCOME TAX RATES

In January 2013, the 33% and 35% tax rates are scheduled to increase to 36% and 39.6%, respectively. While eventual changes may divert from the current schedule, it is unlikely any tax legislation will be passed before the elections in November, and whatever happens, investors are likely to see higher tax rates going forward.

TIP

2012 PLANNING TIP:

There are likely to be tax rate changes to individual income brackets next year. Where possible, it could be advantageous to include as much income as possible in your 2012 tax return. Strategies for accelerating income may include:

- *Negotiating future compensation in advance (such as sales commissions or bonuses)*
- *Conducting a Roth IRA conversion before year-end*
- *Exercising non-qualified stock options*

SCHEDULED TAX RATE CHANGES

SINGLE	MARRIED FILING JOINTLY	2012	2013
Up to $8,700	Up to $17,400	10%	15%
$8,701 - $35,350	$17,401 - $70,700	15%	15%
$35,351 - $85,650	$70,701 - $142,700	25%	28%
$85,651 - $178,650	$142,701 - $217,450	28%	31%
$178,651 - $388,350	$217,451 - $388,350	33%	36%
Over $388,350	Over $388,351	35%	39.6%

2013 PLANNING TIP:

Consider opportunities for tax-deferred growth:

- *You may currently defer up to $17,000 a year, or $22,500 if you're age 50 or over, into a 401(k) or 403(b)*
- *You may also be able to deduct IRA contributions even if you participate in a retirement plan at work if your modified adjusted gross income is under $68,000 for single or head of household tax filers, or $112,000 for those married and filing jointly. The maximum contribution to an IRA in 2012 remains $5,000, or $6,000 if you're age 50 or over.*
- *Annuities also offer an opportunity for tax-deferred growth on assets.*
- *Accumulating cash value in life insurance can also offer tax-deferred growth and tax-advantaged retirement income.*

TAX-EFFICIENT IRA STRATEGY

If you waiver back and forth between the wisdom of saving via a tax-deductible traditional IRA or a tax-free distribution Roth IRA, consider using them in concert. For example, contribute to a traditional IRA to defer more income when your personal income tax rate is higher, then convert your accumulated assets to a Roth when your tax rate is reduced so you pay a lower rate on the conversion and position assets for tax-free distributions in retirement. You can continue to repeat this process for years until/unless there are changes to the IRA rules.

LONG-TERM CAPITAL GAINS AND DIVIDENDS

The Bush-era tax cuts reduced the maximum long-term capital gains tax rate (applied to investments held more than 12 months) to the current rate of 15% for the majority of taxpayers. Those rates are scheduled to return to 20% in 2013. Furthermore, today's 15% tax rate on qualified dividends is scheduled to return to ordinary income rates in 2013, with a top rate as high as 39.6%.

On top of those increases, capital gains will be subject to an additional 3.8% Medicare tax imposed by the Health Care and Education Reconciliation Act of 2010 for single taxpayers with income over $200,000 ($250,000 for married taxpayers). All combined, the total maximum long-term capital gains tax rate will be 23.8% starting January 1, 2013. While there is a possibility that current rates may be extended, it is important to plan for multiple scenarios, including the likelihood of higher tax rates in the future.

In a lower tax environment such as we're in right now, many investors elect to sell off highly appreciated stock in order to pay less in taxes rather than holding for the longer term. Recent changes in tax law now require you to select which shares you are selling at the time of the transaction. To take full advantage of this year's lower tax rates, you'll want to select the shares with the lowest cost basis to realize the largest gains.

If you have unrealized investment losses, you may want to wait to realize them in 2013 so you can use the loss to offset higher taxes on next year's return.

DEFINING NET INVESTMENT INCOME

In 2013, a 3.8% tax will be assessed on the lesser of (1) Net Investment Income (NII) or (2) Modified Adjusted Gross Income in excess of $200,000/$250,000 (single/married filing jointly).

NII consists of interest, dividends, annuities, royalties, rental income, passive activity income and capital gains from sale of property less allowable expense deductions (advisory fees, commissions, etc.).

TIP

2012 PLANNING TIP:

If you have highly appreciated or highly concentrated assets you've considered liquidating, 2012 may be a good year to sell and realize profits. This is called "tax gain harvesting," and current tax rates offer an ideal time to use this strategy to rebalance your portfolio.

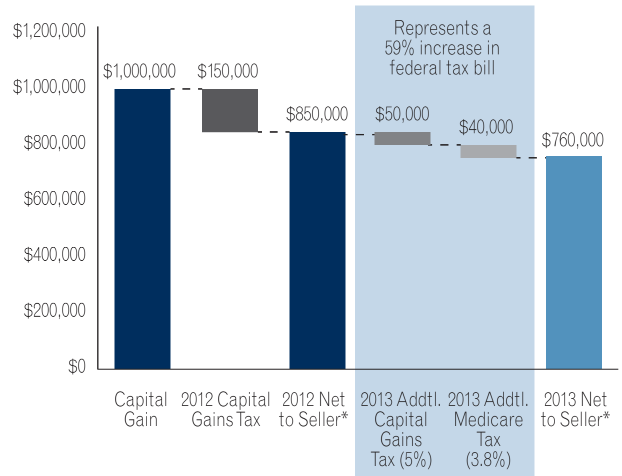
Tax gain harvesting opportunities may include:

- *Highly appreciated securities*
- *Concentrated equity positions*
- *Nonqualified employee stock options*
- *A business*

For example, say you sell your business in 2012, generating $1 million in long-term capital gains. Once you pay the current capital gains tax rate, your net profit would be about $850,000. If you wait until next year to sell your business, based on the current tax rate schedule, you would net only $760,000 – nearly $100,000 less, as illustrated in the graph at right.

This strategy makes sense even if you repurchase or replace the investment. By selling and repurchasing you lock in the 15% long-term capital gain tax rate and reset your basis higher.

2013 LONG-TERM CAPITAL GAINS RATE INCREASES



*Net does not incorporate state and local taxes due as these vary by state. Source: Transact AOCP; 2012. For illustrative purposes. Actual figures may vary depending on your personal tax situation.

2013 PLANNING TIP:

If you decide to harvest gains in 2012, it will give you a chance to rebalance your portfolio and/or rethink your asset allocation for a specific goal, such as retirement income. For tax-advantaged ways to reposition assets for retirement income, consider municipal bonds or an annuity. Income from municipal bonds is not subject to federal income tax or taxes in the state they are issued. Earnings in an annuity grow tax-deferred until distributed.

While interest on municipal bonds is generally exempt from federal income tax, it may be subject to the federal alternative minimum tax, state or local taxes.

Going forward, consider rebalancing using new money coming into accounts. That way you avoid incurring unnecessary long-term capital gain taxes while rates are high.

ALTERNATIVE MINIMUM TAX

The Alternate Minimum Tax (AMT) is a parallel tax system created in 1970 to ensure that everyone, regardless of how many tax breaks they qualified for, would pay a minimum level of taxes. In previous years, Congress created a patch to reduce the number of people affected by the AMT. If Congress does not provide a retroactive patch by April 2013, the AMT threshold will drop for taxpayers filing jointly to $45,000. This could potentially result in a higher tax bill on your 2012 return.

Every taxpayer must pay the greater of the amount owed in the regular tax system or the Alternate Minimum Tax system.

ESTATE TAX PLANNING

Currently, the United States imposes three types of taxes on wealth transfers:

GIFT TAX	ESTATE TAX	GENERATION SKIPPING TRANSFER TAX (GSTT)
Assessed on the net value of assets one person gives to another while living	Assessed on the net value of assets transferred when a person dies	Assessed on the net value of some wealth transfers to grandchildren and certain other individuals during life or upon death

Another of the tax advantages scheduled to end in 2012 is the significantly higher exclusion amount one person can gift to another before gift taxes are assessed. From this perspective, today's higher gift tax exclusions make 2012 a good year to make lifetime gifts to children and grandchildren.

Currently, you may gift up to $13,000 ($26,000 for couples) per year per person to any number of individuals without triggering taxes. Gifts in excess of this amount are applied against your lifetime gift tax exemption, which is $5,120,000 per individual in 2012 ($10,240,000 for a married couple). Amounts above these limits will be taxed at 35%. Furthermore, if one spouse dies, the surviving spouse may use the remainder of the deceased's unused exemption to make additional gifts.

In 2013, however, the exemption amount is scheduled to drop to $1 million per person ($2 million per couple), with the potential top tax rate of 55% for amounts over this limit. The portability of the lifetime exemption amount between spouses is also scheduled to expire. This creates a dramatic difference in the tax efficiency of transferring wealth.

TIP

2012 PLANNING TIP:

With real estate prices at their current lows and the gift tax exclusion at its current high, 2012 is a good time to consider gifting a family vacation home to your children. You can do so by transferring it to a Qualified Personal Residence Trust (QPRT) for a specified term of years. The present-day value of the house, appreciating at the IRS's assumed rate of investment return and based on assumed mortality rates after the term of the QPRT has expired, will constitute the taxable gift that counts toward your lifetime gift exclusion. If you are still alive when the QPRT term is up, your heirs will receive ownership without incurring gift or estate tax consequences. If you pass away before the term is up, the house will be included in your estate. When you consider that the market value of the property may be low right now, the QPRT is an attractive estate planning option for 2012.

2013 PLANNING TIP:

A Generation Skipping Transfer Tax (GSTT) Trust is a long-term trust designed to avoid estate taxes when one generation transfers wealth to the next generation. If the Generation Skipping Transfer Tax exemption is reduced in 2013, a GSTT Trust may be an effective way to transfer assets out of your estate so as not to incur estate or generation-skipping taxes. Typically, you would transfer assets into a separate GSTT Trust for each of your children. During the lifetime of each child, the income and principal can be used for health, education, maintenance and support of the child. When the child dies, the assets will pass to his or her children in equal trust shares and the scenario may be repeated for as long as the applicable state laws will allow.

ESTATE TAX PLANNING (CONTINUED)

Making gifts during your lifetime offers several advantages:

- The assets you transfer while you are still alive are removed from your estate
- Any future appreciation that could be earned by these assets is also removed from your estate
- Any future income shifted to beneficiaries in a lower income tax bracket will enable them to keep more of the income generated
- The transferred assets, and their subsequent appreciation, may be protected from potential creditors, lawsuits or divorce proceedings
- Transferring assets while living allows you to ensure distribution goes according to your desires

If you are interested in gifting wealth but do not wish to relinquish complete control over the assets, consider placing the gift in an irrevocable trust.

CHARITABLE GIVING

Most of the time, donations to qualified charities count as an itemized deduction for that tax year. This includes cash, real estate, goods or other assets. The deductibility of charitable gifts is based on several factors, such as the donor's income, the nature of the donation and the charity receiving the donation.

The current administration has proposed changes to limit the total value of itemized deductions to no more than 28% of adjusted gross income for taxpayers in the 36% and 39.6% brackets. Under this scenario, a philanthropic donation would provide significantly reduced tax savings, so it's important to consider other ways to position philanthropic gifts for maximum tax advantages.

TIP

2012 PLANNING TIPS:

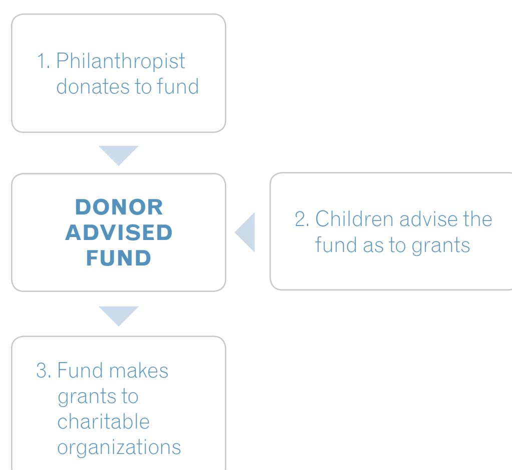
If you convert a traditional IRA (or other qualified retirement assets) to a Roth in 2012, you will owe taxes on the converted amount but you'll likely pay less in ordinary income taxes than you will a year from now. If you combine this strategy with a philanthropic gift, your charitable deduction may help offset the taxes you owe on the IRA conversion.

It is likely in 2012 that Congress will again allow those who are at least 70½ to donate up to $100,000 to a charity directly from their IRAs. While the gift would not qualify for a tax deduction, neither would it be taxable to either the donor or the qualified charity, and it can be used to satisfy required minimum distribution requirements.

2013 PLANNING TIPS:

Consider establishing a charitable lead annuity trust (CLAT), which is designed to generate a larger tax deduction in a low-interest rate environment. You may fund a CLAT with cash, investments and even life insurance. Over the term of the trust, the CLAT will pay out annuity income to the charitable organization of your choice while continuing to earn interest. At the end of the term, the remaining balance in the trust is transferred to your beneficiaries (not the charity). Due to the current low discount rate used in calculating the amount of the lead payments to the charity, the individual beneficiaries receive a significantly higher amount at the end of the trust term. For most CLATs, you may take a one-time income tax deduction in the year the trust is funded.

A Donor Advised Fund is a tax-qualified public charity that allows you to make a donation and claim the current income tax deduction. In addition, you may appoint your children as advisors on how the donation is invested within the fund, which charities will ultimately receive gifts and how much they will receive.



CONCLUSION

All that is necessary for taxes to increase in 2013 is for Congress to do nothing. Given the heated environment of an election year, it would be unusual for the two parties to come to a consensus over something as controversial as taxes, particularly in light of the nation's alarming federal deficit.

While planning for the future tax landscape is important, it is equally important that you do not make changes to your investment portfolio or financial plan based on tax considerations alone. Your Raymond James financial advisor can help you review how today's tax environment and/or pending changes may impact your personal situation and objectives. He or she also can work with your CPA or tax professional to coordinate appropriate tax strategies.

Remember, what is most critical is establishing your personal goals for both the short and long term. Tax strategies can be used to help you achieve these goals and should be utilized within the context of your overall financial picture.

WORK WITH YOUR FINANCIAL ADVISOR

Identify and implement tax planning strategies that are advantageous for your situation in 2012	▶	Discuss potential strategies depending on how tax legislation may change in 2013 and beyond	▶	Create contingency plans for different tax scenarios

Please note: Changes in tax laws or regulations may occur at any time and could substantially impact your situation. Raymond James financial advisors do not render advice on tax or legal matters. You should discuss any tax or legal matters with the appropriate professional.

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