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Dear Client:

Year-end tax planning issues are nothing new, but the implications as we approach 2014 are unusually significant. For one thing, timely action could nail down a host of tax breaks that won't be around next year unless Congress acts to extend them, which at the present time, looks doubtful. Doing a bit of year-end planning might also help higher earning taxpayers avoid or postpone paying the new 3.8% tax on unearned income called for under the Health Care Act. We hope that you will find time to read through this newsletter as soon as you can. It's filled with tax-saving ideas, many of which won't work if you wait too long. For instance:

- **Expiring Tax Provisions.** Now is the time to take advantage of tax breaks that are available through the end of this year but won't be around next year unless Congress acts.

  For individuals, these include, among others: the option to deduct state and local sales and use taxes instead of state and local income taxes; the above-the-line deduction for qualified higher education expenses; the ability to deduct up to $2 million of mortgage debt forgiveness; and tax-free distributions by those age 70 or older from IRAs for charitable purposes.

  For businesses, expiring tax breaks include: 50% bonus first-year depreciation for most new machinery, equipment and software; an extraordinarily high $500,000 expensing limitation; the research tax credit; and the 15-year write-off for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements.

- **The New 3.8% Medicare Investment Income Tax.** Higher earning taxpayers need to plan for the new 3.8% Medicare tax on net investment income. This tax, created as part of the Health Care Act, comes into play when your modified adjusted gross income is over $250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case. With some planning, this tax might be minimized or avoided altogether, by deferring net investment income or reducing modified adjusted gross income or both.

- **The New 0.9% Medicare Tax.** The Health Care Act also added another tax starting in 2013 . . . an additional 0.9% Medicare (hospital insurance,) tax that applies to individuals receiving employment wages in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately).

  This tax will be withheld by your employer in many cases, but there will be situations where you may need to have more withheld toward year-end to cover the tax. For instance, if you earned $150,000 from each of two employers during the year, you would owe the additional Medicare tax, but there would be no withholding by either employer for the additional tax.

  The new Medicare tax can also be over-withheld. This can happen when only one of the married spouses works and earns enough for the employer to withhold, but the couple's income won't be high enough to actually cause the tax to be owed.

What’s New in 2013?

Among the many important federal tax developments during 2013 are the following:

- **The Fiscal Cliff Legislation.** Tax changes under fiscal cliff legislation were mostly positive. ***The American Taxpayer Relief Act of 2012*** that was signed last January is a sweeping tax package that includes, among many other items, a permanent extension of the Bush-era tax cuts for most taxpayers, permanent relief from the alternative minimum tax (AMT) for individual taxpayers, and a host of retroactively resuscitated and extended tax breaks for individuals and businesses. The Act also increases income taxes and limits deductions and exemptions for some high-income individuals. In addition, it provides permanent estate, gift and generation-skipping transfer tax relief, although with a slightly higher rate than applied for years before the act passed.

- **New Simplified Option for Claiming a Home Office Deduction.** The IRS has provided an optional safe harbor method that individuals can use to determine the amount of their deductible home office expenses, effective for tax years beginning on or after Jan. 1, 2013. The safe harbor—$5 × square feet of qualified use (up to 300 square feet)—provides an alternative to the calculation, allocation, and substantiation of actual expenses that would otherwise be required.

- **Tax Treatment of Same-Sex Spouses.** The IRS and other Federal agencies issued guidance on the treatment of same-sex spouses and couples for tax and other purposes in light of the Supreme Court's landmark Windsor decision striking down section 3 of the Defense of Marriage Act (DOMA), which had required same-sex spouses to be treated as unmarried for purposes of federal law.

- **Mileage Reimbursement Rates for 2013**. The optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) for business travel taking place in **2013** is **56.5¢** per mile. The 2013 rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction is **24¢** per mile. The rate for using a car for 2013 charitable purposes remains at **14¢** per mile.

- **Watch Out for a New IRS Phone Scam.** There's a "sophisticated" phone scam targeting taxpayers nationwide, including recent immigrants,. Victims are told they owe money to the IRS and that they must pay promptly through a pre-loaded debit card or wire transfer. If the victim refuses, they are threatened with arrest, deportation or suspension of a business or driver's license. In many cases, the IRS reports, the caller becomes hostile and insulting.

- The scam often includes one or more of these other characteristics: fake names and IRS badge numbers; the use of common names and surnames to identify themselves; reciting the last four digits of a victim's Social Security number; forcing an IRS toll-free number to show on the caller ID; sending victims bogus IRS e-mails to support the bogus calls; adding the background noise of other calls being conducted to mimic a call site; and (especially nasty) threatening victims with jail time or driver's license revocation and hanging up, followed shortly by another scammer's call who pretends to be from the local police or DMV and forces onto the victim's phone a caller ID that supports the bogus claim.

- ***IMPORTANT: The IRS does not request credit card numbers, a pre-paid debit card or a wire transfer over the phone!***

The Year is Fast Drawing to a Close. Included with this letter is a checklist that our firm developed to help you with year-end tax planning. Not all these tips (they’re based on current tax rules) will apply in your particular situation, but you (or a family member) are likely to benefit from many of them.

Please call us soon and make an appointment to go over your year-end tax options. That way we can meet, narrow down the specific actions that will benefit you and your family and get you started on your year-end tax-saving moves.

Have a wonderful holiday season. We look forward to hearing from you soon.

2013 YEAR-END TAX TIPS

Use this Checklist and then Call Us

Not all these tips based on current tax rules will apply in your particular situation, but you (or a family member) are likely to benefit from many of them. The sooner you call us and make an appointment, the more time we will have to meet, narrow down the specific actions that will benefit you and your family and get you started on your year-end tax-saving moves.

Year-End Tax Planning Moves for Individuals

☐ Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.

☐ If you become eligible to make health savings account (HSA) contributions in December of this year, you can make a full year's worth of deductible HSA contributions for 2013.

☐ Harvest your losses on stocks while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later. It may be advisable for us to meet to discuss year-end trades you should consider making.

☐ Keep in mind that delaying 2013 income into 2014 might push you into a higher tax bracket next year or have a detrimental impact on various income tax deductions that are reduced at higher income levels.

☐ Postpone income until 2014 and accelerate deductions into 2013 to lower your 2013 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2013 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest.

☐ Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2013. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year or where lower income in 2014 will result in a higher tax credit for an individual who plans to purchase health insurance on a health exchange and is eligible for a premium assistance credit.

☐ If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA money invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2013.

☐ If you converted assets in a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value, and if you leave things as-is, you will wind up paying a higher tax than is necessary. You can back out of the transaction by recharacterizing the rollover or conversion, that is, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA.

☐ If a bonus is coming to you, it may be advantageous to try to have your employer defer the bonus payment until 2014.

☐ Consider using a credit card to prepay expenses that can generate deductions for this year.

☐ Take an eligible rollover distribution from a qualified retirement plan before the end of 2013 if you are facing a penalty for underpayment of estimated tax and the increased withholding option is unavailable or won't sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2013. You can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2013, but the withheld tax will be applied pro rata over the full 2013 tax year to reduce previous underpayments of estimated tax.

☐ Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2013, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state property taxes on your residence, state income taxes (or state sales tax if you elect this deduction option), miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes in the case of a taxpayer who is over age 65 or whose spouse is over age 65 as of the close of the tax year. As a result, in some cases, deductions should not be accelerated.

☐ If you are a homeowner, make energy saving improvements to the residence, such as putting in extra insulation or installing energy saving windows, or an energy efficient heater or air conditioner. You may qualify for a tax credit if the assets are installed in your home before 2014.

☐ Unless Congress extends it, the up-to-$4,000 above-the-line deduction for qualified higher education expenses will not be available after 2013. Thus, consider prepaying eligible expenses if doing so will increase your deduction for qualified higher education expenses. Generally, the deduction is allowed for qualified education expenses paid in 2013 in connection with enrollment at an institution of higher education during 2013 or for an academic period beginning in 2013 or in the first 3 months of 2014.

☐ You may want to pay contested taxes to be able to deduct them this year while continuing to contest them next year.

☐ You may want to settle an insurance or damage claim in order to maximize your casualty loss deduction this year.

☐ If you are age 70-1/2 or older, own IRAs and are thinking of making a charitable gift, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer, if made before year-end, can achieve important tax savings.

☐ Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70-1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. If you turned age 70-1/2 in 2013, you can delay the first required distribution to 2014, but if you do, you will have to take a double distribution in 2014 the amount required for 2013 plus the amount required for 2014. Think twice before delaying 2013 distributions to 2014. Bunching income into 2014 might push you into a higher tax bracket or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2014 if you will be in a substantially lower bracket that year, for example, because you plan to retire late this year.

☐ Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give $14,000 in 2013 to each of an unlimited number of individuals but you can't carry over unused exclusions from one year to the next. The transfers also may save family income taxes where income-earning property is given to family members in lower income tax brackets who are not subject to the kiddie tax.

Year-End Tax-Planning Moves for Businesses & Business Owners

- □ Businesses should consider making expenditures that qualify for the business property expensing option. For tax years beginning in 2013, the expensing limit is $500,000 and the investment ceiling limit is $2,000,000. And a limited amount of expensing may be claimed for qualified real property.

- □ However, unless Congress changes the rules, for tax years beginning in 2014, the dollar limit will drop to $25,000, the beginning-of-phase-out amount will drop to $200,000, and expensing won't be available for qualified real property. The generous dollar ceilings that apply this year mean that many small and medium sized businesses that make timely purchases will be able to currently deduct most if not all their outlays for machinery and equipment. What's more, the expensing deduction is not prorated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.

- □ Businesses also should consider making expenditures that qualify for 50% bonus first year depreciation if bought and placed in service this year. This bonus write-off generally won't be available next year unless Congress acts to extend it. Thus, enterprises planning to purchase new depreciable property this year or the next should try to accelerate their buying plans, if doing so makes sound business sense.

- □ Nail down a work opportunity tax credit (WOTC) by hiring qualifying workers (such as certain veterans) before the end of 2013. Under current law, the WOTC won't be available for workers hired after this year.

- □ Make qualified research expenses before the end of 2013 to claim a research credit, which won't be available for post-2013 expenditures unless Congress extends the credit.

- □ Depending on your particular situation, you may also want to consider deferring a debt-cancellation event until 2014, and disposing of a passive activity to allow you to deduct suspended losses.

- □ If you own an interest in a partnership or S corporation you may need to increase your basis in the entity so you can deduct a loss from it for this year.

<u>NOW</u> IS THE TIME TO PLAN FOR YOUR 2013 TAXES! Situations occur almost every day that can impact your income taxes. Waiting until 2014 is likely to mean missing tax saving opportunities that are only available until the end of 2013.

In 2013 did you have a significant income change; change your name or address; marry, divorce or live apart from your spouse; have or adopt a child; lose a spouse or a child; start or sell a business; purchase or sell business equipment or rental property; create a living trust; or receive any correspondence from the IRS?

<u>Call today for a tax planning appointment</u>. The sooner we meet, the more time we will have for tax saving action.