2013 Year-End Tax Planning Considerations

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As January 1, 2014 gets closer, year-end tax planning considerations should be starting to take shape. New tax legislation has brought greater certainty to year-end planning, but has also created new challenges. The number of changes made to the Tax Code and the opportunities these changes bring may seem overwhelming. However, early planning will help you to maximize your potential tax savings and minimize your tax liability. This letter is intended to be a mile-high view of some key year-end tax planning strategies.

Changes for 2013 and beyond

In 2012, year-end planning was complicated by the great uncertainty over the fate of the Bush-era tax cuts. For more than 10 years, individuals had enjoyed lower income tax rates, but these rates were scheduled to expire after 2012. Moreover, many tax credits and deductions that had been made more generous were also set to expire after 2012. In January 2013, Congress passed the American Taxpayer Relief Act of 2012, which made permanent many, but not all, of the Bush-era tax cuts and also some tax benefits enacted during the Obama administration. Congress also permanently "patched" the alternative minimum tax (AMT) to prevent its encroachment on middle income taxpayers. The result is much greater certainty in year-end tax planning for 2013 because we know what the individual tax rates are in 2014, how many tax credits and deductions are structured, and much more.

Of course, there are always complexities in the Tax Code. In 2013, two new Medicare taxes kicked-in (a 3.8-percent net investment income (NII) surtax and a 0.9-percent Additional Medicare Tax). In addition, the U.S. Supreme Court ruled that the federal government's denial of recognition of same-sex marriage was unconstitutional, opening the door to allowing married same-sex couples to file joint federal tax returns and take advantage of other tax benefits available to married couples. Beginning in 2014, some of the most far reaching provisions of the Affordable Care Act will become effective: the individual mandate, the start of Marketplaces to obtain insurance and a special tax credit to help offset the cost of insurance.

Planning for expiring tax incentives

First, do not lose the benefit of some generous, but temporary tax incentives, that are available in 2013 but may not be in 2014. Are you planning to purchase a big-ticket item such as a new car or boat? The state and local sales tax deduction (available in lieu of the deduction for state and local income taxes) is scheduled to expire after 2013, and you may want to accelerate that purchase to take advantage of the tax break. A valuable tax credit for making certain energy efficient home improvements, including windows and heating and cooling systems, and a deduction for teachers' classroom expenses are also scheduled to expire after 2013.

These are just some of many incentives that will sunset after 2013 unless extended by Congress. The window for maximizing your tax savings for 2013 is closing. Please contact our office for more details.

Planning for new taxes and rates

Some individuals may be surprised that they owe additional taxes in 2013, even with the extension of the Bush-era tax cuts. Three new taxes are in effect for 2013: the NII surtax, the Additional Medicare Tax and a revived 39.6 percent tax bracket for higher income individuals. The 3.8-percent NII surtax very broadly applies to individuals, estates and trusts that have certain investment income above set threshold amounts. These amounts include a $250,000 threshold for married couples filing jointly; $200,000 for single filers. One strategy to consider is to keep, if possible, income below the threshold levels for the NII surtax by spreading income out over a number of years or finding offsetting above-the-line deductions. If you are considering the sale of your home, and the proceeds will exceed the homesale exclusion, please contact our office so we can discuss any possible NII surtax.

The Additional Medicare Tax applies to wages and self-employment income above threshold amounts including $250,000 for married couples filing joint returns and $200,000 for single individuals. If you have not already reviewed your income tax withholding for 2013, now is the time to do it. One way to reduce the sting of any Additional Medicare Tax liability is to withhold an additional amount of income tax.

As discussed, ATRA extended the Bush-era tax rates for middle and lower income individuals. ATRA also revived the 39.6 percent top tax rate. For 2013, the starting points for the 39.6 percent bracket, for 2013 are 450,000 for married couples filing jointly and surviving spouses, $425,000 for heads of households, $400,000 for single filers, and $225,000 for married couples filing separately. ATRA also revived the personal exemption phaseout and the limitation on itemized deductions for higher income individuals.

Starting in 2013, ATRA also sets the top rate for capital gains and dividends to 20 percent. This top rate aligns itself with the levels at with the new 39.6 percent income tax rate bracket starts: capital gains and dividends to the extent they would be otherwise taxed at the 39.6 percent rate as marginal ordinary income will be taxed at the 20 percent rate. ATRA did not change the application of ordinary income rates to short-term capital gains. However, individuals should plan for the possibility of being subject to a higher top rate (39.6 percent).

Planning for health care changes

The Affordable Care Act brings a sea-change to our traditional image of health insurance. Beginning in 2014, the law requires individuals to either carry minimum essential health care coverage or make a shared responsibility payment (also known as a penalty). Most employer-sponsored health insurance is deemed to be minimum essential coverage, as is coverage provided by Medicare, Medicaid, and

other government programs. Self-employed individuals and small business owners should revisit their health insurance coverage, if they have coverage, before year-end and weigh the benefits and costs of obtaining coverage in a public Marketplace (or a private insurance exchange) for themselves and their employees. Small businesses may be eligible for a tax credit to help pay for health insurance. Individuals may qualify for a premium assistance tax credit, which is refundable and payable in advance, to offset the cost of coverage.

Individuals who itemize their deductions also need to keep in mind the 10 percent floor for qualified medical expenses. This change took effect at the beginning of 2013. It means that you can only claim deductions for medical expenses when they reach 10 percent of adjusted gross income (for regular tax purposes and for alternative minimum tax purposes). There is a temporary exception for individuals over age 65 for regular tax purposes.

Planning for gifts

Gift-giving is often overlooked as a year-end planning strategy. For 2013, individuals can make tax-free gifts (no tax consequences for the giver or the recipient) of up to $14,000 to any individual. Married couples may "split" their gifts to each recipient, which effectively raises the tax-free gift to $28,000. Gifts between spouses are always tax-free unless one spouse is not a U.S. citizen. In that case, the first $143,000 in gifts made in 2013 are tax-free.

There are special rules for gifts made for medical care and education that can be a valuable component of a year-end tax strategy, especially for individuals who want to help a family member of friend. Monetary gifts given directly to a college to pay tuition or to a medical service provider are tax-free to the person making the gift and the person benefitting from education or medical care.

Gifts to charity also are frequently made at year-end. Through the end of 2013, taxpayers age 70 ½ and older can make a tax-free distribution from individual retirement accounts to a charity. The maximum distribution is $100,000. Individuals taking this option cannot claim a deduction for the charitable gift.

Planning for retirement savings

Year-end is a good time to review if your retirement savings plans and tax strategies complement each other. For 2013, the maximum amount of contributions that can be made to an IRA is $5,500, with a $1,000 catch-up amount allowed for individuals over age 50. Keep in mind that the maximum amount that can be contributed to a Roth IRA begins to decrease once a taxpayer's adjusted gross income crosses a certain threshold. For example, married couples filing jointly will begin to see their contributions begin to phase out when their AGI is $178,000. Once their AGI reaches $188,000 or more, they can no longer contribute to a Roth IRA. For single filers the corresponding income thresholds for 2013 are $112,000 and $127,000. Please note that 2013 contributions, for tax purposes, may be made until April 15, 2014.

Traditional IRAs and Roth IRAs are very different savings vehicles. A traditional IRA or Roth IRA set up years ago may not be the best savings vehicle today or for the immediate future if employment and other personal circumstances have changed. Every individual has unique goals for retirement savings and no one size fits all. Please contact our office for a more detailed discussion of your retirement plans.

We have reviewed only some of the many year-end tax planning strategies that could help you minimize your 2013 tax bill and maximize savings. Please contact our office to schedule an appointment to personalize your 2013 year-end tax planning.