Fall, 2013

Rounds and Brooks, CPAs, P.C.

Year End Tax Planning, 2013

Introduction

There are many differences for the 2013 tax year and it's a good time to take a look at your tax situation. A number of new tax provisions apply at various thresholds, including certain levels of wages and self-employment income, adjusted gross income and overall taxable income. Watch for the break-points that might put you in a higher tax bracket or limit your deductions. Tax planning to reduce income and/or consolidate deductions may avoid various limitations in the tax law. Contributing to qualified retirement plans, deferring income, investing for tax-exempt income, and grouping deductions into 2013 are just some of the midyear planning opportunities that could reduce your taxes. The new thresholds aren't consistent through the various limitations, so it's more important than ever to perform calculations to determine the best strategies.

Shifting income and future appreciation from investments to family members by means of gifting may be a tax-planning opportunity. For gift tax purposes, the annual exclusion in 2013 has been increased from $13,000 to $14,000. In addition, the estate, gift, and generation skipping transfer tax has been permanently set at a top rate of 40 percent with a $5.25 million exemption for total lifetime gifts or for estate of decedents dying in 2013. However, when dependent children are still under 19, or under 24 while full-time students, the so-called kiddie tax applies the parents' tax rate to the children's investment income in excess of $2,000 for 2013. That may reduce in the short term the income tax benefit of shifting income.

Income

Check your 2013 income tax withholding or 2013 estimated tax payments, particularly if you receive self-employment income. An underpayment penalty will apply on April 15, 2014 if your 2013 withholding and estimated tax payments do not equal at least 90 percent of your 2013 total tax.

Other exceptions apply based on your prior-year tax. If your estimates equal or exceed 100 percent of your 2012 total tax (110 percent if your 2012 adjusted gross income exceeded $150,000), the penalty will not apply.

Be sure to report all of your income. The IRS is watching for unreported offshore bank accounts and brokerage accounts. There is nothing wrong with international investments, but all of the related income must be reported on Form 1040, and information about foreign accounts must be separately reported on Form TD F 90-221 .

Starting in 2013, an additional 0.9 percent Medicare tax is being applied to wages and self-employment income for those

Welcome Darbe!

If you have contacted us recently you may have noticed a new voice on the other end of the phone. Please help us in welcoming our new receptionist, Darbe to our office. Darbe is a mom to three kids and is working part-time for us.

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whose earnings exceed certain thresholds:

- For single taxpayers, the tax applies to wages and self-employment income that exceed $200,000.00.
- For married taxpayers filing joint returns, the tax applies to wages and self-employment income on joint income exceeding $250,000.00

Employers may not withhold this new tax if individuals wages do not exceed the threshold. But, if joint wages exceed the threshold, a tax underpayment may result if the new tax is not considered in estimated tax requirements.

Beginning in 2013, the top rate on dividend income and long-term capital gains has increased from 15 percent to 20 percent for taxable income in excess of:

- $400,000 for single taxpayers
- $450,000 for married taxpayers filing jointly.

In addition, the new 3.8 percent Medicare tax on net investment income will apply. Net investment income includes income from passive activities, so there may be an opportunity to take another look at your businesses and consider their classification, grouping elections, tax basis in these entities, etc., to help minimize this tax.

The application of the new 3.8 percent tax starts at adjusted gross income of:

- $200,000 for single taxpayers
- $250,000 for married tax payers filing jointly

Consequently, for these higher-income individuals, a combined top tax of 23.8 percent on dividends and long-term capital gains can apply.

Reducing long-term capital gain income by selling capital loss investments to offset the capital gain is a tax-planning opportunity resulting in a lower overall gain subject to tax. For taxpayers with taxable income (including capital gain and dividend income) of up to $72,500, the capital gain and dividend income is taxed at a zero percent rate. In addition, the 15 percent rate applied at lower levels of taxable income. Therefore, planning techniques to shift income or deductions between years could affect the rate at which your capital gain and dividend income is taxed.

Other tax planning opportunities to reduce the new 3.8 percent tax include:

- Investing in tax-free municipal bonds
- Reducing investment income subject to tax with investment expenses and account maintenance fees
- Avoiding the tax with qualified plan contributions
- Deferring the tax with installment sales and like-kind exchanges
- Grouping passive partnership profit-and-loss investments to minimize overall passive income subject to the tax.

Business Income

Several business provisions in the tax law are available **only through 2013.** For this reason, it may be prudent to plan to use them by the end of the year. They include:

- Section 179 expensing of up to $500,000 of new or used equipment when total fixed asset additions do not exceed $2 million for the year.

* Lesser expensing is available when fixed asset additions exceed $2 million but are less than $2.5 million.

* No deduction is available when fixed asset additions equal or exceed $2.5 million.

- a 50 percent bonus depreciation on new equipment.
- A 15 year rather than a 30-year cost recovery on qualified leasehold improvements and restaurant and retail assets
- Research and development credits
- The Work Opportunity Tax Credit.

Starting in 2013, taxpayers may deduct annually $5 per square foot of office space, up to 300 square feet, for as much as $1,500 in deductions in computing deductible expenses for a home office in lieu of actual expenses. A larger deduction might be computed on actual expenses. A home office deduction generally is allowed only when a portion of a home is used as the principal place of business and exclusively for business—not just as a convenience for bringing work home.

Deductions from gross income

Certain deductions from gross income have been extended only through the end of the year, so it may be prudent to begin identifying opportunities to take advantage of those tax breaks. Among the provisions are:

- The deduction of up to $250 for K-12 teacher's expenses
- The deduction of up to $4,000 of tuition and related expenses (limited at higher income levels)

Some of these deductions may not be available for taxpayers at various levels of higher income.

Retirement Savings

In a typical qualified retirement plan, a tax deduction is allowed when contributions are made to the plan, and future distributions are taxable. For a Roth IRAs, no deduction is allowed for contributions, but distributions of original contributions and income are tax-free.

Last year, a qualified retirement plan could allow participants to contribute to a Roth account. Plans also could allow participants to convert pretax accounts to Roth accounts, but only for amounts participants had a right to withdraw, usually because they were at least 59 1/2.

Starting in 2013, any amount in a non-Roth account can be rolled over to a Roth account in the same employer plan, whether or not the participant is 59 1/2. The conversion is subject to regular income tax but not an early distribution penalty.

Personal Exemptions

Each taxpayer and dependent in a tax return is allowed a personal exemption of $3,900, which reduces taxable income and the related income tax. A limitation that was in the tax law several years ago has been resurrected in 2013. For single taxpayers with more than $250,000 of adjusted gross income and married taxpayers filing joint returns with adjusted gross income over $300,000, the amount of each personal exemption is reduced, causing an increase in total tax.

Personal exemptions are completely phased out at adjusted gross income of $372,501 for single taxpayers and $422,501 for married taxpayers filing joint returns. Tax planning that reduces taxable income may have the added benefit of preserving more of the personal exemptions.

Itemized Deductions

The total amount of itemized deductions—frequently consisting of state income taxes, real estate taxes, mortgage interest expense and charitable contributions—is reduced for single taxpayers with more than $250,000 in adjusted gross income and married taxpayers filing joint returns which adjusted gross income over $300,000. A taxpayer may not lose more than 80 percent of itemized deductions.

State Taxes

Year-end tax projections are especially important for state taxes. Just like the IRS, states generally impose withholding and estimated tax requirements, and they charge underpayment penalties if sufficient payments are not made during the year.

State taxes are deductible in computing federal income tax, but the timing of payments may be important. A tax-planning strategy is to prepay by Dec. 31, 2013, state tax estimates due in January 2014 and projected balances due on April 15, 2014 to accelerate deductions into 2013.

However, this strategy is not beneficial for a year in which you are paying the alternative minimum tax since the AMT doesn't allow deductions for taxes, including state income taxes. If this sounds complicated, that's because it is. A tax projection is the best way to approach this issue.

Charitable Contributions

A number of natural disasters have already occurred this year. Unfortunately, disasters bring out scam artists who impersonate charities to obtain money or private information under false pretenses. Be sure to verify charitable organizations before sending a check or providing a credit card number.

Now is the time to document charitable contributions made so far this year. Receipts or canceled checks are required for donations of up to $250 or more. The acknowledgement letter must state whether any goods or services were provided to you by the charity.

Only your contribution in excess of the fair market value of anything you received is deductible. For example, if you buy a $250 ticket to a charity ball and a dinner valued by the charity at $75 is served, the excess payment of $175 is tax deductible.

With an increase in the capital gains tax from 15 percent to 20 percent this year for higher-income taxpayers, in may be advantageous to contribute appreciated stocks held longer than one year directly to a charity. In that case, the full fair market value of the contribution would be deductible, but the related capital gain is not subject to tax.

A transfer of IRA assets directly to a charity is also permitted through the end of the Year. No charitable deduction is allowed because a deduction was permitted when the IRA originally was funded. However, the transfer is not a taxable distribution from the account, yet it fulfills the obligation of the required minimum distribution for taxpayers over age 70 1/2.

Tax Rates

The so-called Bush tax cuts have been extended permanently for most taxpayers, avoiding an increase in all tax brackets. But the top rate has increased from 35 percent to 39.6 percent for single taxpayers with more than $400,000 in taxable income and for married taxpayers filing a joint return with more than $450,000 in taxable income.

Coupled with the new 3.8 percent tax on net investment income and the expanded 0.9 percent Medicare tax, tax planning is an important exercise, especially for higher-income taxpayers. However, tax planning is important for all taxpayers who want to reduce their tax liability and avoid surprises at tax year filing time.

Credits

The dependent care credit for children under 13 has been permanently extended. Eligible expenses of up to $3,000 for one child and up to $6,000 for two or more children are allowed.

The credit is reduced from 35 percent to 20 percent when adjusted gross income exceeds $43,000. A planning opportunity exists by first electing up to $5,000 in pretax dependent care during open enrollment in employee benefit plans this fall and then using the dependent care credits for expenses above that amount.

The child tax credit has been made permanent. The credit of up to $1,000 per child is available for dependent children under age 17. The credit is reduced and eventually eliminated when adjusted gross income exceeds $75,000 for single taxpayers or $110,000 for married taxpayers filing a joint return. Tax planning to reduce adjusted gross income may provide a larger child tax credit for the year.

The American Opportunity Tax Credit for college costs has been extended for five years through 2017. A credit of up to $2,500 may be claimed during the first four years of college. The credit phases our for adjusted gross income in excess of $80,000 for single taxpayers and $160,000 for married taxpayers filing a joint return.

The $1,500 credit for new windows and doors has expired, but a credit of up to $500 for residential energy property is still available if prior years' credits were not taken.

Credits in particular are valuable because they reduce taxes dollar-for-dollar, while deductions reduce the amount of income subject to tax.

Preventing Fraud and Scams

Tax fraud through the use of identity theft tops the IRS 2013 list of tax scams. Tax returns and tax information should be safeguarded due to the listed personal information, including Social Security numbers. Keep in mind that the IRS does not initiate contact with taxpayers by email to request personal or financial information, so don't be a victim of a phishing scam. If you are on the move, notify the IRS of your change of address. For name changes because of marriage or divorce, for example, be sure to notify your local Social Security Administration office.

If you are purging old documents, you should consider shredding those documents before throwing them out. Remember tax returns should be kept forever, while tax related documents must be kept for 7 years.

The Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act enacted comprehensive health insurance reforms designed to ensure Americans have access to quality, affordable health insurance. The Act will roll out in phases which has already started with the new Patient's Bill of Rights in 2010, Medicare changes in 2011, and open enrollment in the Health Insurance Marketplace beginning October 1, 2013. The marketplace is designed to help you look for and compare private health plans, get answers to questions about coverage options, and costs. Also effective October 1, 2013 ,employers are required to provide information to their employees about the Act and how to obtain medical insurance if not provided by their employer. We will continue to learn more about the Affordable Care Act as information is released.

We're on the Web check us out at www.roundsandbrooks.com

Tax Bracket	Single	Married Filing Jointly	Head of Household
10% Bracket	$0 – $8,950	$0 – $17,900	$0 – $12,900
15% Bracket	$8,950 – $36,250	$17,900 – $72,500	$12,750 – $48,600
25% Bracket	$36,250 – $87,850	$72,500 – $146,400	$48,600 – $125,450
28% Bracket	$87,850 – $183,250	$146,400 – $223,050	$125,450 – $203,150
33% Bracket	$183,250 – $400,000	$223,050 – $450,000	$203,150 – $400,000
39.6% Bracket	$400,000+	$450,000+	$400,000+

IRS Mileage Rates for 2013

Standard mileage for business	$0.565/mile
Standard mileage for charity	$0.14/mile
Standard mileage for medical	$0.23/mile

Conclusion

The benefit from tax planning, a projection of 2013—and possibly 2014—income and deductions and income taxes for the year can be performed now and then updated for a final year-end look. Taking some time to plan now can save real tax dollars in 2013 or, at the very least, push taxes to later years.

Contact us to help you plan to take action now to reduce your 2013 tax burden.

Rounds and Brook, CPAs PC

321 S. 9th Street
Montrose CO 81401

Phone: 970-249-4909
Fax: 970-249-6919
E-mail:
Heather:
hrounds@roundsandbrooks.com
Michele:
mbrooks@roundsandbrooks.com