

Financial
Planning
Advisory

Tax Planning in an
Environment of
Continued Uncertainty

To minimize your 2011 tax liability, you may need to take certain steps by December 31. In an environment of continued uncertainty, however, tax planning can be a challenge.

The steps you should take before year end depend in part on the deductions that will be available and the rates that will apply in future years, especially the coming year. Unfortunately, there is significant tax law uncertainty. At the end of 2011 and 2012, various tax breaks are scheduled to expire. In 2013, tax rates are scheduled to increase. Will expiring breaks and rates be extended? Will other tax law changes be signed into law? It is difficult to predict what will happen given Washington's increased focus on reducing the deficit, the level of discord in Congress, and the fact that 2012 is an election year.

The appropriate year-end tax planning steps also depend on your existing and future personal financial situation. Recent market volatility may have affected your circumstances and created more uncertainty about what lies ahead. Regular dialogue with your William Blair advisor can help you make changes as needed to achieve your long-term investment objectives, but potential tax consequences also should be considered.

What follows is an overview of key considerations in four tax planning areas:

- 1. Income planning**
- 2. Investment portfolio**
- 3. Retirement planning**
- 4. Estate planning**



Julie Alcala, CPA, CFP®
Senior Financial Planning Advisor
+1 312 364 8065
jalcala@williamblair.com



Kelly Oliven, CFP®
Financial Planning Advisor
+1 312 364 8451
koliven@williamblair.com

1. Key Consideration: Income Planning

One important variable that affects your overall tax liability for the year is whether your income is subject to regular or AMT rates. Also important are the deductions and credits you can take to offset your otherwise taxable income. The timing of income and deductible expenses can affect both the rate you pay and *when* you pay.

By regularly reviewing your year-to-date income, expenses, and potential tax, you may be able to time income and expenses in a way that reduces, or at least defers, your tax liability. In other words, tax planning should not be just a year-end activity.

The same tax rates apply for 2011 and 2012, so this year consider whether you could be in a higher or lower tax bracket in 2012. If you will be in the same tax bracket next year, you may want to defer income to 2012 and accelerate deductions into 2011 if possible. This will defer tax, which generally is beneficial. Next year, however, you will need to also consider the return of higher tax rates in 2013 and perhaps consider the opposite approach.

Additional Considerations

Alternative minimum tax (AMT). AMT income is determined by a separate calculation, which treats some income items differently and does not allow certain deductions. You must pay AMT if your AMT liability exceeds your regular tax liability. The top AMT rate is only 28%, but it typically applies to a larger income base and can result in a higher tax bill. Actions intended to defer tax could instead trigger or increase AMT liability this year or next, so it is important to consider the potential for AMT. A significant exemption applies, but it phases out for taxpayers with higher incomes. The exemption and the top of the phase-out ranges are scheduled to drop significantly in 2012. This means you may be more likely to be subject to the AMT next year, which should be considered in your income and deduction timing decisions this year. Fortunately, an AMT credit is available in certain situations.

Temporary elimination of income-based deduction phase-outs. Until last year, these limits reduced the benefit of certain itemized deductions for higher-income taxpayers. The phase-out elimination makes certain deductions more valuable, such as charitable donations. However, the phase-outs are scheduled to return in 2013. You may want to take advantage of the current window of opportunity by maximizing your charitable donations this year and next, particularly if you have higher-than-normal income (such

Regular Income Tax Rates and Brackets

2011 TAX RATE	SINGLE	MARRIED FILING JOINTLY
10%	\$0 - \$8,500	\$0 - \$17,000
15%	\$8,501 - \$34,500	\$17,001 - \$69,000
25%	\$34,501 - \$83,600	\$69,001 - \$139,350
28%	\$83,601 - \$174,400	\$139,351 - \$212,300
33%	\$177,401 - \$379,150	\$212,301 - \$379,150
35%	Over \$379,150	Over \$379,150

2012 TAX RATE	SINGLE	MARRIED FILING JOINTLY	2013 TAX RATE
10%	\$0 - \$8,700	\$0 - \$17,400	15%
15%	\$8,701 - \$35,350	\$17,401 - \$70,700	15%
25%	\$35,351 - \$85,650	\$70,701 - \$142,700	28%
28%	\$85,651 - \$178,650	\$142,701 - \$217,450	31%
33%	\$178,651 - \$388,350	\$217,451 - \$388,350	36%
35%	Over \$388,350	Over \$388,350	39.6%

AMT Exemptions

2011	SINGLE	MARRIED FILING JOINTLY
Amount	\$48,450	\$74,450
Phase-out ¹	\$112,500 - \$306,300	\$150,000 - \$447,800

2012	SINGLE	MARRIED FILING JOINTLY
Amount	\$33,750	\$45,000
Phase-out ¹	\$112,500 - \$247,500	\$150,000 - \$330,000

¹The alternative minimum tax (AMT) income ranges over which the exemption phases out and only a partial exemption is available. The exemption is completely phased out if AMT income exceeds the top of the applicable range.

Regular Tax vs. AMT: What is deductible?

EXPENSE	REGULAR TAX	AMT
State and local income or sales tax	●	
Real estate tax	●	
Mortgage interest	●	●
Interest on home equity debt not used to improve your principal residence	●	
Investment interest	●	●
Investment expenses	●	
Professional fees	●	
Unreimbursed employee business expenses	●	
Medical expenses	●	●
Charitable contributions	●	●

as from a Roth IRA conversion). For more information, see our September 2011 Financial Planning Advisory, “Charitable Giving: Strategies and Opportunities” (www.williamblair.com/pwm-resources), or contact us for a copy.

Underpayment penalties. As you review your year-to-date income, it is a good idea to look at whether you have paid enough tax throughout the year to avoid these penalties. Your estimated payments or withholding generally must equal at least 90% of your tax liability for 2011 or 110% of your 2010 tax. If you estimate your tax liability and determine you have underpaid, consider having the tax shortfall withheld from your salary or year-end bonus by December 31. This is often a better strategy than making up the difference with an increased quarterly tax payment, which may still leave you exposed to penalties for earlier quarters. If you typically have large variability in income (especially if it is skewed toward the end of the year), you may want to consider using the annualized income installment method in 2012.

Legislation To Watch For

- The lower income tax rates could be extended beyond 2012 for everyone, or they might be extended for only the lower and middle brackets.
- The higher AMT exemptions and larger phase-out ranges could be extended beyond 2011.
- The elimination of the itemized deduction phase-out could be extended beyond 2012.

2. Key Consideration: Investment Portfolio

Recent market volatility may mean you can take advantage of tax-loss harvesting. Losses are not losses for tax purposes until they are recognized—that is, until you sell the investment for less than what you paid for it. Then you can use the loss to offset recognized gains or perhaps even ordinary income. Alternatively, the loss might be carried forward to offset gains in future years.

By working with your William Blair financial advisor now to determine your year-to-date gains and losses, you can coordinate sales of other investments before year end to achieve your tax and investment planning goals. The tax benefit of recognizing a loss will depend in part on the netting rules that relate to short-term versus long-term gains and losses. See the table “Netting Capital Gains and Losses” below.

If you are trying to achieve a tax loss with minimal change in your portfolio’s asset allocation, keep in mind the wash-sale rule. It prevents you from using a loss on a security if you buy the same or a substantially identical security within 30 days before or after you sell the security that created the loss.

Additional Considerations

Lower long-term capital gains and qualified dividend rates. The 15% tax rate applies through 2012. You may want to consider whether you should sell appreciated assets to take advantage of the lower rate while it is still

Netting Capital Gains and Losses

When analyzing a capital gain or loss situation, begin by netting long-term items together and short-term items together. Then long and short items are netted to produce the final capital gain or loss result and taxed as follows:

Long-term gain

netted with

short-term gain

The long term gain gets the preferential rates of 15%, 25%, or 28% (or 0% for 10% and 15% income brackets). The short-term gain is taxed with your other income at your marginal rate.

Long-term gain

netted with

short-term loss

Two scenarios to consider:

1. If the gain is bigger than the loss, you have to net the long-term gain and can take advantage of the preferential rates for the net gain.
2. If the loss is bigger than the gain, it is a net short-term loss, and you can use up to \$3,000 of the loss against other types of income and carry forward any amount above the \$3,000.

Long-term loss

netted with

short-term gain

Two scenarios to consider:

1. If the gain is bigger than the loss, you have a net short-term gain, which is taxed at your marginal rate.
2. If the loss is bigger than the gain, you have a net long-term loss, and you can use up to \$3,000 of the loss against other types of income and carry forward any amount above the \$3,000.

Long-term loss

netted with

short-term loss

If the combined loss is less than \$3,000, you can use the entire amount to offset ordinary income. If there is more than \$3,000 in losses, you will use the short-term loss first and then carry forward the remainder, maintaining the character of each loss.

available or re-evaluate your qualified-dividend-producing investments in light of the possibility of higher rates in 2013.

Investment interest expense deduction. If you borrow funds to make investments, the interest is deductible up to your “net investment income,” which includes taxable interest, nonqualified dividends and *short-term* capital gains reduced by other investment expenses.

Non-tax factors. When making investment decisions, tax consequences are only one of many factors to consider. The capital market environment as well as your risk tolerance, financial goals, and personal situation also should be taken into account. In other words, it is important to be tax aware, but tax considerations should not be the primary driver of your investment or other financial planning decisions; a combination of factors should be considered. In the current economic environment, non-tax factors could change at any time. Therefore, being flexible and speaking with your William Blair advisor regularly about your portfolio and your overall financial situation are key to achieving your goals.

Legislation To Watch For

- The lower capital gains and dividend tax rates could be extended beyond 2012 for everyone, or they might be extended for only the lower and middle brackets.

3. Key Consideration: Retirement Planning

One often-overlooked tax planning issue is required minimum distributions (RMDs). RMDs apply to most traditional retirement plan owners age 70 ½ or older and generally to those who have inherited a retirement plan,

regardless of age or plan type. It is critical to take any RMDs by year end because the penalty for noncompliance is 50% of the amount you should have withdrawn but did not.

Because RMDs from traditional plans are generally fully taxable at ordinary-income rates, they can generate substantial tax liability. If you are age 70 ½ or older, you can reduce or eliminate this liability by making a direct IRA rollover to charity of up to \$100,000 through December 31, 2011. Although the donation does not qualify for a charitable income tax deduction, you save the tax you would otherwise have owed on the distribution. This tax-saving opportunity is scheduled to expire December 31, 2011.

Additional Considerations

Maximizing contributions. Consider contributing the maximum allowed to an employer-sponsored retirement plan, such as a 401(k). Contributions are typically pretax, so they can reduce your taxable income. Plan assets can grow tax-deferred until you take distributions. Your employer may even match some or all of your contributions—also on a pretax basis. If you are a business owner or self-employed, you may be able to set up a plan that allows much larger contributions. To make the most of your contribution opportunities, be aware of the limits and deadlines.

Roth IRA conversions. If you are ineligible to contribute to a Roth IRA because of the income-based limits that apply and you have a traditional IRA, you may benefit from converting it to a Roth IRA. The income-based limit on who can convert has been permanently lifted, and a conversion can allow you to turn *tax-deferred* growth into *tax-free* growth. It also can provide estate planning advantages: Roth IRAs do not require you to take RMDs, so you can let the entire balance grow tax-free for the benefit of your heirs. The tradeoff of a Roth IRA conversion is that the converted amount is generally taxable in the year of the conversion. Whether a conversion makes sense for you depends on a variety of factors that you should discuss with your advisors.

Roth IRA recharacterizations and reconversions. With recent market volatility, you may end up owing tax on value that has been lost since the conversion, or the tax may simply become less affordable. You have the option to “undo” the conversion in a recharacterization. (The deadline for recharacterizations of 2010 conversions, however, was October 17, 2011.) You avoid tax on the conversion-date balance, including the lost value. If a

What Is the Maximum Tax Rate?

TYPE OF INVESTMENT INCOME	2011-2012	2013*
Short-Term Capital Gains	35%	39.6%
Long-Term Capital Gains	15%	20.0%
Nonqualified Dividends	35%	39.6%
Qualified Dividends	15%	39.6%

*In 2013, the following taxes also apply:

- Additional 0.9% Medicare tax on high-income taxpayers (2.35% of wages vs. 1.45%.
- Unearned income Medicare contribution of 3.8% on certain types of investment income for those with gross income exceeding \$200,000 individual / \$250,000 couples.

conversion is otherwise desirable, you can reconvert, subject to applicable timing requirements. The tax you will owe will be based on the account's potentially lower value on the date of the reconversion. There are many important considerations you should discuss with your advisors before implementing a recharacterization or reconversion.

Legislation To Watch For

- The ability to avoid taxes on traditional IRA distributions by making a direct contribution to charity of up to \$100,000 may be extended beyond 2011.

4. Key Consideration: Estate Planning

Now may be a good time to consider wealth-transfer planning. Recent estate tax law changes are set to expire December 31, 2012, and you may benefit from making transfers by that date.

First, consider annual exclusion gifts. They can be made to any individual but must be made by year end or the \$13,000 per recipient exclusion for the year will be lost. If you are married, you and your spouse can together give \$26,000, but you may need to file a gift tax return. Multiply \$26,000 by the number of children and grandchildren you have, and you may be able to remove a significant amount of wealth from your estate without reducing the estate tax exemption that will be available at your death.

Second, making gifts this year and next allows you to take advantage of the \$5 million gift tax exemption while it is available. Both the gift and estate tax exemptions are scheduled to drop to \$1 million in 2013.

Lastly, gifting can allow you to shift income to family members in lower tax brackets, perhaps saving tax overall for the family. For example, if you have children or grandchildren in the 10% or 15% regular income tax brackets who qualify for the 0% long-term capital-gains rate, you can give them highly appreciated assets that they potentially could sell at a 0% tax cost.

It is important to balance estate planning with retirement needs to ensure that you do not jeopardize your own financial security or your ability to live your desired lifestyle. For more information, see our June 2011 Financial Planning Advisory, “Balancing Retirement with Wealth-Transfer Goals” (www.williamblair.com/pwm-resources), or request a copy from your William Blair advisor.

Additional Considerations

“*Kiddie*” tax. For children subject to this tax, any unearned income beyond \$1,900 (for 2011 and 2012) is

Roth Recharacterizations and Reconversions

KEY DATE	ACTION
Jan. 1, 2012	The earliest date you can reconvert if you recharacterize a 2011 conversion in 2011
April 16, 2012	The date by which you must file a 2011 tax return or request an automatic extension to be eligible to recharacterize a 2011 conversion
Oct. 16, 2012	The deadline for: <ul style="list-style-type: none"> • Recharacterizing a 2011 conversion • Filing an extended return reflecting a recharacterization of a 2011 conversion
30 days from the date of recharacterization	The earliest date you can reconvert if you recharacterized a 2011 conversion.
3 years from the date of your original return or within 2 years from the date you paid return the tax, whichever is later	The deadline in 2012 for filing an amended return to claim an additional refund if you recharacterize a 2011 conversion after filing your 2011 tax return

Note: Exceptions may apply in certain circumstances

Retirement Plan Contribution Limits

TYPE OF PLAN	LIMIT ¹		CONTRIBUTION DEADLINE
	2011	2012	
401(k)	\$16,500	\$17,000	Dec. 31, 2011
Catch-up*	+ \$5,500	+ \$5,500	
Simple	\$11,500	\$11,500	Dec. 31, 2011
Catch-up*	+ \$2,500	+ \$2,500	
IRA	\$5,000	\$5,000	April 16, 2012
Catch-up*	+ \$1,000	+ \$1,000	
<i>Plans for Business Owners and the Self-employed</i>			
Profit-sharing plan	\$49,000	\$50,000	Oct. 15, 2012 ²
Catch-up*	+ \$5,500	+ \$5,500	
SEP	\$49,000	\$5,500	Oct. 15, 2012 ²
Catch-up*	+ \$5,500	+ \$5,500	

*For taxpayers over age 50.

¹Other factors may reduce your limit.

²If tax return extension is filed.

taxed at their parents' marginal rate rather than their own, likely lower, rate, reducing the benefits of income shifting. Keep this in mind before transferring assets to children—or to young adults. The kiddie tax applies to children under age 19 as well as to full-time students under age 24 (unless the students provide more than half of their own support from earned income).

Regular estate plan review. It is important to regularly review your estate plan in light of not only tax law changes, but also economic changes, family changes, and changes in your personal financial situation. For more information, see our January 2011 Financial Planning Advisory, “Estate Planning Strategies in an Environment of Change” (www.williamblair.com/pwm-resources), or request a copy from your William Blair advisor.

Decisions for estates of those who died in 2010. Executors of these estates have a choice: they can allow the estate tax to apply, or they can opt out and apply the modified carryover basis rules. The deadline for filing the form to opt out of the estate tax generally is November 15, 2011, so executors need to make a decision soon. For more information, see our August 22, 2011, Financial Planning Update, “IRS Provides Guidance for Executors on 2010 Estate Tax Elections” (www.williamblair.com/pwm-resources).

William Blair’s website provides investors access to publications, webinars, and events on an array of private wealth management topics. To access these resources, visit: williamblair.com/PWM-resources.

Legislation To Watch For

- Higher exemptions and lower rates could be extended beyond 2012.

Importance of Reviewing Your Situation

In an environment of continued uncertainty, the importance of reviewing your situation cannot be overemphasized. Only by looking at key considerations now can you take any appropriate actions to reduce your taxes, where possible, while achieving your overall financial goals. It also is critical to involve your William Blair advisors and tax professional in the review process. They can help you determine the best steps for your particular situation.

Transfer Tax Exemptions and Highest Rates

	GIFT TAX EXEMPTION	ESTATE TAX XEMPTION ²	GST TAX EXEMPTION	HIGHEST ESTATE, GIFT, AND GST TAX RATE ¹
2011	\$5M	\$5M	\$5M	35%
2012	\$5.12M ¹	\$5.12M ¹	\$5.12M ¹	35%
2013	\$1M	\$1M	\$1M ²	55% ³

¹Indexed for inflation

²Less any gift tax exemption already used during life; for 2011 and 2012, these amounts are “portable” between spouses

³The benefits of the graduated gift and estate tax rates and exemptions are phased out for gifts/estates over \$10 million

Tax Law Provision Changes

TAX LAW PROVISION	AVAILABLE UNDER RULES		
	2011	2012	2013
Lower ordinary income tax rates	Yes	Yes	No
Higher AMT exemption and larger phase-out range	Yes	No	No
Elimination of income-based phase-outs on personal exemptions and itemized deductions	Yes	Yes	No
Deduction for state and local sales tax in lieu of state and local income tax	Yes	No	No
Lower long-term capital gains and qualified dividend rates	Yes	Yes	No
Ability to make a direct, tax-free donation to charity of up to \$100,000 from your IRA (if you are 70½ or older)	Yes	No	No
Lower gift, estate, and GST tax rates, and higher exemptions	Yes	Yes	No
Estate tax exemption portability between spouses	Yes	Yes	No

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William Blair

| +1 312 236 1600 tel

| 222 West Adams Street
Chicago, Illinois 60606