



# Korbitz Financial Planning Newsletter

## 2013 Year-End Tax Planning Considerations



As the end of the 2013 tax year approaches, set aside some time to evaluate your situation. Here are some things to keep in mind as you consider potential year-end tax moves.

401(k) plans allow you to contribute funds pretax, reducing your 2013 income. Contributions that you make to a Roth IRA (assuming you meet the income requirements) or a Roth 401(k) plan are made with after-tax dollars, but qualified Roth distributions are completely free from federal income tax. For 2013, you can contribute up to \$17,500 to a 401(k) plan (\$23,000 if you're age 50 or older), and up to \$5,500 to a traditional or Roth IRA (\$6,500 if you're age 50 or older). The window to make 2013 contributions to an employer plan typically closes at the end of the year, while you generally have until the due date of your federal income tax return to make 2013 IRA contributions.

### 1. The tax landscape has changed for higher-income individuals

This year a new 39.6% federal income tax rate applies if your taxable income exceeds \$400,000 (\$450,000 if you're married and file a joint return, \$225,000 if you're married and file separately). If your income crosses that threshold, you'll also be subject to a new 20% maximum tax rate on long-term capital gains and qualifying dividends (last year, the maximum rate that applied was 15%).

That's not all--you could see a difference even if your income doesn't reach that level. That's because if your adjusted gross income is more than \$250,000 (\$300,000 if you're married and file a joint return, \$150,000 if you're married and file separately), your personal and dependency exemptions may be phased out this year, and your itemized deductions may be limited.

### 2. New Medicare taxes apply

Two new Medicare taxes apply this year. If your wages exceed \$200,000 this year (\$250,000 if you're married and file a joint return, \$125,000 if you're married and file separately), the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--is increased by 0.9%. Also, a 3.8% Medicare contribution tax generally applies to some or all of your net investment income if your modified adjusted gross income exceeds those dollar thresholds.

### 3. Don't forget the basics--retirement plan contributions

Make sure that you're taking full advantage of tax-advantaged retirement savings vehicles. Traditional IRAs (assuming that you qualify to make deductible contributions) and employer-sponsored retirement plans such as

### 4. Expiring provisions

A number of key provisions are scheduled to expire at the end of 2013, including:

- Increased Internal Revenue Code Section 179 expense limits and "bonus" depreciation provisions end.
- The increased (100%) exclusion of capital gain from the sale or exchange of qualified small business stock (provided certain requirements, including a five-year holding period, are met) will not apply to qualified small business stock issued and acquired after 2013.
- This will be the last year that you'll be able to make qualified charitable distributions (QCDs) of up to \$100,000 from an IRA directly to a qualified charity if you're 70½ or older; such distributions may be excluded from income and count toward satisfying any required minimum distributions (RMDs) you would otherwise have to receive from your IRA in 2013.
- The above-the-line deductions for qualified higher education expenses, and for up to \$250 of out-of-pocket classroom expenses paid by education professionals, will not be available starting with the 2014 tax year.
- This will also be the last year you'll be able to elect to deduct state and local sales tax in lieu of state and local income tax if you itemize deductions.

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This has been a busy month for me, and it is only about half over. I completed my third marathon on October 6th, and set a new Personal Best for myself. It was a near perfect day to run 26.2 miles, and I enjoyed the experience.

I spent several days last week in Philadelphia at the convention of the National Association of Personal Financial Advisors (NAPFA), which is one of several professional organizations that I am active in. I had the opportunity to hear a number of world class speakers, including Joe Davis, the Global Chief Economist and Head of Investment Strategy Group at Vanguard. He was much more even keeled about the economy than most of the talking heads you see on television.

I hope you have a pleasant fall, which is my favorite season. As always, please email or call if you wish to set up an appointment or have any questions.

Eric

### October 2013 Newsletter

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## Stretch IRAs

The term "stretch IRA" has become a popular way to refer to an IRA (either traditional or Roth) with provisions that make it easier to "stretch out" the time period that funds can stay in your IRA after your death, even over several generations. It's not a special IRA, and there's nothing dramatic about this "stretch" language. Any IRA can include stretch provisions, but not all do.

### Why is "stretching" important?

Any earnings in an IRA grow tax deferred. Over time, this tax-deferred growth can help you accumulate significant retirement funds. If you're able to support yourself in retirement without the need to tap into your IRA, you may want to continue this tax-deferred growth for as long as possible. In fact, you may want your heirs to benefit--to the greatest extent possible--from this tax-deferred growth as well.

But funds can't stay in your IRA forever. Required minimum distribution (RMD) rules will apply after your death (for traditional IRAs, minimum distributions are also required during your lifetime after age 70½).

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow. You'll want to check your IRA custodial or trust agreement carefully to make sure that it contains the following important stretch provisions.

### Key stretch provision #1

The RMD rules let your beneficiary take distributions from an inherited IRA over a fixed period of time, based on your beneficiary's life expectancy. For example, if your beneficiary is age 20 in the year following your death, he or she can take payments over 63 additional years (special rules apply to spousal beneficiaries).

As you can see, this rule can keep your IRA funds growing tax deferred for a very long time. But even though the RMD rules allow your beneficiary to "stretch out" payments over his or her life expectancy, your particular IRA may not. For example, your IRA might require your beneficiary to take a lump-sum payment, or receive payments within 5 years after your death. If stretching payments out over time is important to you, make sure your IRA contract lets your beneficiary take payments over his or her life expectancy.

### Key stretch provision #2

What happens if your beneficiary elects to take distributions over his or her life expectancy but dies a few years later, with funds still in the

inherited IRA? This is where the IRA language becomes crucial.

If, as is commonly the case, the IRA language doesn't address what happens when your beneficiary dies, then the IRA balance is typically paid to your beneficiary's estate.

However, IRA providers are increasingly allowing an original beneficiary to name a successor beneficiary. In this case, when your original beneficiary dies, the successor beneficiary "steps into the shoes" of your original beneficiary and can continue to take RMDs over the original beneficiary's remaining distribution schedule.

When reviewing your IRA language, it's important to understand that a successor beneficiary is not the same as a contingent beneficiary. Most IRA providers allow you to name a contingent beneficiary. Your contingent beneficiary becomes entitled to your IRA proceeds only if your original beneficiary dies before you.

### Stretch even further ...

If you name your spouse as beneficiary, your IRA can stretch even further. This is because your spouse can elect to treat your IRA as his or her own, or to transfer the IRA assets to his or her own IRA. Your spouse then becomes the owner of your IRA, rather than a beneficiary. As owner, your spouse won't have to start taking distributions from your traditional IRA until he or she reaches age 70½ (and no lifetime RMDs are required from your Roth IRA). Plus, your spouse can name a new beneficiary to continue receiving payments after he or she dies.

### What if your IRA doesn't stretch?

If your IRA doesn't contain the appropriate stretch provisions, don't fret--you can always transfer your funds to an IRA that contains the desired language. In addition, upon your death, your beneficiary can transfer the IRA funds (in your name) directly to another IRA that has the appropriate stretch language.

### A word of caution

While you might appreciate the value of tax-deferred growth, your beneficiary might prefer instant gratification. If so, there's little to prevent your beneficiary from simply taking a lump-sum distribution upon inheriting the IRA, rather than "stretching out" distributions over his or her life expectancy. It's possible, though, to name a trust as the beneficiary of your IRA to establish some control over how distributions will be taken after your death.

## Estate Planning and Income Tax Basis



**Income tax basis can be important when deciding whether to make gifts now or transfer property at your death. When you make a gift of property, the recipient generally receives your basis in the property. When you transfer property at your death, the recipient generally receives a basis equal to the fair market value of the property. The difference can substantially affect the amount of taxable gain when the recipient sells the property.**

Income tax basis can be important when deciding whether to make gifts now or transfer property at your death. This is because the income tax basis of the person receiving the property depends on whether the transfer is by gift or at death. This, in turn, affects the amount of taxable gain subject to income tax when the person sells the property.

### What is income tax basis?

Income tax basis is the base figure you use when determining whether you have recognized capital gain or loss on the sale of property for income tax purposes. (Gain or loss on the sale of property equals the difference between your adjusted tax basis and the amount you realize upon the sale of the property.) When you purchase property, your basis is generally equal to the purchase price. However, there may be some adjustments made to basis.

### What is the income tax basis for property you receive by gift?

When you receive a gift, you generally take the donor's basis in the property. (This is often referred to as a "carryover" or "transferred" basis.) The carried-over basis is increased--but not above fair market value (FMV)--by any gift tax paid that is attributable to appreciation in value of the gift (appreciation is equal to the excess of FMV over the donor's basis in the gift immediately before the gift). However, for purpose of determining loss on a subsequent sale, the carried-over basis cannot exceed the FMV of the property at the time of the gift.

**Example:** Say your father gives you stock worth \$1,000. He purchased the stock for \$500. Assume the gift incurs no gift tax. Your basis in the stock, for the purpose of determining gain on the sale of the stock, is \$500. If you sold the stock for \$1,000, you would have gain of \$500 (\$1,000 received minus \$500 basis).

Now assume that the stock is only worth \$200 at the time of the gift and you sell it for \$200. Your basis in the stock, for purpose of determining gain on the sale of the stock, is still \$500; but your basis for purpose of determining loss is \$200. You do not pay tax on the sale of the stock. You do not recognize a loss either. In this case, your father should have sold the stock (and recognized the loss of \$300--his basis of \$500 minus \$200 received) and then transferred the sales proceeds to you as a gift. (You are not permitted to transfer losses.)

### What is the income tax basis for property you inherit?

When you inherit property, you generally

receive an initial basis in property equal to the property's FMV. The FMV is established on the date of death or on an alternate valuation date six months after death. This is often referred to as a "stepped-up basis," since basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

**Example:** Say your mother leaves you stock worth \$1,000 at her death. She purchased the stock for \$500. Your basis in the stock is a stepped-up basis of \$1,000. If you sold the stock for \$1,000, you would have no gain (\$1,000 received minus \$1,000 basis).

Now assume that the stock is only worth \$200 at the time of your mother's death. Your basis in the stock is a stepped-down basis of \$200. If you sold the stock for more than \$200, you would have gain.

### Make gift now or transfer at death?

As the following example shows, income tax basis can be important when deciding whether to make gifts now or transfer property at your death.

**Example:** You purchased land for \$25,000. It is now worth \$250,000. You give the property to your child (assume the gift incurs no gift tax), who then has a tax basis of \$25,000. If your child sells the land for \$250,000, your child would have taxable gain of \$225,000 (\$250,000 sales proceeds minus \$25,000 basis).

If, instead, you kept the land and transferred it to your child at your death when the land is worth \$250,000, your child would have a tax basis of \$250,000. If your child sells the land for \$250,000, your child would have no taxable gain (\$250,000 sales proceeds minus \$250,000 basis).

In addition to income tax basis, you might consider the following questions:

- Will making gifts reduce your combined gift and estate taxes? For example, future appreciation on gifted property is removed from your gross estate for federal estate tax purposes.
- Does the recipient need a gift now or can it wait? How long would a recipient have to wait until your death?
- What are the marginal income tax rates of you and the recipient?
- Do you have other property or cash that you could give?
- Can you afford to make a gift now?

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## Do I need to make any changes to my Medicare coverage for next year?

If you're currently enrolled in Medicare, you've probably begun receiving information about your coverage. That's because the annual enrollment period for Medicare runs from October 15 through December 7. During this period, you can make changes to your Medicare coverage that will be effective on January 1, 2014. If you're satisfied with your current coverage you don't need to make changes, but you should review your options before you decide to stay with your current plan.

Your Medicare plan sends you two important documents every year that you should review. The first, called the Evidence of Coverage, gives you information about what your plan covers, and its cost. The second, called the Annual Notice of Change, lists changes to your plan for the upcoming year (these will take effect in January). You can use these documents to evaluate your current plan and decide if you need different coverage. If you haven't already gotten one, you should soon receive a copy of Medicare & You 2013, the official government Medicare handbook. It

contains detailed information about Medicare that should help you decide if your current plan is right for you.

As you review your coverage, here are a few points to consider:

- Will your current plan cover all the services you need and the health-care providers you need to see next year?
- Does your current plan cost more or less than other options? Consider premiums, deductibles, and other out-of-pocket costs you pay such as co-payments or coinsurance costs; are any of these costs changing?
- Do you need to join a Medicare drug plan? When comparing plans, consider the cost of drugs under each plan, and make sure the drugs you take will still be covered next year.
- Does your Medigap plan (if you have one) still meet your needs?

If you have questions about Medicare, you can call 1-800-MEDICARE (1-800-633-4227 or TTY 1-877-486-2048) or visit the Medicare website at [www.medicare.gov](http://www.medicare.gov).



## Will interest rates rise this year?

The Fed hasn't yet raised its target interest rate from less than 0.25%, and it has promised not to do so before unemployment reaches

roughly 6.5%, which it doesn't expect to happen until next year. However, some interest rates have already begun to go up. For example, according to Freddie Mac, the average interest rate on a 30-year fixed-rate mortgage shot above 4% last June for the first time since late 2011, hitting its highest level in almost 2 years. In the same month, the yield on the 10-year Treasury bond went above 2.5% for the first time since August 2011.

Why are interest rates rising even though the Fed's target rate hasn't? Because bond investors are concerned that higher interest rates in the future will hurt the value of bonds that pay today's lower rates. Immediately after the Fed's June announcement, investors began pulling money out of bond mutual funds in droves, reversing a multiyear trend. If there's less demand for bonds, yields have to rise to attract investors.

Aside from bonds, why are investors concerned about a possible Fed rate hike? Bonds aren't

the only financial asset that can be affected by potential future interest rate changes. Dividend-paying stocks with hefty yields have benefitted in recent years; more competitive bond yields could start to reverse that dynamic. Shares of preferred stock typically behave much like those of bonds, since their dividend payments also are fixed; their values could be affected as well.

Also, higher mortgage rates could potentially slow the housing market recovery, though historically they remain at relatively low levels. And if a Fed rate increase were to bring on higher interest rates abroad, that could create even more problems in countries already struggling with sovereign debt--problems that have provoked global market volatility in the past.

The Fed has said any hikes in its target rate will occur only if the economy seems strong enough. If higher rates seem likely to halt the recovery, the Fed could postpone a rate hike even longer. It also will take other measures before raising rates. Even though the timing and size of any Fed action is uncertain, it's best to be aware of its potential impact.