



**CORDASCO
& COMPANY P.C.**

Certified Public Accountants

2013

**YEAR-END INCOME TAX PLANNING
FOR INDIVIDUALS**

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2013 YEAR-END INCOME TAX PLANNING FOR INDIVIDUALS

INTRODUCTION

As the end of 2013 approaches, it's time to consider planning moves that could reduce your 2013 taxes. Year-end planning is particularly important given the rapid pace of tax law changes and the extensive list of current tax breaks scheduled to *expire at the end of 2013*. In addition, there are several 2013 law changes providing new tax saving opportunities as well as the many "time-tested" tax saving techniques that continue to apply.

We are sending you this letter to remind you of the *traditional* year-end tax planning strategies that help lower your taxable income and postpone the payment of your taxes to later years. In this letter, we also help you navigate *new* tax planning opportunities available to individuals because of recent law changes.

Planning Alert! Since many tax breaks are currently scheduled to *expire after 2013*, it is extremely important that you act timely to obtain maximum benefits!

Tax Tip. Many of the recent tax changes impacting your 2013 income tax liability are dependent on the amount of your adjusted gross income, modified adjusted gross income, or taxable income. We highlight these income thresholds prominently in this newsletter.

Caution! Tax planning strategies suggested in this letter may subject you to the alternative minimum tax (AMT). For example, many deductions are not allowed for AMT purposes, such as: personal exemptions, the standard deduction, state and local income taxes, and real estate taxes. Also, the AMT can be triggered by taking large capital gains, having high levels of dividend income, or exercising incentive stock options. Therefore, **we suggest that you call our firm before implementing any tax planning technique discussed in this letter.** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the AMT and any state income tax) with and without that strategy. **Please Note!** This letter contains ideas for Federal income tax planning only. **State income tax issues are not addressed.**

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PLANNING FOR TAX BREAKS EXPIRING AFTER 2013

A host of current tax breaks for individual taxpayers are scheduled to expire at the *end of 2013*, unless Congress extends these provisions.

Caution! Although Congress has traditionally extended a majority of expiring tax breaks in the past, there is no guarantee that it will do so in the future.

Tax Tip. Regardless of how Congress ultimately addresses these expiring tax breaks, there are real tax savings available if you take advantage of these provisions *before the end of 2013*. The following are some of the more popular tax breaks that we have enjoyed over the past several years, but are *currently scheduled to expire after 2013*: School Teachers' Deduction (Up to \$250) for Certain School Supplies; Deduction for State and Local Sales Taxes; Deduction (Up to \$4,000) for Qualified Higher Education Expenses; Qualifying Tax-Free Transfers directly from IRAs to Charities for Those at Least 70½; Increased Charitable Deduction Limits for Qualifying Conservation Easements; \$500 Credit for Qualified Energy-Efficient Home Improvements; Deduction for Qualified Home Mortgage Insurance Premiums; Income Exclusion for Principal Residence Mortgage Cancellations; and Temporary 100% Gain Exclusion from Sale of "Qualified Small Business Stock."

Planning Alert! If you would like to take advantage of any of these provisions, but you need more information, please call our office so we can help you take the necessary steps to lock in these tax benefits before it is too late. The following provides more details for several of these expiring items:

Tax-Free IRA Payments To Charities If You Are At Least 70½. For the past several years, we have had a popular rule that allows taxpayers, who have reached age 70½, to have their IRA trustee contribute up to \$100,000 from their IRAs directly to a qualified charity, and exclude the distribution from income. The IRA transfer to the charity also counts toward the IRA owner's "required minimum distributions" (RMDs) for the year.

Planning Alert! To qualify, the check from your IRA must be made out "directly" to your designated charity. Since this tax break is currently scheduled to *expire after 2013*, you should make arrangements for the transfer with your IRA trustee *well before the end of 2013* if you want to take advantage of this provision.

Deducting Sales Taxes. For the past several years, we have had a *temporary* rule that has allowed taxpayers to "elect" to deduct "either" state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among residents who live in states with little or no state income taxes or states where the state income taxes paid is generally less than the sales taxes paid.

Planning Alert! This provision is currently scheduled to *expire after 2013*.

Tax Tip. If you plan to deduct sales tax for 2013 and you are considering the purchase of a big ticket item (e.g., car, boat), accelerating the purchase from *2014 into 2013* will preserve the sales tax deduction if Congress does not extend this provision beyond 2013.

The Qualified Tuition Deduction. If you pay for *qualified* higher education tuition and fees for yourself, your spouse, or your dependents, you may qualify for an education expense deduction. This maximum \$4,000 deduction is available whether or not you itemize. You are allowed the maximum \$4,000 deduction only if your adjusted gross income (“AGI”) does not exceed \$130,000 on a joint return (\$65,000 if single). If your AGI is between \$130,000 and \$160,000 (\$65,000 and \$80,000 if you’re single) your maximum deduction drops to \$2,000.

Caution! If your AGI exceeds \$160,000 (if joint) or \$80,000 (if single) by even \$1, the entire deduction is lost.

Planning Alert! This deduction is *currently scheduled to expire after 2013*. Even though Congress has extended this provision in prior years when it was scheduled to expire, there is no guarantee that it will do so again.

Tax Tip. If you expect to take this deduction and your adjusted gross income is close to the \$130,000 or \$160,000 limits (\$65,000 or \$80,000 if you’re single), we would be glad to review your situation and see if we can take steps to keep your income below those thresholds *for 2013*.

Income Exclusion For Discharge Of Qualified Principal Residence Indebtedness. The provision allowing you to exclude the income from the discharge of all or a portion of a mortgage (not exceeding \$2 million) that you incurred to purchase, construct, or substantially improve your principal residence, *expires after 2013*.

Tax Tip. If it appears that your mortgage lender may reduce the mortgage balance on your principal residence (this could include a foreclosure, a short sale of your principal residence, or a forgiveness of a portion of your mortgage), and you think this cancellation of debt exclusion might apply, taking steps to complete the transaction *before 2014* will ensure that the exclusion is available.

Temporary 100% Exclusion For “Qualified Small Business Stock” Expires After 2013. If you sell “qualified small business stock” (QSBS) **acquired after September 27, 2010 and before January 1, 2014**, you may be able to exclude the **entire gain** from taxable income **if you hold the stock for more than 5 years** before the sale (the gain will also be exempt from the alternative minimum tax). QSBS is generally stock of a non-publicly traded domestic “C” corporation engaged in a qualifying business, purchased directly from the corporation, and **held for more**

than 5 years; where the issuing corporation meets certain active business requirements and has assets at the time the stock is issued of \$50 million or less. Stock in corporations engaged in a professional service, banking, insurance, financing, leasing, investing, hotel, motel, restaurant, mining, or farming businesses generally *do not* qualify.

Planning Alert! If you are considering investing in a small business, we will gladly help you evaluate whether structuring your investment as QSBS will work to your overall tax advantage. However, you must act promptly to take advantage of this narrow window of opportunity to qualify for the 100% exclusion. Unless Congress extends this tax break, only stock acquired ***from September 28, 2010 through December 31, 2013*** qualifies for the 100% exclusion (after you satisfy the 5-year holding requirement). Also, to qualify for the exclusion, you must purchase the stock directly from the corporation that is issuing the stock or from an underwriter of the stock (stock purchased from other third parties does not qualify).

Credit For Energy-Efficient Improvements To Your Residence. The temporary 10% credit (with a life-time cap of \$500) for qualified energy-efficient improvements to your “principal residence” ***expires after 2013.***

Planning Alert! The current 30% credit for installing a ***qualifying solar water heater, solar electric generating property, geothermal heat pump, or small wind energy property*** is not ***currently scheduled to expire until after 2016.*** This 30% credit applies if you install the qualifying energy-efficient property in or on your residential property located in the U.S., and the residence does ***not*** have to be your “**principal residence.**” So, installations in your second residence or vacation home may qualify. The 30% credit also applies to the installation costs.

Tax Tip. The IRS says on its website that this 30% credit is available to the extent that the purchase price of a new home can be reasonably allocated to the qualifying energy-efficient equipment. Therefore, if you purchased a new home in 2013, be sure to ask the builder to provide you a cost breakdown of any solar electric panels, solar water heaters, etc.

Caution! Expenditures related to swimming pools or hot tubs (e.g., solar equipment to heat water or run electrical pumps) do not qualify. Also, to ***take the 30% credit for 2013,*** the property must ***actually be installed*** no later than December 31, 2013.

NEW TAXES AND TAX RATES IMPACT YEAR-END PLANNING

Traditional year-end tax planning typically includes strategies that lower your current taxable income and postpone the payment of taxes to later years. The classic technique to accomplish both of these goals is to *defer the recognition of taxable income* to later years, and to *accelerate deductible expenses* into the current tax year. Although these strategies are still advisable for many taxpayers, please keep in mind that 2013 has ushered in for higher-income individuals: **1) a new top tax bracket of 39.6%** (up from the previous top bracket of 35%); **2) a new .9% Additional Medicare Tax**; and **3) a new 3.8% tax** on net investment income. These changes should be considered in preparation for year-end planning.

Background. On January 1, 2013, Congress passed the “*American Tax Relief Act (“ATRA”) Of 2012*” which, among other changes, permanently retains the Bush-era tax rates for lower and moderate income individuals, while also permanently raising the highest tax rates on regular income, dividends, and capital gains for individuals with higher incomes.

Planning Alert! Our reference to “*permanent*” means that the provision *has no sunset date* after ATRA (Congress could always change these rates again with future legislation).

Highest “Ordinary” Income Tax Rate For Individuals Increased To 39.6%. ATRA continues the Bush-era 10% to 35% tax brackets with no sunset and adds an additional 39.6% tax bracket for higher income individuals. *Beginning in 2013*, the new 39.6% bracket applies to *taxable income* of an individual *in excess of* the following thresholds: **\$450,000** for married couples *filing joint returns* (\$225,000 if married filing separate returns); **\$400,000** for *single filers*; and **\$425,000** for *heads of households*. These thresholds are adjusted for inflation after 2013.

- **39.6% Rate Creates New Marriage Penalty.** The income thresholds for the new 39.6% tax bracket have created a new marriage tax penalty. For example, if a married couple files a 2013 joint return and each spouse has taxable income of \$400,000, their joint taxable income of \$800,000 will generally be taxed at 39.6% to the extent it exceeds the \$450,000 threshold for married individuals filing joint returns (i.e., \$350,000 will be taxed at 39.6%). By contrast, if the individuals were not married and each filed as single, neither would be subject to the 39.6% tax rate because neither would have exceeded the \$400,000 taxable income threshold that triggers the 39.6% rate for single individuals.

Highest “Income Tax” Rate For Estates And Trusts Increased To 39.6%. *Beginning in 2013*, ATRA permanently increases the highest income tax rate for income taxed to a trust or estate from 35% to 39.6%. For 2013, the 39.6% rate applies to trust or estate taxable income that *exceeds \$11,950*.

Tax Tip! The income threshold for taxing an individual at 39.6% (e.g., \$400,000 if single) is substantially higher than the income level for taxing a trust or estate at 39.6% (i.e., \$11,950 for 2013). Consequently, ATRA has created an additional tax incentive for distributing trust or estate income to an individual beneficiary where the beneficiary's income is taxed in a lower tax bracket.

Tax Tip! If you want the trust's or estate's taxable income to be taxed to the beneficiary, the income generally must be distributed by the end of the current taxable year of the trust or estate. For example, assume that a trust has a taxable year-end of December 31, 2013, and you want the trust's income to be taxed to the beneficiary. The trust must generally distribute the income (to the extent the trust document allows the distribution) to the beneficiary *no later than December 31, 2013*.

Planning Alert! The distribution may be *made within the first 65 days of 2014* if the trustee makes an *affirmative election* (by checking the appropriate box on the trust's 2013 income tax return) to treat the distribution as though made in 2013.

Highest Long-Term Capital Gain And Qualified Dividend Rates Increased To 20%. ATRA permanently retains the maximum long-term capital gain and qualified dividend rates at 15% for lower and moderate income individuals. ATRA also permanently retains the zero percent tax rate for long-term capital gains and qualified dividends where the capital gain or dividend income would otherwise be taxed in the 15% or 10% tax brackets (for 2013, taxable income up to \$36,250 for single individuals and \$72,500 for joint filers is taxed in the 15% bracket or below). However, *beginning in 2013*, for long-term capital gains or qualified dividends that would otherwise be taxed in the 39.6% bracket, ATRA increases the rate to 20%. For example, to the extent long-term capital gains of a single individual cause his or her taxable income to exceed \$400,000 in 2013 (i.e., the income threshold for the 39.6% bracket), the capital gains will be taxed at 20%.

Caution! The current maximum rates of 28% on the gain from the sale of collectibles (e.g., works of art, antiques, etc.) and 25% on the gain attributable to straight-line depreciation taken on depreciable realty were not changed and continue to apply for 2013 and subsequent years. **Trust And Estates.** For long-term capital gains and/or qualified dividends that would otherwise be taxed in the 39.6% bracket of a trust or estate (i.e., for 2013, where taxable income exceeds \$11,950), ATRA permanently increases the rate to 20%.

Personal Exemption And Itemized Deduction Phase-Outs Reinstated. During most of the past two decades, higher-income individuals were subject to an income phase-out provision that reduced their *personal exemptions* and *itemized deductions* as their income exceeded certain thresholds. All individuals were given a three-year reprieve from these phase-outs *from 2010 through 2012*. *Beginning in 2013*, ATRA permanently reinstates these phase-out provisions for individuals with *adjusted gross incomes* exceeding the following threshold amounts: **\$300,000** for married couples *filing joint returns* (\$150,000 if married filing separately); **\$250,000** for *single filers*; and **\$275,000** for *heads of households*. These thresholds will be adjusted for inflation after 2013.

Tax Tip. The phase-out provisions *do not apply* to the following itemized deductions: medical expenses, investment interest, gambling losses, casualty losses, and theft losses.

Practice Alert! Individuals whose itemized deductions and/or personal exemptions are reduced by these phase-out provisions will have higher “effective” tax rates than listed in the published statutory-rate schedules.

.9% Additional Medicare Tax On “Earned Income” Of Higher-Income Individuals. Payroll taxes imposed on your W-2 earnings include both a Social Security tax and a separate Medicare tax. Prior to 2013, the overall Medicare tax rate was 2.9% (1.45% imposed on the employee and an additional 1.45% imposed on the employer). If you are self-employed, you must pay the entire 2.9% Medicare tax on your income from self-employment. Generally, *effective for wages and self-employment earnings received after 2012* that exceed certain thresholds, the *Affordable Care Act* imposes a new **.9% Additional Medicare Tax** on individuals with higher W-2 wages and self-employment income. This .9% Medicare tax generally applies to the amount by which the *sum of your W-2 wages and your earnings from self employment* exceeds the following thresholds: **\$250,000** if you are *married filing jointly*; **\$200,000** if you are *single*; or **\$125,000** if you are *married filing separately*. For married individuals filing a joint return, the .9% Medicare tax will apply to the extent *the sum of both spouses’ W-2 earnings and self-employment earnings* exceeds the \$250,000 threshold.

Planning Alert! These income thresholds are fixed and are *not indexed* for future inflation.

3.8% Tax On “Net Investment Income” Of Higher-Income Taxpayers. Beginning in 2013, the *Affordable Care Act* imposes a new 3.8% tax on the *net investment income* (3.8% NIIT) of *higher-income taxpayers*. With limited exceptions, “*net investment income*” generally includes the following types of income (less applicable expenses): interest, dividends, annuities, royalties, rents, “passive” income (as defined under the traditional “passive activity” loss rules), long-term and short-term capital gains, and income from the business of trading in financial securities and commodities.

Planning Alert! Income, including “passive” income, *is not* “*net investment income*” (and is therefore exempt from this new 3.8% NIIT), *if the income is “self-employment income”* subject to the 2.9% Medicare tax. The 3.8% NIIT applies to individuals with modified adjusted gross income (MAGI) exceeding the following “*thresholds*” (which are *not indexed* for future inflation): **\$250,000** for *married filing jointly*; **\$200,000** if *single*; and **\$125,000** if *married filing separately*. The 3.8% NIIT is imposed upon *the lesser of* an individual’s **1)** modified adjusted gross income (MAGI) in excess of the *threshold*, or **2)** net investment income.

- **Example.** For 2013, Mark (a single taxpayer) has MAGI of \$210,000 comprised of W-2 compensation of \$180,000 and “investment income” (e.g., capital gains, interest, dividends) of

\$30,000. Mark has \$10,000 of deductible expenses allocable to investment income. Therefore, Mark's "net investment income" is \$20,000. The 3.8% NIIT would be imposed on the **lesser of 1) \$10,000** (i.e., Mark's MAGI of \$210,000 less the \$200,000 threshold for a single individual), or **2) \$20,000** (Mark's net investment income). Therefore, Mark would pay NIIT of \$380 (i.e., \$10,000 x 3.8%).

- **3.8% NIIT Creates New Marriage Penalty.** The MAGI thresholds for the new 3.8% NIIT have created a new marriage tax penalty. For example, assume two single individuals each has MAGI of \$200,000, which includes \$20,000 of investment income and assume they have no deductible expenses allocable to investment income. Neither would be subject to the 3.8% NIIT because each person's MAGI does not exceed the \$200,000 threshold for a single taxpayer. By contrast, if they were married filing jointly, their combined MAGI would be \$400,000 and their combined net investment income would be \$40,000. Since the MAGI threshold for a married couple filing jointly is only \$250,000, the couple's net investment income of \$40,000 would be hit with a NIIT of \$1,520 (i.e., \$40,000 x 3.8%).
- **Trusts And Estates Are Subject To The 3.8% NIIT.** In 2013, *trusts and estates* are subject to the 3.8% NIIT on the **lesser of: 1) the adjusted gross income of the trust or estate in excess of \$11,950, or 2) the undistributed net investment income of the trust or estate.**

TAX PLANNING FOR INVESTMENT INCOME

Planning To Minimize The New 3.8% Net Investment Income Tax (3.8% NIIT). The introduction of the *new 3.8% Net Investment Income Tax* (3.8% NIIT) calls for new planning strategies **starting in 2013**, including:

- **Consider Shifting To Investments That Generate Tax-Exempt Income.** Fortunately, the following types of income are *not subject* to the 3.8% NIIT: *tax-exempt bond interest*; gain on the sale of a principal residence *otherwise excluded* from income under the *home-sale exclusion* rules (i.e., up to \$250,000 on a single return, up to \$500,000 on a joint return); and *distributions from qualified retirement plans* (e.g., 401(k) plans, IRAs, §403(b) annuities, etc.). Therefore, investments that generate tax-exempt income are more attractive beginning in 2013. For example, tax exempt municipal bond interest will potentially provide higher-income individuals with a double tax benefit: **1) the interest will not be included in the taxpayer's MAGI**, thus reducing the chance that the taxpayer will exceed the income thresholds for the 3.8% NIIT, and **2) the tax-exempt interest itself is exempt from the 3.8% tax.**

Planning Alert! Although taxable distributions from qualified retirement plans (e.g., IRAs, 401(k) plans, etc.) are not investment income, the taxable distributions will increase your "modified adjusted gross income" (MAGI). Therefore, to the extent the taxable distributions cause your MAGI to exceed the 3.8% MAGI thresholds (e.g., \$250,000 for joint returns; \$200,000 for singles), the distributions could cause your "net investment income" to be hit with the 3.8% NIIT.

- **Consider Roth IRAs (Including Roth IRA Conversions).** Tax-free distributions from a Roth IRA are exempt from the 3.8% NIIT, and do not increase your MAGI (and, thus will not increase your exposure to the 3.8% tax). Therefore, these tax-favored features should be factored into any analysis of whether you should contribute to a Roth IRA. However, if you are considering converting a traditional IRA into a Roth, the income triggered by the conversion would increase your MAGI and, therefore, may increase your potential exposure to the 3.8% NIIT on your *net investment income* (e.g., capital gains, dividends, interest, passive income, rents).

Planning Alert! If you want a Roth conversion to be *effective for 2013*, you must transfer the amount from the regular IRA to the Roth IRA *no later than December 31, 2013* (you do not have until the due date of your 2013 tax return).

Caution! Whether you should convert your traditional IRA to a Roth IRA can be an exceedingly complicated issue, and this new 3.8% NIIT is just one of many factors that you should consider. *Please call our firm* if you need help in deciding whether or not to convert to a Roth IRA.

- **Consider “Tax-Deferred” Investments.** The 3.8% NIIT does not apply to earnings generated by a *tax-deferred annuity* (TDA) contract *until the income is distributed*. Thus, after first considering the economics, investing in a TDA in your higher-income years may allow you to defer the annuity income until later years when your MAGI is below the 3.8% NIIT thresholds.
- **“Passive” Income.** “*Net Investment Income*” for purposes of the 3.8% NIIT generally includes net income from a business activity if you are a “passive” owner (unless the income constitutes *self-employment* income that is subject to the 2.9% Medicare tax). You will generally be deemed a “passive” owner if you do not “materially participate” in the business as determined under the traditional “passive activity loss” rules. For example, under the *passive activity loss* rules, you may be a “*passive*” owner unless you spend more than 500 hours working in the business during the year or meet some other material participation test. Furthermore, subject to limited exceptions (e.g., qualified real estate professionals, rentals to a business in which you are not passive), *rental income* is generally deemed to be “passive” income under the *passive activity loss* rules, regardless of how many hours you work in the rental activity. If you believe you have “passive” income from an activity, please contact our firm. We will gladly evaluate your situation to determine whether there are steps you could take to avoid “passive” income classification, and thus, minimize your exposure to the 3.8% NIIT.
- **Trusts And Estates Can Be Subject To The 3.8% NIIT.** Starting in 2013, if a trust or estate has *net investment income*, and also has *adjusted gross income* (AGI) in excess of a “*threshold*” amount (for 2013, the threshold is \$11,950), it must pay the 3.8% NIIT *unless the income is timely distributed to beneficiaries*.

Caution! Timely distributions of *net investment income* from an estate or trust could cause the beneficiary to be subject to the 3.8% NIIT on the distributed investment income. However, the beneficiary would avoid the 3.8% tax altogether on the distributed investment income if the beneficiary's MAGI is below the NIIT threshold for individuals (e.g., below \$200,000 for a beneficiary who is single).

Tax Tip! If you want the trust's or estate's net investment income (NII) to be taxed to the beneficiary, the NII must generally be distributed by the end of the taxable year of the trust or estate. For example, assume that a trust has a taxable year-end of December, 31, 2013, and you want the trust's NII to be taxed to the beneficiary. The trust must generally distribute its NII to the beneficiary *no later than December 31, 2013*.

Planning Alert! The distribution may be *made within the first 65 days of 2014*, if the trustee makes an *affirmative election* (by checking the appropriate box on the trust's 2013 income tax return) to treat the distribution as made in 2013.

Traditional Year-End Planning With Capital Gains And Losses. Generally, net capital gains (both short- term and long-term) are potentially subject to the new 3.8% NIIT. Starting in 2013, this could result in an individual who is taxed in the 39.6% ordinary income tax bracket paying tax on his or her *net long-term capital gains* at a **23.8%** rate (i.e., the maximum capital gains tax rate of 20% plus the 3.8% NIIT). This individual's *net short-term capital gains* could be taxed as high as **43.4%** (i.e., 39.6% plus 3.8%). Consequently, traditional planning strategies involving the timing of your year-end sales of stocks, bonds, or other securities may save you more taxes this year than in previous years. The following are time-tested, year-end tax planning ideas for sales of capital assets.

Planning Alert! Always consider the *economics of a sale or exchange first!*

- **Planning With Zero Percent Tax Rate For Capital Gains And Dividends.** Long-term capital gains and qualified dividends that would be taxed (if ordinary income) in the 15% or lower ordinary income tax bracket, are taxed at a zero percent rate.

Planning Alert! For 2013, ordinary income (e.g., W-2, interest income) up to \$72,500 for joint returns (\$36,250 if single) is taxed at the 15% rate, or below. Thus, taxpayers filing jointly can benefit from the zero percent tax rate if (and to the extent) they have 2013 ordinary taxable income under \$72,500 (\$36,250 if single).

Tax Tip. Taxpayers who have historically been in higher tax brackets but now find themselves between jobs, recently retired, or expecting to report higher-than-normal business deductions in 2013, may temporarily have income low enough to take advantage of the zero percent rate for 2013. If you are experiencing any of these situations, please call our firm and we will help you take advantage of this zero percent tax rate for long-term capital gains and qualified dividends.

- **Lower-Income Retirees.** The zero percent rate for long-term capital gains and qualified dividends is particularly important to lower-income retirees who rely largely on investment portfolios that generate dividends and long-term capital gains. Furthermore, gifts of appreciated securities to lower-income donees who then sell the securities could reduce the tax on all or part of the gain from 15% or 20% to zero percent.

Caution! If the donee is subject to the so-called *kiddie tax*, this planning technique will generally not work.

- **Timing Your Capital Gains and Losses.** If you have already recognized capital gains in 2013, you should consider selling securities *prior to January 1, 2014* that have declined in value. These losses will be deductible on your 2013 return to the extent of your recognized capital gains, plus \$3,000.

Tax Tip. These losses may have the added benefit of reducing your income to a level that will qualify you for other tax breaks, such as the: \$2,500 American Opportunity Tuition Tax Credit, \$1,000 child credit, \$12,970 adoption credit, etc.

Planning Alert! If within 30 days before or after the sale of loss securities, you acquire the same securities, the loss will not be allowed currently because of the “wash sale” rules (although the disallowed loss will increase the basis of the acquired stock).

Tax Tip. If you are afraid of missing an upswing in the market during this 60-day period, consider buying shares of a different company in the same sector. Also, there is *no* wash sale rule for *gains*. Thus, if you decide to sell stock at a gain in order to take advantage of a zero capital gains rate, or to absorb capital losses, you may acquire the same securities within 30 days without impacting the recognition of the gain.

- **Making the Most of Capital Losses.** Some investors may still have substantial loss carry forwards coming into 2013. If your stock sales to date have created a *net* capital loss exceeding \$3,000, consider selling enough appreciated securities *before the end of 2013* to decrease your net capital loss to \$3,000. Stocks that you think have reached their peak would be good candidates. All else being equal, you should sell the short-term gain (held 12 months or less) securities first. This will allow your *net* capital loss (in excess of \$3,000) to offset your short-term capital gain, while preserving favorable long-term capital gain treatment for later years.

Planning Alert! Your *net* short-term capital gains can be used to free up a deduction for any “investment interest” you have incurred (e.g., interest you have paid on your margin account). If you eliminate your short-term capital gains by recognizing your short-term capital losses, you may be restricting your ability to deduct your investment interest.

Tax Tip. If you are considering selling “loss” investments held 12 months or less, and you also have short-term capital gains and investment interest expense, please call our office. We will help you determine which strategy will maximize your tax savings.

- **Year-End Mutual Fund Purchases.** If you are thinking about buying mutual fund shares near year-end, watch out for a common tax trap. Mutual funds typically distribute income, including capital gains, near the end of each year. If you invest in the fund near the end of the year, but on or before the record date for this payout, you generally will be taxed on a year-end distribution as if you had held the fund all year. This, in essence, treats a return of your investment as a taxable distribution.

Practice Alert! With the increased tax rates on both long-term and short-term capital gains, this can be a costly mistake. Therefore, before investing, you should determine the amount and timing of any year-end payout and the record date for such distributions.

POSTPONING TAXABLE INCOME

It continues to be a good idea to defer income into 2014 if you believe that your marginal tax rate for 2014 will be equal to or less than your 2013 marginal tax rate. In addition, deferring income into 2014 could increase various credits and deductions for 2013 that would otherwise be phased out as your adjusted gross income increases.

Tax Tip. This classic tax planning strategy may be particularly valuable for 2013 if it also keeps your 2013 income below the phase-out thresholds for any of the tax breaks that are currently scheduled to expire after 2013 (e.g., \$4,000 qualified higher education expense deduction, deduction for home mortgage “insurance premiums”).

Planning Alert! Deferring taxable income from 2013 to 2014 may have an added benefit if: **1)** the deferral of income causes your 2013 taxable income to fall below the thresholds for the new 39.6% tax bracket (i.e., \$450,000 for joint returns; \$400,000 if single), or **2)** if you have *net investment income* and the income deferral causes your 2013 modified adjusted gross income (MAGI) to fall below the thresholds for the new 3.8% NIIT (i.e., \$250,000 for joint returns; \$200,000 if single).

If, after considering these factors, you believe that deferring taxable income into 2014 will save you taxes, consider the following strategies:

Self-Employment Income. If you are self-employed and use the cash method of accounting, consider delaying year-end billings to defer income until 2014.

Planning Alert! If you have already received the check in 2013, deferring the deposit does not defer the income. Also, you may not want to defer billing if you believe this will increase your risk of not getting paid.

Installment Sales. If you plan to sell certain appreciated property in 2013, you might be able to defer the gain until later years by taking back a promissory note instead of cash. If you qualify for installment treatment, the gain will be taxed to you as you collect the principal payments on the note. This is called reporting your gain on the “installment method.”

Planning Alert! Although the sale of real estate and closely-held stock generally qualify for this deferral treatment, some sales do not. For example, even if you are a cash method taxpayer, you cannot use this gain deferral technique if you sell publicly-traded stock or securities. Also, you may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid.

- **Installment Sales Of Assets May Reduce Exposure To The 3.8% NIIT.** After 2012, installment sales of investment assets may prevent an individual’s income for the year of sale and possibly subsequent years from exceeding the NIIT thresholds (i.e., \$250,000 for joint returns; \$200,000 if single) and therefore avoid the 3.8% NIIT on the gain. However, as mentioned above, you may not want to take back a promissory note in lieu of cash if you believe this reduces your chances of getting paid.

“Required Minimum Distributions” From Retirement Plans And IRAs. If you want to postpone the distribution (and therefore the taxation) of amounts in your traditional IRA or a qualified retirement plan as long as possible, there are several things to consider. First and foremost, it is critical that you name the appropriate beneficiaries such as an individual or a “qualified trust.” If your estate is the beneficiary of your IRA or qualified plan account, your heirs will generally miss out on substantial tax deferral opportunities after your death. In addition to naming an individual or individuals as your beneficiary, you should also name a “contingent beneficiary” in case your primary beneficiary dies before you. If you do not name a qualified beneficiary or if your estate is your beneficiary and you die before reaching age 70½, your entire retirement account generally must be distributed and taxed within **five years** after the year of your death. This will cause your beneficiaries to lose valuable tax deferral options.

Planning Alert! The rules for maximizing the tax deferral possibilities for IRAs and qualified plan accounts are complicated. We will gladly review your beneficiary designations and offer planning suggestions. However, here are some actions, relating to retirement plans and IRAs, that should *be considered before the end of 2013:*

- **Post Mortem Planning For Retirement Plan and IRA Distributions.** If you are the beneficiary of an IRA or qualified plan account of someone that has died in 2013, there are certain planning techniques you should consider as soon as possible.

Tax Tip. If the decedent named multiple beneficiaries or included an estate or charity as a beneficiary, we should review the situation as soon as possible to see if there is anything we can do to avoid certain tax traps. The rules for rearranging IRA beneficiaries for maximum tax deferral are complicated and are subject to rigid deadlines. Acting before certain deadlines pass is critical. If the owner died in 2013, the best tax results can generally be achieved by making any necessary changes **no later than December 31, 2013**. If you need assistance, please call our office as soon as possible so we can advise you.

- **IRA Owners Who Attain Age 70½ During 2013.** If you reached age 70½ at any time during 2013, you must begin distributions from a traditional IRA account **no later than April 1st of**

2014. A 50% penalty applies to the excess of the required minimum distribution over the amount actually distributed. If you wait until 2014 to take your first payment, you will still be required to take your second required minimum distribution no later than December 31, 2014, which will cause you to take two payments in 2014. This “bunching” of the first two annual payments into one tax year (2014) could cause your income to be taxed in a higher tax bracket and, therefore, result in more overall tax than if you received the first required payment in 2013.

Tax Tip. If you reached age 70½ in 2013, and you own an IRA or other qualified retirement account, please call us and we will help you navigate these rules to your best advantage.

- **Rollovers by Surviving Spouses.** If an individual **over age 70½** died during 2013 and the beneficiary of the decedent’s IRA or qualified plan is the surviving spouse, and the *surviving spouse* is **over 59½**, the surviving spouse should consider rolling the decedent’s qualified plan or IRA amount into his or her name **on or before December 31, 2013**. If the decedent’s retirement account is rolled into an IRA in the surviving spouse’s name **before 2014**, then **1)** provided the surviving spouse has not reached age 70½, no distributions are required in 2014, and **2)** if the surviving spouse is at least 70½, the required minimum distribution in 2014 will be determined using the Uniform Lifetime Distribution Table that results in a smaller annual required payout. Therefore, **converting the account into the surviving spouse’s name on or before December 31, 2013**, could substantially reduce the amount of the required minimum distribution for 2014 where the decedent was at least 70½.

Planning Alert! If the surviving spouse is not yet 59½, leaving the IRA or qualified plan account in the name of the decedent may be the best option if the surviving spouse needs to withdraw amounts from the retirement account before age 59½. If the account is transferred into the spouse’s name, and the spouse receives a distribution before reaching age 59½, the distribution could be subject to a 10% early distribution penalty unless made as a series of payments based on the surviving spouse’s life expectancy.

TAKING ADVANTAGE OF DEDUCTIONS

“Above-The-Line” Deductions Become Even More Important In 2013. So-called *“above-the-line”* deductions reduce both your “adjusted gross income” (AGI) and your “modified adjusted gross income” (MAGI), while *“itemized”* deductions (i.e., below-the-line deductions) do *not* reduce either AGI or MAGI. *Starting in 2013*, your level of AGI or MAGI becomes much more important because they determine your exposure to: **1)** the 3.8% net investment tax (3.8% NIIT only applies if MAGI exceeds \$250,000 if married filing jointly; \$200,000 if filing single), and **2)** the phase-out of your itemized deductions and your personal exemptions (only applies if AGI exceeds \$300,000 if married filing jointly; \$250,000 if single). Consequently, starting in 2013, an above-the-line deduction may provide you a double tax benefit by reducing your taxable income and, to the extent the deduction reduces your AGI or MAGI below the applicable thresholds, reducing your exposure to the 3.8% NIIT or the itemized deduction and personal exemption phase-outs.

- **“Above-The-Line” Deductions May Have Additional Tax Benefits.** *“Above-the-line”* deductions include deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, qualified education tuition, qualified moving expenses, alimony, and business expenses for a self-employed individual.

Tax Tip. *Above-the-line* deductions may not only allow you to reduce your exposure to the 3.8% NIIT or the itemized deduction/personal exemption phase-outs, these deductions could also reduce your AGI or MAGI below the phase-out thresholds for many other tax benefits (e.g., child credit, education credits, adoption credit, deductible IRA contributions, etc.)

- **Accelerating “Above-The-Line” Deductions.** As a cash method taxpayer, you can generally accelerate a 2014 deduction into 2013 by “paying” it in 2013. “Payment” typically occurs in 2013 if a check is delivered to the post office, if your electronic payment is debited to your account, or if an item is charged on a *third-party credit card* (e.g., Visa, MasterCard, Discover, American Express) in 2013.

Caution! If you post-date the check to 2014 or if your check is rejected, no payment has been made in 2013.

Planning Alert! The IRS says that prepayments of expenses applicable to periods beyond 12 months after the payment are not deductible in 2013.

- **Temporary Rule For Tax-Free IRA Payments To Charities May Be Equivalent To An Above-The-Line Deduction!** As discussed in more detail below, the charitable contribution deduction is an “itemized” deduction and does not reduce your AGI or MAGI. However, the

popular (but *temporary*) rule that allows a taxpayer who is at least age 70½ to have the IRA trustee make a *qualifying* transfer of up to \$100,000 from his or her IRA directly to a qualified charity and allows the tax-free transfer to reduce the required minimum distribution for the year, may be more beneficial than an itemized deduction. Having the IRA trustee make the charitable contribution is the equivalent of receiving an above-the-line deduction for the charitable contribution to the extent the transfer eliminates a taxable required minimum distribution for the year. The contribution reduces your AGI and MAGI by the lesser of the amount of the charitable contribution or the reduction in the IRA distributions for the year. Therefore, reducing your AGI and MAGI using this technique, may increase deductions that are reduced as your AGI increases, may keep you in a lower tax bracket, and may prevent your being subject to the NIIT by keeping you below the applicable MAGI thresholds.

Tax Tip! To qualify under this provision, the check from your IRA must be made out “directly” to your designated charity.

Planning Alert! This tax break *is scheduled to expire after 2013*.

Accelerating “Itemized” Deductions Into 2013. As mentioned above, although “*itemized*” deductions (i.e., *below-the-line* deductions) do *not* reduce your AGI or MAGI, they still may provide valuable tax savings. *Itemized deductions* generally include charitable contributions, state and local income taxes (or the optional state and local sales tax deduction), property taxes, medical expenses, unreimbursed employee travel expenses, home mortgage interest, and gambling losses (to the extent of gambling income). However, if your itemized deductions fail to exceed your standard deduction in most years, you are not receiving maximum benefit for your itemized deductions. You could possibly reduce your taxes over the long term by bunching the payment of your itemized deductions in alternate tax years. This may produce tax savings by allowing you to itemize deductions in the years when your expenses are bunched, and use the standard deduction in other years.

Tax Tip. The easiest deductions to shift from 2014 to 2013 are *charitable contributions, state and local taxes, and your January, 2014 home mortgage interest payment*. For 2013, the standard deduction is \$12,200 on a joint return and \$6,100 for single individuals. If you are blind or age 65, you get an additional standard deduction of \$1,200 if you’re married (\$1,500 if single). **Watch Out For AMT!** Certain itemized deductions are not allowed in computing your alternative minimum tax (AMT), such as state and local taxes (including state income taxes) and unreimbursed employee business expenses. Before you accelerate 2014 itemized deductions into 2013, to be safe, we should calculate your taxes “with and without” accelerating the deduction so we can determine the AMT impact of this strategy.

“Bunching” Medical Expenses Even More Important Starting In 2013. Prior to 2013, you were allowed an *itemized deduction* for un-reimbursed medical expenses (including un-reimbursed health insurance premiums) only to the extent your aggregate medical expenses exceeded 7.5% of adjusted gross income (10% for alternative minimum tax purposes). ***Starting***

in 2013, the *Affordable Care Act* generally increases this threshold from 7.5% of adjusted gross income (AGI) *to 10% of AGI*. **Exception For Seniors.** If either you or your spouse is at least age 65 before the close of the tax year, the 7.5% of AGI threshold will continue to apply **through 2016** (whether you file a joint return or separate returns). Therefore, consider accelerating as many elective medical expenses (i.e., braces, new eye glasses, etc.) into 2013 as possible if paying the expenses in 2013 will cause your deductible medical expenses to be above the 2013 AGI threshold, but you will not exceed the threshold if the expenses are paid in 2014.

Planning Alert! The 10% of AGI threshold for alternative minimum tax purposes has not changed.

- **Qualified Long-Term Care Services.** Generally, deductible medical expenses include the **cost of maintenance or personal care services prescribed by a “licensed health care practitioner”** for a “chronically ill” individual. You must meet technical requirements before you may deduct these types of expenses as medical deductions.
- **IRS Medical Mileage Rate.** The standard IRS medical deduction mileage rate for use of your vehicle for essential medical care purposes is **24 cents per mile for 2013**.

Take Advantage Of Health Savings Accounts (HSAs). Qualifying contributions to health savings accounts (HSAs) are “above-the-line” deductions (i.e., fully deductible whether or not you itemize deductions), and distributions for qualifying medical expenses are tax free. To qualify for an HSA, you must be covered by a qualifying “high deductible health plan” (HDHP). **For 2013**, if you have “family” coverage, your HDHP must have a minimum annual deductible of \$2,500 (\$1,250 for self only coverage). For 2013, your maximum contribution to an HSA is \$3,250 (\$4,250 if 55 or older) for self-only coverage, and \$6,450 (\$7,450 if 55 or older) for family coverage, even if your qualifying HDHP deductible is less.

Tax Tip. As long as you are covered by a qualifying high deductible health plan by **December 1, 2013**, you will be able to contribute up to the maximum 2013 contribution limitation (e.g., \$6,450 for family coverage in 2013), subject to potential recapture rules.

Caution! You may only reimburse drugs from the HSA without tax or penalty if you have a prescription for the drug or if the drug is insulin. IRS says, however, that if you obtain a prescription for an over-the-counter drug, it may be reimbursed tax-free and without penalty. If your HSA reimburses over-the-counter drugs for which you do not have a prescription or other non-qualifying medical expenses, the reimbursement is includable in your income and is generally subject to a 20% penalty.

Don’t Miss Use-It-Or-Lose-It Deadline For Flex Plans. If you participate in a cafeteria or flexible savings account plan (flex plans), you can generally elect to make a pre-tax salary reduction contribution to the plan. You can then access that account to reimburse yourself tax free for qualified expenditures (e.g., medical expenses, dependent care assistance, and adoption assistance). For most *calendar-year* plans, you must clean out your 2013 account by March 15,

2014, or forfeit any funds that aren't used for qualifying expenses.

Planning Alert! The March 15, 2014 deadline applies only to flex plans **that have been amended** to give participants 2½ months after year-end to use up current year contributions to the plan. If your calendar-year flex plan does not contain the 2½ month provision, you must use up your account by **December 31, 2013, or forfeit the balance.** Also, reimbursements for drugs and medicines (other than insulin) will be tax free only if you have a prescription for the drug or medication.

- **Starting In 2013 – Annual Contributions to Health FSAs Capped At \$2,500.** Previously, there was no limit (except as imposed by the plan itself) on the amount which an employee could elect to contribute to a health FSA through salary reductions. **Starting in 2013**, annual salary reduction contributions to a health FSA **are capped at \$2,500** (which is adjusted for inflation after 2013).

Home Office Deduction. Qualifying for home office deductions (e.g., depreciation, insurance, utilities, repairs and maintenance) often takes careful planning. To qualify, your home office must be used **“regularly and exclusively”** as your **“principal place of business.”** For example, your home office will be deemed your **principal place of business** if you use the office to perform **management or administrative duties** for your business **and** there is **no other fixed location** where you perform substantial management or administrative duties for your business. If you are an “employee” (as opposed to being self employed), in addition to meeting these requirements, you must also establish that your home office is **“for the convenience of your employer”** (this generally means you're not provided an office at work).

Tax Tip. The IRS says that if you have a qualifying home office, you can deduct the costs of traveling from your home office to another work location as a business expense. So, by having a qualified home office, you will generally have more deductible business travel expenses.

Note! The **“business standard mileage”** rate for 2013 is **56.5 cents** per mile. Furthermore, if you're an employee who qualifies for home office deductions, you should ask your employer to reimburse your home office expenses. This reimbursement should be excluded from your income if reimbursed under an **“accountable reimbursement plan.”** We can help you establish a qualifying **accountable reimbursement plan** with your employer.

- **IRS Releases Computational Safe Harbor.** Starting in 2013, the IRS will allow an individual with a qualifying home office to elect to compute certain home office expenses using the following formula: \$5.00 times the home office's actual square footage (not to exceed 300 square feet). Thus, the maximum deduction under this formula is \$1,500 (300 square feet x \$5.00). If you elect to use this safe harbor, you must forgo the following “actual” expenses otherwise allocable to your home office: depreciation, maintenance, home insurance, and utilities.

Tax Tip. To determine whether this computational safe harbor will save you overall taxes, in most cases we will need to compute your home office deductions under the regular “actual cost” method and the “safe-harbor” method, and choose the method producing the greatest tax benefit.

Planning Alert! You generally must reduce your *unreimbursed* employee business expenses (including home office expenses) by 2% of your adjusted gross income, and the unreimbursed expenses are not deductible at all for alternative minimum tax (AMT) purposes. However, as mentioned above, you can avoid the 2% reduction rule and the AMT exposure if you properly document your employee business expenses and get reimbursed by your employer under an “accountable reimbursement plan.”

Caution! The IRS says that if your employer reimburses you for your home office depreciation, utilities, etc., you may not use the new IRS computational safe harbor of \$5.00 per square foot.

Charitable Contributions. As you plan for your year-end charitable giving, consider the following planning techniques:

- **“Pay” Your Charitable Contribution in 2013.** A charitable contribution deduction is allowed for 2013 if the check is *mailed on or before December 31, 2013*, or the contribution is made by a credit card charge in 2013. However, if you merely give a note or a pledge to a charity, no deduction is allowed until you pay the note or pledge.
- **Contributions of Appreciated Property.** If you are considering a significant 2013 contribution to a qualified charity (e.g., church, synagogue, or college), it will generally save you taxes if you contribute *appreciated* long-term capital gain property, rather than selling the property and contributing the cash proceeds to the charity. By contributing capital gain property held more than one year (e.g., appreciated stock, real estate, etc.), a deduction is generally allowed for the full value of the property, but no tax is due on the appreciation.

Caution! Your current year deduction for appreciated capital gain property is generally limited to 30% of your AGI, with a 5-year carryover of the excess.

Tax Tip. If you want to continue to hold an investment position in stock that you contribute to charity, consider purchasing stock that is the same or similar to the appreciated stock you contributed. That way, you will have a higher “tax” basis in the replacement stock, without having to recognize the gain on the contributed stock.

Planning Alert! If you want to use “loss” stocks to fund a charitable contribution, you should sell the stock first and then contribute the cash proceeds. This will allow you to deduct the capital loss from the sale, while preserving your charitable contribution deduction. If you contribute the loss stock directly to the charity, although you will get a charitable deduction equal to the value of the contributed stock, you will *lose the capital loss* deduction.

Tax Tip. If you plan to contribute appreciated realty or stock for 2013, make sure that you begin the paperwork for the transfer early enough so that all documentation is completed by ***December 31, 2013.***

Caution! You must obtain a qualified appraisal for contributions of property valued in excess of \$5,000 unless the property is securities for which market quotations are readily available or non publicly traded stock valued at \$10,000 or less.

- **Contributions Made In Cash.** In order to deduct a “cash” contribution to a charity, you must have a receipt, letter, or other written communication from the charity (showing the name of the charity, the date and the amount of the contribution).

Planning Alert! If your contribution is \$250 or more, you *must also satisfy* the “***Mandatory Documentation Requirements for Contributions Of \$250 Or More,***” discussed below.

- **Contributions Made By Check, Debit Card, or Charge Card.** If you make a contribution by check, you are required to have either a receipt described above for “***Contributions Made in Cash,***” a copy of the cancelled check, or some other bank record (e.g., a bank statement). If your contribution is by debit card or by charge card, you are required to have either a receipt as described above for “***Contributions Made in Cash,***” or a bank record (e.g., a bank statement, credit card statement, etc.).

Planning Alert! If your contribution is \$250 or more, you *must also satisfy* the “***Mandatory Documentation Requirements for Contributions Of \$250 Or More,***” discussed below.

- **Mandatory Documentation Requirements for Contributions Of \$250 Or More.** If you contribute ***\$250 or more*** to a charity, you are allowed a deduction ***only if*** you receive a “***qualifying written receipt***” from the charity by the time you file your return (a cancelled check is not enough), if the return is timely filed. The ***qualifying written receipt*** must contain the following information: **1)** the amount of cash and a description (but not value) of any property other than cash you contributed to the charity, **2)** a statement as to whether the charity provided you with any goods or services in return for your contribution, and **3)** a description and good faith estimate of the value of any goods or services, if any, the charity provided to you (or, if applicable, a statement that the goods and services consisted solely of intangible religious benefits). ***In addition,*** for all noncash contributions, the receipt must contain the date of the charitable contribution and a description of the property contributed. Furthermore, to take a charitable contribution deduction ***for noncash property valued in excess of \$5,000,*** you must have both a ***qualifying written receipt*** (as described above), and an ***appraisal*** by a ***qualified appraiser.*** Moreover, if you are claiming a deduction of ***more than \$500*** for a ***vehicle, a boat, or an airplane*** you contributed to charity, the law requires that you obtain a ***Form 1098-C*** as well as a ***qualifying written receipt*** (if the deduction is \$250 or more) from the charity in order to deduct your contribution.

- **Contributions of Clothing and Household Items.** Even if you meet the previously-discussed documentation requirements, you are not allowed a deduction for charitable contributions of *clothing or household items* unless the items are in **“good used condition or better.”**

Tax Tip. You should consider contributing your clothing and household items to charities that have a policy of accepting only items that are in good condition.

- **IRS Charitable Mileage Rate.** The standard IRS charitable deduction mileage rate for use of your vehicle for qualified charitable purposes is **14 cents** per mile **for 2013.**
- **IRS Is Rigidly Enforcing The Charitable Contribution Documentation Requirements.** Over the last two years, the IRS has taken several taxpayers to court denying a charitable deduction for those who failed to timely obtain documentation that satisfies the strict requirements discussed above. Consequently, please make sure you have the required documentation for all your 2013 charitable contributions.

Maximizing Home Mortgage Interest Deduction. If you are looking to maximize your 2013 itemized deductions, you can increase your home mortgage interest deduction by paying your January, 2014 payment **on or before December 31, 2013.** Typically, the January mortgage payment includes interest that was accrued in December and, therefore, is deductible if paid in December.

Planning Alert! Make sure that you send in your January, 2014 mortgage payment early enough in December for your lender to actually receive it before year-end. That way, your lender will be sure to reflect that last payment on your 2013 Form 1098, and we can avoid a matching problem on your 2013 return. Here are some other planning strategies for the interest deduction you should consider:

- **Look For Deductible “Points.”** Points paid in connection with the purchase or improvement of your *principal residence* are immediately deductible. Points are deductible even if the bank labels them as something else. For example, points include “loan-processing fees,” “loan premium charges,” or “loan origination fees” so long as they don’t represent fees for services, etc. (e.g., appraisal, title, inspection, attorneys’ fees, credit checks, property taxes, or mortgage insurance premiums).

Tax Tip. If 2013 marks at least the second time that you refinanced your home, and you are not refinancing with the same lender, you may deduct in 2013 any unamortized points from the previous refinancing.

- **Remember To Deduct Seller-Paid Points.** If you bought a house this year and negotiated for the seller to pay your points at closing, the IRS says you can deduct those seller-paid points as though you paid them yourself.

- **Pay Off Personal Loans First.** If you have both home mortgage loans and other personal debt, pay off the personal debt first because interest on personal debt is generally not deductible but home mortgage interest is generally deductible. This will maximize your interest deduction.

Time Payment Of State And Local Taxes To Your Benefit. If you anticipate deducting your state and local income taxes, consider paying them (fourth quarter estimate and balance due for 2013) and any property taxes for 2013 *prior to January 1, 2014* if your tax rate for 2013 is higher than or the same as your projected 2014 tax rate. This will provide a deduction for 2013 (a year early) and possibly against income taxed at a higher rate.

Planning Alert! State and local income and property taxes are not deductible for AMT purposes. Consequently, you should not employ this tactic without carefully calculating the alternative minimum tax impact. Also, “overpayment” of your 2013 state and local income taxes is generally not advisable particularly if a refund in 2014 from a 2013 overpayment will be taxed at a higher rate than the rate that applied to the 2013 deduction.

Please consult us before you overpay state or local income taxes!

- ***Temporary Rule For Deducting Sales Tax Expires After 2013!*** As discussed previously, for the past several years we have had a *temporary* rule that allows taxpayers to “elect” to deduct “either” state and local *income* taxes or state and local *sales* taxes, as itemized deductions. This election has been particularly popular among individuals who live in states with little or no state income taxes, or states where the state income taxes are generally lower than the sales taxes.

Planning Alert! This provision is currently scheduled to *expire after 2013*. Therefore, if your state and local sales taxes are usually greater than your state and local income taxes, consider making any large purchases subject to sales taxes that you plan to make in 2014, in 2013 instead. That way you will get the sales tax deduction even if Congress fails to extend the sales tax deduction into 2014.

PLANNING WITH EDUCATION COSTS

Over the years, Congress has provided a host education tax incentives through a maze of deductions and credits that can significantly reduce your taxes, including: the “American Opportunity Credit” the Lifetime Learning credit, the student loan interest deduction, and others. As you develop your 2013 tax year-end planning strategies, the following should help you plan for these interrelated (and sometimes overlapping) education tax incentives:

“American Opportunity Education Tax Credit” (Formerly “Hope Credit”). Since 2009, we have had the “*American Opportunity Tax Credit*” which: **1)** provides a credit for qualifying college tuition, related fees, and course materials of *up to \$2,500* (100% of the 1st \$2,000 of qualifying education expenses plus 25% of the next \$2,000 of qualifying expenses); **2)** allows a

student (or the person claiming the student as a dependent) to take the credit for up to four years (i.e., generally, freshman through senior years); **3)** phases out the credit as the modified adjusted gross income of the person claiming the credit increases **from \$160,000 to \$180,000 for those filing joint returns** and **from \$80,000 to \$90,000 for single filers**; and **4)** makes 40% of the credit refundable (*unless the person claiming the credit is subject to the so-called kiddie tax rules*). **Planning Alert!** To get the full \$2,500 credit for 2013, you must pay qualifying expenses of at least \$4,000 for the student **by December 31, 2013**. For example, if you paid tuition and books of \$2,500 for the fall, 2013 semester for a college freshman, you would need to pay tuition of at least \$1,500 for the spring, 2014 semester by **December 31, 2013**, to get the full credit of \$2,500 for 2013.

The Lifetime Learning Credit. The *Lifetime Learning tax credit* equals 20% of the first \$10,000 of qualified higher education tuition and fees. The credit phases out ratably as your modified adjusted gross income increases from **\$107,000 to \$127,000** on a joint return (**\$53,000 to \$63,000** on a single return). The Lifetime Learning credit is for an unlimited number of years and can be used for graduate or professional degrees (as well as undergraduate education). The Lifetime Learning credit **limitation of \$2,000 is a per tax return limitation**. However, the \$2,500 American Opportunity Education Credit limitation (discussed above) is a per student limitation.

Planning Alert! If your income is **more than \$127,000 (\$63,000 on a single return)**, you do not qualify for the Lifetime Learning credit. However, the IRS says the student (e.g., your child) may claim the credit on his or her return, provided you elect not to claim that child as a dependent on your tax return (even if the child otherwise qualifies as your dependent). Since the Lifetime Learning credit is a *non-refundable* credit, your child must have sufficient income tax liability to utilize the credit on his or her return.

Student Loan Interest. For **2013**, you may deduct (whether or not you itemized deductions) up to \$2,500 of interest on qualified student loans. Your deduction phases out as your adjusted gross income increases from **\$125,000 to \$155,000 on a joint return (from \$60,000 to \$75,000 on a single return)**. The IRS says that if a family member pays your interest, the payment will be treated as a gift to you, and you will then be treated as paying the interest yourself.

Using IRA Funds For Education Expenses. If you have an IRA, you can withdraw funds for qualified higher education expenses without having to pay the normal 10% early distribution penalty. The distribution is, however, still taxable.

Tax Tip. The taxes on the distribution for higher education expenses may be offset by an American Opportunity Tax credit or a Lifetime Learning credit resulting from the payment of the qualifying education expenses.

Caution! This exception from the early distribution penalty for qualifying education expenses *only applies to distributions from IRAs*. Therefore, if you receive a distribution from your *employer's retirement plan* and you do not meet any other exception to the 10% penalty; you will generally pay the 10% penalty tax even if you pay qualifying education expenses during the year.

Tax Tip. You could avoid the 10% penalty by first rolling the distribution from your employer's retirement plan *into an IRA*, and then distributing funds from the IRA to pay for the education expenses.

Planning Alert! You must withdraw the IRA funds *in the same tax year* that you pay the qualified education expenses to avoid the 10% early distribution penalty. Therefore, if you have *paid qualifying education expenses in 2013* and want a penalty-free reimbursement from your IRA for those expenses, you must make the distribution *no later than December 31, 2013*.

The Qualified Tuition Deduction Up To \$4,000. A discussion of the “above-the-line” deduction of up to \$4,000 for qualified tuition payments is located in an earlier segment in this letter entitled: ***“PLANNING FOR TAX BREAKS EXPIRING AFTER 2013.”***

PLANNING WITH RETIREMENT PLANS

Consider Contributing The Maximum Amount To Your Retirement Plan. As your income rises and your marginal tax rate increases, deductible retirement plan contributions generally become more valuable. Also, making your deductible contribution to the plan as early as possible generally increases your retirement benefits. As you evaluate how much you should contribute, consider the following:

- **IRA Contributions.** If you are married, even if your spouse has no earnings, you can generally deduct in the aggregate up to \$11,000 (\$13,000 if you are both at least age 50 by the end of the year) for contributions to your and your spouse's traditional IRAs. You and your spouse must have *combined earned income* at least equal to the total contributions. However, no more than \$5,500 (\$6,500 if you're at least age 50) may be contributed to either you or your spouse's separate IRA for 2013. If you are an active participant in your employer's retirement plan during 2013, your IRA deduction is reduced ratably as your adjusted gross income increases from **\$95,000 to \$115,000** on a joint return (**\$59,000 to \$69,000** on a single return). However, if you file a joint return with your spouse and your spouse is an active participant in his or her employer's plan and you are not an active participant in a plan, your IRA deduction is reduced as the adjusted gross income on your joint return goes from **\$178,000 to \$188,000**.

Planning Alert! Every dollar you contribute to a deductible IRA reduces your allowable contribution to a nondeductible Roth IRA. For 2013, your ability to contribute to a Roth IRA is phased out ratably as your adjusted gross income increases from **\$178,000 to \$188,000** on a joint return or from **\$112,000 to \$127,000** if you are single.

- **Workers At Least Age 70½.** If you are age 70½ or older, you *cannot* make a contribution to a traditional IRA for yourself.

Tax Tip. If you are working, age 70½ or older, have a spouse under age 70½, and otherwise qualify, you can make a deductible IRA contribution to a separate traditional IRA for your spouse (not to exceed your compensation) even where the spouse has no earned income. Also, if you otherwise qualify, you can contribute to a nondeductible Roth IRA even after you reach age 70½.

- **Consider Contributing To Your Company's 401(k) Plan.** If you are covered by your company's 401(k) plan, you should consider putting as much of your compensation into the plan as allowable. The maximum amount of compensation you can defer into the 401(k) plan for 2013 is \$17,500 (\$23,000 if you're at least age 50 by the end of 2013). Deferring the maximum compensation amount into the plan is particularly appealing if your employer offers to match your contributions.
- **Seek Advice Before Dipping Into Your IRA!** If you are experiencing financial distress and are considering withdrawing funds from your IRA to fill the financial void, **be extremely careful!** There can be a 10% penalty for withdrawing funds from your IRA on top of any income tax on the distribution. However, there are specific exceptions to the 10% distribution penalty (although you generally must include the amount distributed in your taxable income). For example, you can generally withdraw funds from your IRA without penalty if: **1)** you have reached age 59½, **2)** you have been medically determined to be disabled, **3)** you are using the funds for qualified education expenses, **4)** you are receiving unemployment benefits and you use the funds for medical insurance premiums, or **5)** you take substantially equal payments over your life expectancy.

Planning Alert! These rules are exceedingly technical and if not properly followed, can result in a 10% penalty in addition to any income tax due on the distribution. Please call our firm if you need to access your IRA funds and we will help you determine if you qualify for one of these exceptions to the penalty.

MISCELLANEOUS YEAR-END TAX PLANNING OPPORTUNITIES

Stock “Traders” Should Consider The “Mark-to-Market” Election. If you are a “trader” (instead of an “investor”) in stocks, the “mark-to-market” election could possibly save you taxes. Generally, you may qualify as a “trader” if you have frequent purchases and sales of stock, you hold the stock for short-term gain (rather than long-term appreciation and dividends), and you have a high volume of stock transactions throughout the year. As a trader, you can elect (for tax purposes) to mark your stock down or up to market at year end. This election will convert what would generally be short-term capital gains and losses, into “ordinary” gains and losses.

Tax Tip. This election could save taxes if at some point you incur significant losses. If you qualify as a “trader,” making a timely “mark-to-market” election allows you to deduct those losses as “ordinary losses,” instead of being limited by the \$3,000 ceiling on net capital losses. Also, making this election **will not** subject your mark-to-market stock gains to Social Security or Medicare taxes.

Planning Alert! Unless you made the election for a prior year, the mark-to-market election, unfortunately, must be made by the due date (without regard to extensions) of your **prior year’s tax return**. Even though it is too late to make the election for 2013, you may wish to make the election by April 15, 2014, for 2014 and future years. Please call us if you think this election might save you taxes and we will be glad to fill you in on the details.

Exercising Incentive Stock Options (ISOs) Could Trigger AMT. Exercising an incentive stock option (ISO) in 2013 can generate a 2013 alternative minimum tax (AMT) if the difference between the stock’s value and the exercise price is substantial.

Tax Tip. If you exercised an ISO **in 2013** and the stock you acquired has declined in value since the date of exercise, it may be possible to eliminate or reduce your 2013 AMT tax liability if you sell the stock **on or before December 31, 2013**. Please check with us if you have exercised incentive stock options during 2013 and the price of the stock has fallen since the date of exercise.

Consider Increasing Withholding If Facing An Estimated Tax Underpayment Penalty. If you have failed to pay sufficient estimated taxes during 2013 potentially causing an estimated tax underpayment penalty, **increasing your withholdings before the end of 2013** may solve the problem. Any income tax withholding (including withholdings at the end of 2013 from a year-end bonus or IRA distribution) is generally deemed paid 1/4 on April 15, 2013, June 17, 2013, September 16, 2013 and January 15, 2014. Therefore, amounts **withheld on or before December 31, 2013** may reduce or eliminate your penalty for underpaying estimated taxes.

Tax Tip. If you are a higher-income individual with **investment income** that will trigger the **3.8% NIIT** for 2013, this could subject you to the underpayment penalty if you haven’t

adjusted your estimated tax payments or withholdings to cover the 3.8% NIIT and do not otherwise meet one of the exceptions to the penalty (i.e., paying in 110% of last year's tax). Increasing your withholdings on or before December 31, 2013 could eliminate that penalty.

Planning Alert! If you use this technique by withholding taxes from an IRA distribution near year end, to avoid paying taxes (and possibly a 10% penalty) on the IRA distribution, you must roll the distribution (unreduced by the withheld taxes) into a new IRA within 60 days of the distribution. Also, you are allowed to take a distribution from an IRA and roll it over into a new IRA, *only one time per year* (beginning with the date you received the distribution). So, if you used this withholding technique with your IRA last year, you must generally meet the one-year waiting period for it to work this year for the same IRA account. Please call us if you have any questions.

Maximize Tax-Favored Medical Benefits For Children Under Age 27. An employer-provided health plan may provide tax-free reimbursements to an employee's child **who is under age 27 at the end of the tax year**. This exclusion applies even if the employee cannot claim the child as a dependent for tax purposes.

Tax Tip. If your employer's health insurance plan is currently covering your child who will turn age 27 in 2014, accelerating discretionary medical expenses for that child from **2014 into 2013** will allow your employer's 2013 reimbursements to be tax-free.

Planning Alert! If you are *self-employed*, you may take an "above-the-line" deduction (i.e., unrestricted by the limitations on "itemized deductions") for health insurance premiums that you pay for your child who is **under age 27 at the end of the year**, even if the child is not your "dependent" for tax purposes.

Consider Utilizing The \$14,000 Annual Gift Tax Exclusion. For individuals dying in 2013, there is generally a **40%** estate tax to the extent the estate's value plus any taxable gifts made during the decedent's life exceeds **\$5.25 million** (the "estate and gift unified exclusion amount"). This \$5.25 million unified exclusion amount is indexed for inflation after 2013.

Tax Tip. You can reduce your estate without using any of the unified exclusion amount and without making taxable gifts by making annual gifts up to the annual gift tax exclusion amount of \$14,000 per donee. Your spouse can do the same, bringing the total gifts that can be made free of gift tax and without using any of the unified exclusion amount to \$28,000 per donee.

Planning Alert! If you make your 2013 gift by check, the IRS says that the donee must actually "deposit" the check **by December 31, 2013** in order to utilize \$14,000 annual gift tax exclusion amount for 2013. Therefore if gifts are made near the end of the year, you should consider making the gifts using a cashier's check which should constitute a gift when the check is delivered

FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information.

Note! The information contained in this letter represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of the provisions discussed may apply to a specific situation.

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