KORBITZ FINANCIAL PLANNING

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December 1, 2013

Dear Clients and Friends:

As January 1, 2014 gets closer, year-end tax planning should be reviewed. Planning will help you to maximize your potential tax savings and minimize your tax liability. This letter is intended to be a high level view of some key year-end tax planning strategies.

Changes for 2013 and beyond

In January 2013, Congress passed the American Taxpayer Relief Act (ATRA) of 2012, which made permanent many of the Bush-era tax cuts and also some tax benefits enacted during the Obama administration. Congress also permanently "patched" the alternative minimum tax (AMT) to prevent its encroachment on middle income taxpayers. The result is much greater certainty in year-end tax planning for 2013 because we know what the individual tax rates are in 2014, how many tax credits and deductions are structured, and much more.

There are always complexities in the Tax Code. In 2013, two new Medicare taxes kicked-in (a 3.8% net investment income (NII) surtax and a 0.9% Additional Medicare Tax). Beginning in 2014, some of the most far reaching provisions of the Affordable Care Act will become effective: the individual mandate, the start of marketplaces to obtain insurance and a special tax credit to help offset the cost of insurance.

Planning for new taxes and rates

Some individuals may be surprised that they owe additional taxes in 2013, even with the extension of the Bush-era tax cuts. Three new taxes are in effect for 2013: the NII surtax, the Additional Medicare Tax and a revived 39.6% tax bracket for higher income individuals. The 3.8% NII surtax very broadly applies to individuals, estates and trusts that have certain investment income above set threshold amounts. These amounts include a $250,000 threshold for married couples filing jointly; $200,000 for single filers. One strategy to consider is to keep, if possible, income below the threshold levels for the NII surtax by spreading income out over a number of years or finding offsetting above-the-line deductions.

The Additional Medicare Tax applies to wages and self-employment income above threshold amounts including $250,000 for married couples filing joint returns and $200,000 for single individuals. If you have not already reviewed your income tax withholding for 2013, now is the time to do it. One way to reduce the sting of any Additional Medicare Tax liability is to withhold an additional amount of income tax before year-end.

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The ATRA extended the Bush-era tax rates for middle and lower income individuals. ATRA also revived the 39.6 % top tax rate. For 2013, the starting points for the 39.6 % bracket, for 2013 are $450,000 for married couples filing jointly and surviving spouses, $425,000 for heads of households, $400,000 for single filers, and $225,000 for married couples filing separately. ATRA also revived the personal exemption phase out (PEP) and the limitation on itemized deductions (Pease) for higher income individuals.

Starting in 2013, ATRA also sets the top rate for capital gains and dividends to 20 %. This top rate aligns itself with the levels at with the new 39.6 % income tax rate bracket starts: capital gains and dividends to the extent they would be otherwise taxed at the 39.6 % rate as marginal ordinary income will be taxed at the 20 % rate. ATRA did not change the application of ordinary income rates to short-term capital gains. However, individuals should plan for the possibility of being subject to a higher top rate.

Planning for health care changes

The Affordable Care Act brings a sea-change to our traditional image of health insurance. The law requires individuals, unless exempt, to either carry minimum essential health care coverage or pay a penalty. Most employer-sponsored health insurance is deemed to be minimum essential coverage, as is coverage provided by Medicare, Medicaid, and other government programs. Self-employed individuals should revisit their health insurance coverage, if they have coverage, before year-end and weigh the benefits and costs of obtaining coverage. Individuals may qualify for a premium assistance tax credit, which is refundable and payable in advance, to offset the cost of coverage.

Individuals with health flexible spending accounts (FSAs) and similar arrangements should take a look at their spending habits for 2013 and predict how they will use these tax-favored funds in the future. In 2013, the maximum salary-reduction contribution to a health FSA is $2,500. Remember that health FSAs have strict “use it or lose it” rules, and the cost of over-the-counter drugs cannot be reimbursed with health FSA dollars unless you obtain a prescription (there are some exceptions). The IRS did recently give employers the option of adding a $500 carryover for FSA plans, though this is not mandatory.

Individuals who itemize their deductions also need to keep in mind the 10 % floor for qualified medical expenses. This change took effect at the beginning of 2013. It means that you can only claim deductions for medical expenses when they reach 10 % of adjusted gross income (for regular tax purposes and for alternative minimum tax purposes). There is a temporary exception for individuals over age 65 for regular tax purposes.

Planning for gifts

Gift-giving is often overlooked as a year-end planning strategy. For 2013, individuals can make tax-free gifts of up to $14,000 to any individual. Married couples may “split” their gifts to each recipient, which effectively raises the tax-free gift to $28,000. Gifts between spouses are always tax-free unless one spouse is not a U.S. citizen.

Gifts to charity also are frequently made at year-end. Through the end of 2013, taxpayers age 70 ½ and older can make a tax-free distribution from individual retirement accounts to a charity. The maximum distribution is $100,000. Individuals taking this option cannot claim a deduction for the charitable gift.

Planning for retirement savings

Year-end is a good time to review if your retirement savings plans and tax strategies complement each other. For 2013 and 2014, the maximum amount of contributions that can be made to an IRA is $5,500, with a $1,000 catch-up amount allowed for individuals over age 50. Keep in mind that the maximum amount that can be contributed to a Roth IRA begins to decrease once a taxpayer's adjusted gross income crosses a certain threshold. For example, married couples filing jointly will begin to see their contributions begin to phase out when their AGI is $178,000. Once their AGI reaches $188,000 or more, they can no longer contribute to a Roth IRA. For single filers the corresponding income thresholds for 2013 are $112,000 and $127,000. Please note that 2013 contributions, for tax purposes, may be made until April 15, 2014.

Traditional IRAs and Roth IRAs are very different savings vehicles. A traditional IRA or Roth IRA set up years ago may not be the best savings vehicle today or for the immediate future if employment and other personal circumstances have changed. Some individuals may be contemplating rolling over a workplace retirement plan into an IRA. Very complex rules apply in these situations and rollovers should be carefully planned. The same in true in converting a traditional IRA to a Roth IRA and vice-versa. Every individual has unique goals for retirement savings and no one size fits all.

Wisconsin Tax Law Changes

The Wisconsin Legislature enacted a number of changes to the Wisconsin tax laws on June 30, 2013. The following is a brief description of those changes that affect individual taxpayers.

- **New Subtraction for Private School Tuition** will be effective for taxable years beginning on or after January 1, 2014.A subtraction from income is allowed for tuition expenses that are paid by a taxpayer for tuition for a student to attend an eligible institution. For each elementary student (grades K-8), the maximum amount of tuition expenses which a taxpayer may subtract in a taxable year is $4,000. For each secondary student (high school), the maximum amount of tuition expenses which a taxpayer may subtract in a taxable year is $10,000. If an individual is an elementary student and a secondary student in the same taxable year (the year they transition from 8th grade to high school), the taxpayer may claim the subtraction for only one grade for that student for that taxable year.

- **Income Tax Rates Reduced** for taxable years beginning on or after January 1, 2013. The individual income tax rates are reduced by 0.10% to 0.20%, but the income tax withholding tables were not changed by the Wisconsin Department of Revenue.

Action Items to Consider before Year-End:

- Consider additional charitable contributions for 2013 (these are deductible for both regular and Alternative Minimum Tax.) The contribution of long term gain securities is a particularly tax effective way to give.
- Review your property tax payment history and ensure that any property taxes that should be paid in 2013 are paid no later than December 31st.
- Review your estimated tax payments that are required for the 4th quarter. State estimated payments are deductible if paid no later than December 31st.

- Consider increasing your 401(k) or 403B contributions for 2014, if you are not at the limit.
- Consider taking advantage of deferred compensation offerings for 2014 to reduce your taxable income.
- Maximize contributions to health savings accounts, to reduce adjusted gross income and taxable income.

Please let me know if you have any questions concerning any items in this letter, or if I can assist you further.

Eric
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