A Brief Taxpayer's Guide to Changes and Planning Ideas
December 2013
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We are pleasantly relieved with the lack of uncertainty this yearend. There are no Taxmaggedons or Fiscal Cliffs threatening to derail our planning assumptions, and we feel pretty confident that there will not be major changes to the tax landscape in 2014. Sure, there is a delayed debt ceiling deadline early in the New Year, but we do not appear to be headed for a disastrous confrontation.

Changes at the Top

High income earners should still prepare to deal with the consequences of last year's compromise. The changes start for married couples filing jointly with modified adjusted gross incomes (MAGI) above $250,000 ($200,000 for individuals), who qualify for a 3.8 percent Medicare surcharge on the lesser of either net investment income or MAGI over the threshold.

These folks are also required to pay an additional .9 percent Medicare payroll tax, although this just applies to earned income, and should only be withheld when one of the individual's earned income exceeds $200,000.

The next change begins gradually at $300,000 adjusted gross income for couples ($250,000 for individuals). They lose 2 percent of their personal exemptions for every $2,500 that exceeds the threshold and 3 percent of their itemized deductions for every dollar above the line. The latter maxes out with a maximum 80 percent loss in value to itemized deductions like mortgage interest and local taxes.

Our highest income tax bracket was split starting in 2013, with a new top marginal rate of 39.6 percent for married couples with ordinary income and short-term capital gains above $450,000 ($400,000 for individuals). These folks will also be the only group to contend with an increased long-term capital gains rate, for which they will pay 20 percent on qualified dividends and investments held at least a year.

On the subject of marginal rates, it is important for taxpayers to take notice of just how small the 35 percent tax bracket has become. High earners could easily trip into – or through, especially if they are single – this bracket, which ranges from $398,350 to $450,000 for couples (**$398,350 to $400,000 for individuals**).

The Sun Sets on a Charitable Opportunity

A provision that has produced great benefit for nonprofit organizations is set to expire at year end, although we hope it will be selected for renewal.

Until January 1st, retirees older than 70½ that qualify for required minimum distributions (RMDs) from their retirement accounts can still choose a direct rollover donation of up to $100,000 to charity without increasing their adjusted gross incomes (AGI). This is a great way to support worthwhile causes and avoid taxation on income that retirees have no need to take.

Of course, retirees can still make charitable donations in the New Year, but direct contributions will no longer be excluded from their AGI.

Another planning idea for those who want to make ongoing annual donations would be to create a charitable giving account and fund it with highly appreciated stock. The great benefit of this approach is that it enables the donor to both frontload their charitable deduction at the stock's fair market value and avoid realizing the capital gain. The donor can then write checks out of that account to the nonprofit organizations of their choice while the principal investment grows tax free.

Tax Reduction Ideas

Folks seeking to reduce their overall taxable income have plenty of options, but a few specific ideas tend to be widely applicable.

Frontload itemized deductions where available. For instance, taxpayers can pay and deduct two years of property or state taxes this year. Of course, they would lose the deduction for next year, but it could be a good planning step for someone with unusually high income in 2013. Be sure to make these payments before December 31st since taxpayers can only take a deduction once they have been paid.

Harvest capital gains or losses for offsets. 2013 has been a strong year for the U.S. stock market, while other asset classes like bonds and emerging market stocks have realized small losses, so there may be an opportunity to reduce taxation by selling some of them before yearend.

Generally speaking, the residential energy tax credit tends to be overhyped by retailers seeking to sell expensive appliances. The lifetime limit on this credit is $500, and most people fail to realize they have already claimed it.

However, it may be worth digging up the receipts if a taxpayer has made several big ticket purchases during the calendar. The combined sales tax deduction may be better than their standard deduction.

Finally, self-employed contractors and consultants should establish and fund a SEP IRA if they have not already done so. They have until April 15th (or October 15th with an extension), and can exclude up to 20 percent of their net income from federal taxes while contributing to their retirement.

Wealth Transition Ideas

The annual gift exemption for 2013 enables the transfer of up to $14,000 per giver to each recipient without triggering a taxable event, meaning an individual with two married children could give away up to $56,000 in 2013 tax free.

Moreover, direct education and medical payments do not count against gift exemption limits, so there is an opportunity to help fund school tuitions or medical bills for family members without increasing anyone's tax bill.

Perhaps the most effective use of gift exemptions for younger family members would be to frontload a 529 plan contribution. Although it would represent a sizeable contribution, taxpayers can advance up to 5 years of gifts into a 529 plan account, which could increase in value over the next decade to enough funds to fully cover a public university education.

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