Year-End 2013 Individual Tax Planning

December 2013

New Taxes take Effect 2013

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There are a couple of new taxes that take effect in 2013: a 3.8 percent tax on net investment income above a threshold amount, and a .9 percent additional tax on wages and self-employment income above a threshold amount. For both taxes, the threshold amount is $200,000 ($250,000 if married filing jointly or $125,000 for married filing separately). Income taken into consideration in calculating net investment income includes most rental income and net gain attributable to the disposition of property other than property held in a trade or business. Thus, this generally covers sales of interests in a partnership or S corporation.

Increased Threshold for Deducting Medical Expenses

Medical and dental expenses that exceed a certain percentage of your adjusted gross income (AGI) for the year are deductible. For years before 2013, that percentage was 7.5 percent. For 2013 and later years, the deduction floor is increased to 10 percent. However, for any tax year ending before January 1,

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It's that time of year where we should think about preparing an estimate of your current year tax liability and see if there isn't some way we can reduce that liability.

What to consider…

There are several things to consider when doing year-end tax planning: taking advantage of expiring tax provisions, deferring income into the following year or accelerating income into the current year, and accelerating expenses into the current year or deferring them into the following year. The proper strategy depends on whether or not you anticipate a significant change in income or expenses next year.

See Page 4 to learn how to edit or replace this picture.

In addition, the following are some changes in the law that took effect this year, as well as some popular deductions and credits to which you may be entitled.

Life Events

Certain life events can also affect your tax situation. If you've gotten married or divorced, had a birth or death in the family, lost or changed jobs, or retired during the year, we need to discuss the tax implications of these events.

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2017, the floor is 7.5 percent if you or your spouse has reached age 65 before the end of that year.

State and Local Sales Tax Deduction

One provision scheduled to expire at the end of 2013 is the election to deduct state and local sales taxes in lieu of state and local income taxes. Thus, if you are thinking of purchasing a large-ticket item that will generate a larger deduction than the state and local income tax deduction, purchasing the item in 2013 may be beneficial.

Expiring Energy-Related Tax Credits

There are two expiring energy-related tax credits that may be worth looking at. One such credit is the residential energy credit, which is available only through the end of 2013. If you are contemplating energy improvements to your home, you may want to accelerate the improvements into 2013. The credit is 10 percent of the amounts paid or incurred for qualified energy efficiency improvements installed during the tax year and the amount of residential energy property expenditures paid or incurred during the tax year, up to a maximum credit of $500.

Another “green” credit due to expire at the end of the year is the credit for qualified two- or three-wheeled plug-in electric vehicles. The credit is equal to the lesser of 10 percent of the cost of such a vehicle or $2,500.

Transfers to Roth Accounts

New in 2013 is an expansion of the option for a taxpayer with a 401(k) plan that includes a qualified Roth contribution program to transfer an amount from his or her regular (pretax) elective deferral account into a designated Roth account in the same plan. In 2012, this was allowed only for participants who were at least 59-1/2 years old. That age limitation does not apply in 2013 and, while the transfer is subject to regular income tax, no early distribution penalty applies. Subsequent distributions from the Roth account, assuming applicable requirements are met, will be tax free.

Student Loan Interest Deduction

If you had any student loans during the year and your modified adjusted gross income (MAGI) is within certain limits, you may deduct up to $2,500 of interest paid on that loan in computing adjusted gross income. For 2013, the deductible amount is phased out if your MAGI is between $60,000 and $75,000 ($125,000 and $155,000 if filing a joint return). You cannot take a student loan interest deduction if your MAGI is $75,000 or more ($155,000 or more if filing a joint return). The deduction is not available if your filing status is married filing separately.

Other Steps to Consider Before the End of the Year

Accelerating Income into 2013

Depending on your projected income, it may make sense to accelerate income into 2013. Besides harvesting gains from your investment portfolio, other options for accelerating income include:

- if you own a traditional IRA or a SEP IRA, converting it into a Roth IRA and recognizing the conversion income this year;
- taking IRA distributions this year rather than next year;
- selling stocks or other assets with taxable gains this year;
- if you are self employed with receivables on hand, trying to get clients or customers to pay before year end; and
- settling lawsuits or insurance claims that will generate income this year.

Deferring Income into 2014

There are also scenarios (for example, if you think that your income will decrease substantially next year) in which it might make sense to defer income into the 2014 tax year or later years. Some options for deferring income include:

- if you are due a year-end bonus, asking your employer to pay the bonus in January 2014;
- if you are considering selling assets that will generate a gain, postponing the sale until 2014;
- delaying the exercise of any stock options you may have;
- if you are selling property, considering an installment sale;
- consider parking investments in deferred annuities;

- establishing an IRA, if you are within certain income requirements; and
- if your employer has a 401(k) plan, consider putting the maximum salary allowed into it before year end.

Deferring Deductions into 2014

Once again, if we expect tax rates to increase next year, or if you anticipate a substantial increase in taxable income, we may want to explore deferring deductions into 2014 by looking at the following:

- postponing year-end charitable contributions, property tax payments, and medical and dental expense payments, to the extent you might get a deduction for such payments, until next year; and
- postponing the sale of any loss-generating property.

Accelerating Deductions into 2013

If you expect your income to decrease next year, we should accelerate what deductions we can into the current year to offset the higher income this year. Some options include:

- consider prepaying your property taxes in December;
- consider making your January mortgage payment in December;
- if you owe state income taxes, consider making up any shortfall in December rather than waiting until your return is due;
- since medical expenses are deductible only to the extent they exceed 10 percent (7.5 percent if you or your spouse are 65 before the end of the year) of your adjusted gross income (AGI), if you have large medical bills not covered by insurance, bunching them into one year may help overcome this threshold;
- making any large charitable contributions in 2013, rather than 2014;
- selling some or all of your loss stocks; and
- if you qualify for a health savings account, consider setting one up and making the maximum contribution allowable.

Deduction for Eligible Teacher Expenses

Another provision that expires this year is the deduction for eligible teacher expenses. For tax years beginning before 2014, eligible educators (i.e., teachers) can deduct from gross income up to $250 of qualified expenses they paid during the year. If spouses are filing jointly and both were eligible educators, the maximum deduction on the joint return is $500. However, neither spouse can deduct more than $250 of his or her qualified expenses.

Qualified Principal Residence Debt Exclusion

Generally, you recognize income when debt is discharged. However, there is a special rule for the discharge of qualified principal residence debt (i.e., mortgage debt). The discharge of such debt is generally excludable from gross income for discharges through 2013.

Qualified principal residence debt is debt that is incurred to buy, build, or substantially improve your principal residence and that is secured by that residence. It also includes debt secured by your principal residence that is used to refinance qualified principal residence debt, but not in excess of the outstanding principal amount of the debt that is refinanced.

Citations:
Mncpa.org
Irs.gov
Parker Tax Publishing
Accounting Today

"The hardest thing in the world to understand is income tax." Albert Einstein

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Miscellaneous Items

Some additional Items to consider:

1. If you have a health flexible spending account with a balance, remember to spend it before year end (unless your employer allows you to go until March 15, 2014, in which case you'll have until then).
2. If you own a vacation home that you rented out, we need to look at the number of days it was used for business versus pleasure to see if there is anything we can do to maximize tax savings with respect to that property. For example, if you spent less than 14 days at the home, it may make sense to spend a couple more days and have the house qualify as a second residence, with the interest being deductible. As a rental home, rental expenses, including interest, are limited to rental income.
3. We should also consider if there is any income that could be shifted to a child so that the income is paid at the child's rate.
4. If you have any foreign assets, there are reporting and filing requirements with respect to those assets. Noncompliance carries stiff penalties.

What to Consider... (Cont.)

Increased Tax Rate

Beginning in 2013, a new top tax rate of 39.6 percent takes effect. This rate applies to taxable income in excess of $450,000 (joint returns and surviving spouses), $425,000 (heads of household), $400,000 (unmarried other than head of household and surviving spouse), and $225,000 (married filing separately).

Increased Tax Rate on Certain Capital Gains and Dividends

While the favorable tax rates in effect before 2013 for capital gains and dividend income were generally made permanent by the American Taxpayer Relief Act of 2012, a new 20-percent rate applies to amounts which would otherwise be taxed at the 39.6-percent rate. Thus, tax rates of 0, 15, and 20 percent apply to capital gain and dividend income, depending on your tax bracket. These rates apply for alternative minimum tax purposes also.

Please call me at your convenience so we can set up an appointment and estimate your tax liability for the year and discuss any questions you may have.

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