Security Sales

1. The following tax rates now apply to most types of capital gains: 35% (short-term), 28% (collectibles) and 15% (long-term). When harvesting losses and triggering gains, gains and losses are netted within each rate group and then, if there is a net loss in any group, net losses are essentially applied to net gains taxable at the highest rates first. Any remaining net gain will be taxed at the applicable tax rate.

- Under current law, the 15% rate on long-term capital gains is scheduled to apply through December 31, 2012.
- In 2012, taxpayers in the 10% or 15% tax brackets pay a capital gains rate of 0%. In appropriate circumstances, parents considering gifts to children should consider transferring low-basis assets to take advantage of the 0% tax bracket, being cognizant of the “kiddie tax” (discussed in more detail below) applicable to children up to age 19, or 24 if they are full-time students who remain dependent.

2. The long-term capital gains rate applies to capital assets held for more than one year. The holding period generally begins the day after purchase and includes the day of sale.

- Purchase and sale dates are based on trade dates, not settlement dates.

3. Exchange Traded Funds (ETFs) that hold physical gold are considered to hold “collectibles” for capital gains purposes and, as such, their long-term capital gains rate is 28%, not 15%. Inverse ETFs focused on metals generally own futures to get their exposure and, therefore, are not considered collectibles. With an ETF invested in futures, there is generally a split of appreciation 60/40 long-term/short-term. However, there are different practices in the case of inverse Exchange Traded Notes (ETNs), depending on the structure of the note: one approach is to treat ETN appreciation as long-term capital gain (15% rate) but another alternative is to treat the appreciation as split 60/40 long-term/short-term.

4. When a stock has been purchased over time in different lots, investors are generally deemed to sell the shares on a first-in, first-out basis. The seller can, however, elect to specifically identify other shares as being sold first. Typically, taxpayers would select the highest basis lots as the first to be sold (to defer a capital gains tax payment), but with expectation/possibility of a rate increase, some taxpayers are considering accelerating gains to capture the 15% rate.

5. Harvesting losses – beware the wash sale rule. If a security is sold at a loss (the wash sale rule does not apply to gains) and a substantially identical security is acquired within 30 days before or after the sale (i.e., a 61-day period), the “wash sale” rule results in a deferral of the loss until the replacement securities are sold. Whether or not securities are substantially identical depends on the facts and circumstances of each case.

- In 2012, November 30, 2012 is the last day on which you can buy replacement securities (i.e., double up) or sell a position at loss and still be able to avoid wash sale rule (by selling ½ of the position or buying replacement securities, respectively, on December 31, 2012).

6. Cost basis of gifted property: Generally, when a donor makes a lifetime gift to a beneficiary, the beneficiary takes the donor’s basis (and holding period), subject to adjustment up for gift tax paid and attributable to appreciation. However, where the fair market value (FMV) of the gifted asset is below the donor’s basis, the beneficiary must track a different basis for a subsequent sale at a gain or at a loss.
2012 YEAR-END TAX-RELATED REMINDERS

- The basis for determining gain on a subsequent sale is the donor’s cost basis.
- The basis for determining a loss on a subsequent sale is the fair market value at the time of transfer.
- For example: Securities gifted have a basis of $10,000 and a FMV of $9,000 at the time of the gift. The property is later sold for $9,500. This would result in neither gain nor loss because the basis for figuring loss is $9,000 (resulting in a gain, not a loss) and the basis for figuring gain is $10,000 (resulting in a loss, not a gain).

7. So, if the subsequent sale of gifted property (where the donor’s basis in the property exceeded his or her fair market value at the time of the gift) takes place at a price point:

- Above the donor’s cost basis, the excess above the cost basis is a gain to the beneficiary.
- Between the fair market value at the time of the gift and the donor’s cost basis, there will be no gain or loss.
- Below fair market value at the time of the gift, the difference between such fair market value and the sales price is a loss to the beneficiary.

2013 and Beyond

Absent Congressional action, the long term capital gains tax of 15% will increase to 20% in 2013. The top ordinary income tax rate will also increase from 35% to 39.6% and dividends will no longer receive “qualified” treatment, causing them to be taxed at ordinary income rates (discussed further below).

Additionally, the Health Care Bill will impose a 0.9% surtax on earned incomes above $200,000/250,000 and a new 3.8% tax on unearned income, resulting in the following top rates for each category:

- Ordinary Income: 40.5%
- Long Term Capital Gains: 23.8%
- Dividend: 43.4%
- Short Term Capital Gains: 43.4%

Further, before 2010 itemized deductions above a certain level were partially phased out, thus increasing income taxes by reducing deductions. Barring legislative extension, if a taxpayer’s Adjusted Gross Income (“AGI”) is above a threshold amount, itemized deductions will be reduced by an amount equal to the lesser of 3% of the excess over the threshold or 80% of allowable deductions.

Accordingly, if higher rates, in fact, come to be, accelerating gains and income to this year could be attractive.

AMT

The Alternative Minimum Tax (AMT) is designed to ensure that taxpayers do not benefit too much from tax-advantaged items. The AMT rate is generally 26% or 28%, depending on income level and filing. The starting point for the AMT is regular taxable income, which is increased by certain adjustments including: state and local income and property taxes, and certain miscellaneous itemized deductions; tax-exempt interest on private activity bonds; and the difference between the market value of stock and the option price on the date of the exercise of Incentive Stock Options (“ISOs”).

ISOs

When an employee exercises an Incentive Stock Option (“ISO”), the spread between the market value of the stock at the time of exercise and the strike price is not subject to ordinary income tax; however, the spread is an adjustment item for purposes of calculating the AMT.

- If the stock has depreciated significantly since an exercise in 2012, the taxpayer may wish to make a taxable sale of the stock (making “disqualifying disposition”). Such a disqualifying disposition takes advantage of a special rule, which, in essence, recasts the ISO as a nonqualified stock option, avoids the AMT impact of the original exercise and limits the compensation income recognized to the difference between the sales price of the stock and the exercise price of the option.

Hedging Reminder

A short against the box entered into as a short-term hedge under the safe harbor of IRC 1259 must be closed out by January 30, 2013 and then the position must be held unhedged for 60 days following the close of the short transaction.

Qualified Dividends

Under current law, a reduced tax rate of 15% on qualified dividends applies through December 31, 2012. To qualify, shareholders must, in general, hold the common stock on which the dividend is paid for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date. Certain preferred shares can also qualify for the reduced rate; the holding period is extended to at least 91 days in the 181-day period beginning 90 days prior to the ex-dividend date.

- The taxpayer’s holding period is suspended for any period for which the taxpayer: (i) has an option to...
sell, is under a contractual obligation to sell, or has on open short sale of substantially identical stock; (ii) is the grantor of an option to buy substantially identical stock; or (iii) has diminished risk of loss by holding substantially identical stock; or (iii)

variable distributions must be taken by April 1 of the year after the IRA owner turns 70½ and must continue to be taken on an annual basis going forward.

• Roth IRAs, in contrast, are funded with after-tax dollars and are allowed to grow on a tax-free basis for the life of the account holder and his or her surviving spouse; that is, RMDs generally do not commence until a nonspouse inherits the Roth IRA account, at which time the Roth is treated as and is subject to the same distribution rules as a traditional IRA. The conversion from an IRA to a Roth IRA results in the recognition of taxable income of all of the gains and income in the IRA. If any of the IRA balance is withdrawn but not converted into a Roth IRA (for example, if some of the IRA balance is transferred on the books of the investor’s agent or when the security is transferred by selling prices on the date of the gift). Depending on the circumstances, a gift of a security may be completed when the security is transferred by the investor actually making the gift.

Roth IRAs

Conversion. Since 2010, virtually all taxpayers may convert an IRA to a Roth IRA. However, limitations based on Adjusted Gross Income prevent certain taxpayers from contributing to Roth IRAs. There are significant differences between a traditional IRA and a Roth IRA:

• IRA assets generally grow on a tax-deferred basis until they are taxed as ordinary income on distribution. As discussed above, in the case of a traditional IRA, required minimum distributions must be taken by April 1 of the year after the IRA owner turns 70½ and must continue to be taken on an annual basis going forward.

Gifts

1. To an individual: The annual exclusion for 2012 is $13,000 per donee ($26,000 for married couple splitting a gift on a gift tax return filed with the IRS). The amount deductible in any one year is subject to a limitation based on a percentage of the donor’s adjusted gross income (AGI). The percentage limitation and cost of fair market value are a function of the type of property given (cash vs. ordinary income property vs. long-term capital gain property) and the classification of the charitable organization as a public charity or

2. To charity: A gift of cash or other property to a charity is deductible in the year the investor actually makes the gift. Gifts of stock traded on an exchange are, in general, valued at the mean between the highest and lowest quoted selling prices on the date of the gift.

• Gifts of stock traded on an exchange are, in general, valued at the mean between the highest and lowest quoted selling prices on the date of the gift.

• Required minimum distributions. The owner of an IRA must start receiving required minimum distributions (“RMDs”) by April 1 of the year following the year in which the owner reaches age 70½. All following RMDs must be taken by December 31 of each year. If a RMD is not taken or if the amount taken is less than the RMD, an excise tax is imposed equal to 50% of the RMD amount not taken.

IRAs

a. The maximum IRA contribution limit for 2012 is $5,000 but it is increased by $1,000 as a “catch-up” contribution for taxpayers over 50. However, if the taxpayers total earned income was less than $5,000, the IRA contribution limit is equal to the taxpayer total earned income. Contributions may be made by the due date of filing tax returns, ignoring extensions, i.e., April 15, 2013. IRS inflation adjustment increased the IRA limit to $5,500 for 2013.

b. Required minimum distributions. The owner of an IRA must start receiving required minimum distributions (“RMDs”) by April 1 of the year following the year in which the owner reaches age 70½. All following RMDs must be taken by December 31 of each year. If a RMD is not taken or if the amount taken is less than the RMD, an excise tax is imposed equal to 50% of the RMD amount not taken.

Beyond that, individuals have a $5.12 million credit against the gift tax. Gifts in excess of such amounts would result in the payment of federal tax and, in some cases (e.g., Connecticut), state gift tax. The top federal gift tax rate this year is a relatively low 35% (in comparison to 2009’s rate of 45% and 2013’s default rate of 55%). Additionally, on January 1st, 2013, the estate tax exemption amount is scheduled to drop from the current $5.12 million to $1 million absent congressional action. Accordingly, individuals considering taxable gifts should seriously consider making such gifts this year.
2012 YEAR-END TAX-RELATED REMINDERS

Table 2: Charitable Contribution Deductibility Limits

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<td><strong>Long-Term Capital Gain Property</strong></td>
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1 Gifts of only certain types of long-term capital gain property called “qualified appreciated stock” to a private foundation may be deducted at fair market value.

Private Foundations: A few things to remember

1. A foundation must, on average, each year distribute to qualified charitable organizations at least 5% of the aggregate fair market value of its assets (and if it fails to do so, will be subject to significant excise taxes on the undistributed amount).

2. A 2% excise tax (which can be reduced to 1% if sufficient distributions are made) is imposed on the net investment income of a foundation.

3. In computation of the excise tax, capital losses can only be utilized in the year realized and do not carry forward for use in future years or carry back to prior years (i.e., use them or lose them).

GRATs

Grantor retained annuity trusts (GRATs) are trusts that may allow a donor to transfer any future appreciation above an IRS-mandated hurdle rate to beneficiaries free of estate and gift taxes. GRATs are especially popular in low interest rate environments such as we’re in now. Under current law, a GRAT may be structured as follows: a donor transfers property to a trust in return for an annuity for a term of years. The value of the annuity is based on an IRS discount rate and is typically structured to be nearly equal to the value of the property transferred into the trust so that there is no or little taxable gift made to the trust (if the value is zero, it is referred to as “a zeroed-out GRAT”). When the term of the annuity ends, any property remaining in the trust is paid to one or more remainder beneficiaries free of estate and gift taxes (often children or a trust for children). The success of the strategy depends upon the donor surviving the term of the annuity (which encourages the use of short annuity terms, often just two years) and a rate of return greater than the hurdle rate.

1. The Small Business and Work Opportunity Tax Act of 2007 raised the applicable age for the “kiddie tax” on which unearned income above $1,900 (increased to $2,000 in 2013) is taxed at the parent’s rate. Since 2008, the kiddie tax is applicable to individuals under age 19, or under age 24 if they are full-time students who remain dependents.

2. Parents may elect to include in their gross income the unearned income in excess of $1,900 (increased to $2,000 in 2013) of a child who is subject to the kiddie tax.

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## 2012 Year-End Tax-Related Reminders

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