Ten questions you should consider now

Focusing on Upcoming Tax Changes

Many significant provisions of the landmark Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) are scheduled to "sunset" (expire) at the end of 2012, which would result in significant tax law changes. If it feels as though we've been here before, that's because we have; the same thing was scheduled to occur at the end of 2010, but Congress voted to extend most of the effected provisions. Will it extend them again? Who knows? That's why you may want to consider taking steps between now and year-end that could dramatically improve your financial picture – regardless of what Congress does.

Together we'll go far

Unless Washington acts, significant changes are ahead

December 2011's last-minute legislation extending the payroll tax cut for only two months instead of the entire year was likely a preview of what taxpayers can expect between now and year-end. Depending on what, if any, tax legislation Congress is able to enact in this contentious environment, we could experience a tax increase for 2013 and later years, as shown in the table below.

The primary effect taxpayers may see is increased tax rates in three areas:

Income taxes

2012 ordinary income tax brackets		2012 rates	2013 rates
Single filer	Joint filer		
$0 – $8,700	$0 – $17,400	10%	15% (bracket starts at $0)
$8,700 – $35,350	$17,400 – $70,700	15%	
$35,350 – $85,650	$70,700 – $142,700	25%	28%
$85,650 – $178,650	$142,700 – $217,450	28%	31%
$178,650 – $388,350	$217,450 – $388,350	33%	36%
Over $388,350	Over $388,350	35%	39.6%

The 10% tax bracket will disappear and the rates for the remaining brackets will increase. As a result, taxpayers may want to consider taking action to influence when they receive income to help take advantage of 2012's lower rates.

Long-term capital gains taxes

2012 ordinary income tax brackets	2012 long-term capital gains rates	2013 long-term capital gains rates*
10%	0%	10%
15%	0%	10%
25%	15%	20%
28%	15%	20%
33%	15%	20%
35%	15%	20%

In 2013, taxpayers in the 15% ordinary income tax bracket (remember, there will be no 10% bracket) will no longer be able to avoid paying long-term capital gains taxes, and those in the higher brackets will see their rate increase from 15% to 20%. (As a result of the 2010 health care reform legislation, higher-income taxpayers will also see an additional 3.8% Medicare tax in 2013.) This means investors need to think about when is the right time to sell appreciated assets.

Qualified dividend taxes

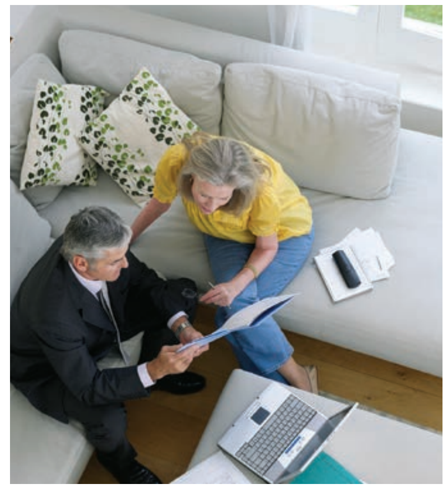
Character of dividend	2012 rates	2013 rates
Ordinary dividend	Ordinary income rates	Ordinary income rates
Qualified dividend	Long-term capital gains rates	Ordinary income rates

In 2012, qualified dividends are taxed at today's attractive long-term capital gains tax rates. Starting in 2013, they will be taxed at ordinary income tax rates, which means investors will need to re-evaluate the role of dividend-paying investments in their portfolios.

**Five-year rule regarding capital gains will be reinstated providing potential for a return of the 8%/18% long-term capital gains tax rate. This will apply to purchases made after Jan. 1, 2001. Consult your tax advisor for more information.*

Ten questions to discuss with your Financial Advisor

The expiration of many of EGTRRA's major provisions could have the biggest effect on taxpayers since the enactment of EGTRRA itself. Fortunately, there's time to take action so you can be prepared in case the "sunset" actually occurs. *To start your discussion, here are 10 questions for you and your Financial Advisor to address:*



QUESTION #1

When should you realize long-term gains?

QUESTION #2

Should you "harvest" capital losses this year?

QUESTION #3

Should you reallocate your portfolio?

- Move from income stocks to growth stocks?
- Purchase tax-exempt bonds?

QUESTION #4

Should you convert your traditional IRA to a Roth IRA?

QUESTION #5

When should you receive income?

- Take traditional IRA and annuity distributions?
- Receive or defer bonus, severance or retirement payments?
- Redeem U.S. Savings Bonds?

QUESTION #6

Are charitable contributions more valuable in 2012 or later years?

QUESTION #7

Should you delay state and local tax payments?

QUESTION #8

When should you take nonqualified 529 plan and Education Savings Account distributions?

QUESTION #9

When should you exercise employer-granted stock options?

QUESTION #10

How should you manage tax-deductible business expenses?

QUESTION #1

When should you realize long-term gains?

Jan. 1, 2013, may see the end of historically low long-term capital gains rates. How much these rates will increase depends on your ordinary income tax rate bracket, as shown in the second table on page 2.

Various Congressional proposals have been made that included alternative schedules, with some affecting only higher-bracket taxpayers; however, at this point they remain just that — proposals. As a result, be sure to watch carefully for any year-end tax legislation, and keep in touch with your tax advisor and Financial Advisor regarding your personal situation. But as it stands now, you may find it beneficial to sell appreciated securities or assets that you've held for the long term in 2012 to take advantage of this year's lower capital gains tax rates. This strategy may be particularly appropriate in certain situations:

You can take advantage of the current 0% long-term capital gains rate. If your net taxable income, including your long-term capital gains, is less than $70,700 (joint filers) or $35,350 (single filers) in 2012, you will be in the 10% or 15% ordinary income tax bracket, which means you may be able to realize some tax-free long-term capital gains. If your capital gains push you over your threshold, some of the gains will be taxed at the 15% long-term capital gains rate.

For example, a husband and wife file jointly and expect to have net taxable income of $75,000 in 2012, which comprises $55,000 in ordinary income and $20,000 in net long-term capital gains on sales of securities. Because their total income exceeds the 15% bracket threshold by $4,300 ($75,000 minus $70,700), their tax picture would appear as follows:

$55,000	Ordinary income
$15,700	Long-term capital gains taxed at 0% rate
$4,300	Long-term capital gains taxed at 15% rate

You hold a concentrated equity position. If you hold a substantial position in one stock that has appreciated over time, selling a portion of the shares and purchasing other investments with the proceeds can help you diversify and reduce the market risk in your portfolio. Or you may have other goals that involve recognizing the gain; you and your Financial Advisor can evaluate various strategies to help manage the risk of a concentrated position and the tax liability that may occur upon selling the investment. Ask your Financial Advisor for a copy of our report, *Managing the Wealth You've Accumulated in One Stock.*

However, given the limited window of opportunity for 2012's historically low long-term capital gains tax rates, you may want to seriously consider selling a portion this year. Doing so can help you avoid the potential tax rate increase that is scheduled for long-term capital gains recognized in 2013 and thereafter.

You have property or a business to sell. If you own real estate or business assets, the upcoming tax rate changes should prompt you to consider how you are managing those assets. In some cases, the buyer and seller of such assets can structure the sale so that proceeds are paid over more than one tax year. Typically, this strategy helps the seller manage his or her tax liability. However, given that both ordinary income tax rates and long-term capital gains tax rates are scheduled to rise in 2013, you may want to attempt to complete a sale, and receive its proceeds, in 2012. If you are contemplating such a sale, work closely with your tax advisor to determine if receiving payments over more than one tax year will be beneficial in a rising-tax-rate environment.

Think ahead before selling

If you decide to sell appreciated securities in 2012 to take advantage of the lower long-term capital gains rates, be strategic in how you do it. For the portion of your portfolio you have designated for long-term goals, work to align your allocation so that you are in a better position to buy and hold. Doing so will let you benefit from 2012's lower long-term capital gains tax rates, and in future years you may need only minimal rebalancing, which should help reduce the gains that you realize when the tax rates are higher.

If your estate could be worth $1 million or more, should you be concerned about estate taxes?

Many of EGTRRA's estate tax provisions are set to expire at the end of 2012. Ask your Financial Advisor for a copy of our report, Estate Planning in 2012. *You'll find ideas regarding potential strategies you may want to discuss with your estate planning attorney, regardless of your net worth or what happens in Congress.*

QUESTION #2

Should you "harvest" capital losses this year?

Typically, investors consider selling investments near year-end to realize losses to offset:

- Capital gains
- Up to $3,000 in ordinary income

However, if you have modest unrealized losses in 2012 (and do not anticipate generating sizable capital gains), you might consider waiting to realize those losses until 2013.

Here's why: Offsetting long-term capital gains that are taxed at 20% (the 2013 rate) will provide more tax savings than using the losses to offset gains taxed at 15% (the 2012 rate). You'll need to work closely with your tax advisor to project any potential capital gains (and don't forget about long-term capital gains distributions from mutual funds). For investors whose income (including long-term capital gains) is within the 10% or 15% income tax bracket, harvesting losses will not provide a tax benefit if it only reduces long-term capital gains. Losses in excess of gains will offer a nominal tax savings at best and may provide more value if left for future years.

If, on the other hand, you have substantial capital losses or capital loss carryforwards, it can sometimes be difficult to use up all of those losses. In this case, it probably does not make sense to postpone offsetting capital gains or waiting to recognize gains.

QUESTION #3

Should you reallocate your portfolio?

In general, a qualified dividend is one paid by a U.S. corporation or an international corporation that trades on a U.S. stock exchange. You may also receive a qualified dividend if you hold shares in a mutual fund that invests in these types of corporations.

Currently, qualified dividends are taxed at a maximum 15% rate — like long-term capital gains; however, in 2013, they are scheduled to be taxed at ordinary income tax rates, which could be a maximum 39.6% rate.

Given this anticipated change, you may want to consider reallocating the portion your portfolio held in taxable accounts using the following strategies.

Consider adding growth-stock holdings. If you don't need current income, you may want to talk with your Financial Advisor about the advantages of shifting some of your equity allocation to growth stocks. Or you might reposition a portion of your tax-deferred account allocation to dividend-paying stocks, where the dividends will be shielded from current taxation. With a dividend-paying stock, your total return is based on both growth and income, and the income portion may be taxed as ordinary income starting in 2013.

If you hold a growth stock for the long term, any appreciation in the stock's price will not be taxed until you sell it. At that point, you would owe long-term capital gains taxes (as long as you held the stock more than one year), which will still be lower than ordinary income tax rates, even after 2012. Because this strategy involves issues surrounding both your long-term asset allocation and taxation, be sure to work closely with your Financial Advisor and tax advisor to help determine the right strategy for your situation.

Reassess your tax-exempt bond holdings. If you need income, carefully weigh the pros and cons of tax-exempt bonds versus dividend-paying stocks. With rising tax rates, tax-exempt income may be more appealing. Dividend-paying stocks run the risk of having their dividend reduced or eliminated altogether. Also, tax-exempt bonds are usually less volatile than stocks.

However, tax-exempt investments have inherent risks. For example, bond investments may not be as well equipped to protect against inflation as stocks. In addition, keep in mind that:

- Certain municipal bond interest may expose you to the alternative minimum tax (AMT).
- Bond prices will fluctuate. In fact, they move inversely to interest rates. If interest rates increase, your bond investments' principal value will fall. You and your Financial Advisor will want to carefully consider this factor given the current outlook for the economy and the markets.

Will the new Medicare tax on investment income affect you?

Starting in 2013, married/joint taxpayers with incomes over $250,000 and single taxpayers with incomes over $200,000 will be subject to a new Medicare tax. If you're in either group, a 3.8% tax will be applied to some or all of your investment income, including capital gains. This will be in addition to ordinary or capital gains taxes that you already pay. To learn more about how this new tax may impact you, ask your Financial Advisor for a copy of our report, New Medicare Taxes on the Horizon.

You'll also want to evaluate the investment's yield. At 2012 income tax rates, a tax-exempt bond with a 4% yield would be comparable to a taxable investment with a 5.3% yield for someone in the 25% federal income tax bracket. If income tax rates increase, this same taxpayer would need to find a taxable investment with a 5.6% yield to generate the same after-tax income as the 4% tax-exempt bond.

If you choose to alter your portfolio's investment mix, talk with your Financial Advisor to help ensure your overall asset allocation remains appropriate for your investment goals, time horizon and risk tolerance.

Consider master limited partnerships (MLPs). If equity dividends are taxed as ordinary income in 2013, investments in MLPs may look more attractive due to their tax-deferral feature. In general, cash flow from MLPs is only partly taxed as ordinary income when received, and the remainder is tax-deferred. The tax-deferred portion is then taxed as ordinary income at the time of sale. MLPs are more complex than regular stocks and typically involve more complicated tax reporting. Before investing in an MLP, be sure you discuss the pros and cons with your Financial Advisor and tax advisor.

QUESTION #4

Should you convert your traditional IRA to a Roth IRA?

Anyone, regardless of income, now can convert a traditional IRA to a Roth IRA. The benefits of converting are the potential for tax-free income in retirement and the ability to pass on assets that your heirs can withdraw tax-free after your death. However, you may incur income taxes in the year you make the conversion. Because income tax rates are scheduled to increase on Jan. 1, 2013 *(see first table on page 2)*, if you're considering converting, you may be better off doing it this year rather than in 2013. If you're considering a Roth conversion, work closely with your tax advisor.

QUESTION #5

When should you receive income?

Payments from your employer. Whether you anticipate receiving a bonus or a lump sum payment due to retirement or a job transition, talk with your employer early about your flexibility in the timing of receiving the payment. Some employees are offered transition payment schedules that stretch over more than one year. This may not be ideal when tax rates are expected to increase (as in 2013). A review of the payment amount, date(s) of receipt and your expected income tax bracket in 2012 and future years will be important in deciding or negotiating when to receive this income.

IRA or annuity distributions. Taxable distributions from IRAs or annuities are a concern in a rising-tax-rate environment. If you are required to take minimum distributions from a retirement plan, IRA or inherited IRA, you'll want to factor that into future-tax-year projections. Taking mandatory distributions boosts your taxable income and may require either an increase in your withholding or, perhaps, paying estimated taxes quarterly to avoid an underpayment penalty.

If you're considering taking an elective distribution in the next few years, taking that distribution in 2012 when income tax rates are lower may be beneficial. This strategy is particularly timely when it comes to potential distributions and recognition of taxable income attributable to a Roth IRA conversion *(see Question #4 on page 7)*.

U.S. Savings Bond interest. If you own E or EE Savings Bonds nearing their 30-year maturity that have accumulated significant tax-deferred interest or HH Savings Bonds that hold tax-deferred interest, remember that when you redeem these bonds, you recognize ordinary interest income based on the redemption value less the price paid for the bond.

If you're considering redeeming these bonds, doing so in 2012 could result in tax savings if tax rates increase next year. On the other hand, an early redemption means you are giving up future interest accruals. You'll need to weigh the advantage of tax-deferred interest accruals against the potentially increased ordinary income tax rate you may incur in the future. (Keep in mind that if you qualify, you may be able to redeem certain EE Savings Bonds tax-free if used to pay for qualified higher-education expenses. Consult your tax advisor for additional information.)

If you are considering redeeming these bonds, be sure to pay attention to your interest accrual dates. If you redeem savings bonds just before the interest accrual date, you may forfeit several months of interest.

QUESTION #6

Are charitable contributions more valuable in 2012 or later years?

As you consider your 2012 charitable contributions, you'll want to project forward to 2013. Talk with your tax advisor along with your Financial Advisor about how you might split your charitable giving budget between the two years. A charitable deduction (as long as it is not subject to limitation based on your income) could potentially be more valuable in 2013 than in 2012. After some analysis, you may find it more beneficial to lower your 2012 charitable contributions and allocate more assets (cash or securities) to your 2013 charitable budget.

If you choose to wait for 2013 to make charitable gifts, you should consider making them with appreciated long-term assets rather than cash. Given the potential for rising tax rates, this strategy deserves a second look. When the strategy is appropriate, the benefits are twofold:

- When gifting long-term appreciated stock to charity, you avoid incurring capital gains taxes on the stock.
- A gift to a qualifying charity provides an income tax deduction (which could be limited based on your income).

Talk with your tax advisor to determine the full tax benefit of your gift in your specific situation.

QUESTION #7

Should you delay state and local tax payments?

Taxpayers often have some flexibility in determining when to make state and local tax payments. Such payments include income, real estate and personal property taxes. All of these items may be deductible for you depending on your tax situation. Review your state's laws or talk with your tax advisor to determine whether you have flexibility to delay these payments into next year. The delayed payment, and subsequent increase in tax deductions, may provide some tax savings if tax rates increase.

Child Tax Credit to decrease

Currently, parents of a qualifying child receive a credit of up to $1,000 that directly offsets their income-tax liability. After 2012, the maximum credit will drop to $500 per qualifying child. For large families, this reduction could represent a significant tax increase.

QUESTION #8

When should you take nonqualified 529 plan and Education Savings Account distributions?

Distributions from 529 plans and Education Savings Accounts (ESAs) result in ordinary taxable income if they are not used for a qualified education expense. If you own these accounts for a student you know, or anticipate, will not need the funds, you may be thinking about liquidating the accounts. For income tax purposes, you may owe less by taking nonqualified distributions this year rather than next.* But before taking taxable distributions or liquidating the account, talk with your Financial Advisor about other alternatives available for these accounts when the funds will not be used for the designated beneficiary.

Education Savings Account changes scheduled

If no additional legislation occurs, be prepared for these changes regarding Education Savings Accounts (ESAs) starting in 2013:

- *The annual contribution limit will fall to $500 per beneficiary*
- *Distributions for expenses related to kindergarten through grade 12 will no longer be federally tax-free.**
- *The contribution deadline will move back to Dec. 31 of the tax year*
- *Income limits for contributions will be reduced for married couples filing jointly*
- *Penalties will apply when contributing to both an ESA and 529 plan for the same beneficiary in a single year*

Talk to your Financial Advisor about alternatives for managing current ESA balances as well as future contributions.

QUESTION #9

When should you exercise employer-granted stock options?

If your company has granted you stock options as part of your compensation package, you may have either (or both) nonqualified stock options (NSOs) or incentive stock options (ISOs). You will want to understand the choices you have and the tax consequences of exercising each type of stock option.

NSOs give you the choice to exercise the options sometime between the vesting date and the expiration date. (See your stock option plan document or your employee benefits representative if you do not know these dates.) When you exercise an NSO, the difference between the stock's fair market value and the exercise price will be taxable compensation that's reported on your W-2.

If you have vested options and the opportunity to exercise them in 2012 or 2013, you'll need to work closely with your tax advisor to determine in which year it might be more beneficial to exercise the options and recognize the income. You and your tax advisor may want to project your taxable income for 2012 and a later year and then decide at which time it may be less taxing to exercise your options and realize the additional income. You'll also want to include your Financial Advisor, who can discuss the stock's market outlook, its valuation and the options' expiration date, in your decision-making process.

**You may incur a 10% penalty for nonqualified distributions, regardless of the year in which you can take them. A few exceptions may apply.*

ISOs are somewhat more complex because your holding period determines whether the exercise proceeds are taxed as ordinary income (similar to NSOs) or long-term capital gains. To benefit from the potential long-term capital gains tax treatment (with its 15% top rate in 2012 and 20% top rate in 2013) versus ordinary income tax rates (which range up to 35% in 2012 and 39.6% in 2013), you must hold the stock you receive more than one year from the exercise date and more than two years from the grant date. Because of the holding period requirement, it's obviously too late to lock in the 15% capital gains tax rate on options you have not yet exercised. However, if you exercised options in 2011 or earlier and still hold the shares, you'll want to weigh the pros and cons of selling them and recognizing gains in 2012 versus later years.

You should also be aware that if you exercise and hold shares from your ISO exercise, the taxable spread (the difference between the stock price on the exercise date and your option cost) will be taxable income for AMT purposes in the year in which the exercise occurs.

If you exercise your ISOs and sell without meeting this holding period, you will recognize taxable W-2 compensation similar to NSOs. Due to the lower capital gains rates, you may find it more attractive to hold ISO shares instead of selling them soon after exercise. But doing so makes it very important to work closely with a tax advisor to determine any potential AMT exposure.

If, instead, you decide to exercise ISOs and sell the stock, you may want to consider selling by year-end to take advantage of 2012's lower ordinary income tax rates. As with NSOs, you'll want to include your Financial Advisor, who can discuss the market outlook for the stock, in your decision-making process.

QUESTION #10

How should you manage tax-deductible business expenses?

If you are a cash-basis taxpayer and business owner who operates the business as an S corporation, partnership or sole-proprietorship, you pay tax on the business's net income on your individual federal income tax return. The business itself does not pay the tax. Therefore, the potential for an increase in tax rates is especially important to you.

Now is the time to plan for eventual tax rate hikes. Specifically, pay close attention to when you incur deductible business expenses. You may postpone some of these expenses to a future year when tax rates may be higher. On the other hand, businesses with carryforward losses may benefit more by accelerating income (to the extent possible based on tax law) into 2012 and deferring expenses to 2013 or later.

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In light of the many tax law changes that are scheduled to take place at year end, now is an excellent time to contact your Financial Advisor about creating or updating your Envision *plan. Give him or her a call today.*

Plan now!

The sunset provisions discussed in this report may affect you in many ways. It is important to talk with your Financial Advisor and tax advisor to understand the full impact on your investment plans. As a team, you'll want to develop a plan to take advantage of any opportunities. If you don't plan, you may not be prepared to act and could lose out on valuable tax-saving strategies.

How you should respond to this uncertainty depends on your view of what steps Congress may take. It is possible that it could once again extend current tax laws for the short-term. Or it could adopt one of the many proposals for tax reform. Regardless what path Congress chooses, it will be important to stay up-to-date with any progress on these issues.

Significant tax law changes like those on the horizon may prompt a change in your investment strategy. Meet with your Financial Advisor to discuss your goals, develop contingency plans or take actions now to benefit from the current tax environment.

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