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2013 YEAR-END TAX PLANNING



2013 TAX PLANNING: THE YEAR OF STICKER SHOCK

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2013 TAX PLANNING THE YEAR OF STICKER SHOCK

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On the Chinese calendar, we are currently in the Year of the Snake. For US tax planning purposes, many people will find that they are in the year of the Sticker Shock.

Seems to be a curious coincidence of unpleasantness, doesn't it?

Most of us who practice in the tax world are quite aware of the myriad tax changes that took effect for the 2013 tax year. Unfortunately, many of you reading this year-end tax planning letter may not be. In fact, you may be surprised to learn that the tax landscape has shifted sharply for those who are now on the wrong side of the line between “middle class” and “higher earners.” If that does, indeed, describe you, you will now be subject to an array of new taxes, higher rates, and harsh deduction limits.

So, what's changed on your tax landscape?

Starting in 2013, a couple of different pieces of legislation took effect and now impose significantly higher taxes on higher earners, increasing the importance of tax awareness and tax planning. The two pieces of legislation to which I am referring are the Affordable Care Act (ACA) and the American Taxpayer Relief Act of 2012 (ATRA).

Although the ACA is not new legislation, 2013 is the first year in which it really began to rear its ugly head. In addition to its many health care related provisions, it imposes a higher payroll tax as well as a surtax on the unearned income of higher-income individuals. For the second half of the one-two punch, the ATRA imposes higher tax rates on ordinary income, capital gains and dividends, while, at the same time, imposing limitations on the availability of both the personal exemption and itemized deductions. This piece highlights these changes.

For tax years beginning after December 31, 2012, the following rules apply:

Increased payroll tax for high-earning workers and self-employed taxpayers.

- An additional 0.9% Medicare tax applies to wages received in excess of the following thresholds:
 - \$250,000 for joint returns;
 - \$125,000 for married taxpayers filing a separate return; and
 - \$200,000 in all other cases.
- The additional 0.9% Medicare tax also applies to self-employment income for the tax year in excess of these amounts.

In most cases, with most classes of income, the tax rates in 2012 are lower than they will be in 2013. In some cases those differences are significant.

With just a short time to the end of the year, if you are in a position to do so, consider taking advantage of the current \$5.12 million gift tax exclusion before year-end by making gifts to your eventual heirs.

Surtax on unearned income of higher-income individuals.

- An additional 3.8% Medicare tax is imposed on certain individuals, estates, and trusts with Net Investment Income.
- For individuals, the tax is assessed on the lesser of
 - net investment income or
 - the excess of modified adjusted gross income over a threshold amount
 - \$250,000 for a joint return or surviving spouse,
 - \$125,000 for a married individual filing a separate return, and
 - \$200,000 for all others.
 - For purposes of this tax on Net Investment Income, gross income does not include certain excluded items, such as
 - interest on tax-exempt bonds,
 - veterans' benefits, and
 - any gain excluded from the sale of one's principal residence.
 - A complete definition is beyond the scope of this letter. For clarification in your particular circumstance, contact one of the tax professionals at Zinner & Co.

Higher individual income tax rates apply to higher-income taxpayers.

- The income tax rates for most individuals stay at 10%, 15%, 25%, 28%, 33% and 35%, as they were in 2012. However, a new 39.6% rate applies for 2013 for taxable income above the following thresholds:
 - \$450,000 for joint filers and surviving spouses;
 - \$425,000 for heads of household;
 - \$400,000 for unmarried filers; and

- \$225,000 for married taxpayers filing separately.
- These dollar amounts are inflation-adjusted for tax years after 2013.

Capital gain and dividend rates rise for higher-income taxpayers.

- The top rate for capital gains and dividends rises to 20% for 2013 (up from 15% in 2012) for taxpayers with taxable income exceeding the following thresholds:
 - \$450,000 for joint filers and surviving spouses;
 - \$425,000 for heads of household;
 - \$400,000 for single filers; and
 - \$225,000 for married taxpayers filing separately.
- In contrast to that, long-term capital gains rates for other taxpayers are as follows:
 - for taxpayers in a tax bracket below 25%, long-term capital gains and qualified dividends are subject to a 0% rate, and
 - taxpayers whose tax bracket is at least 25%, but below 39.6%, are subject to a 15% rate on long-term capital gains and qualified dividends.
- In addition, the capital gain and dividend tax rate for alternative minimum tax purposes also rises from 15% in 2012 to 20% in 2013 for taxpayers subject to the new 39.6% regular tax rate.

Personal exemption is limited for high earners.

- Beginning in 2013, there is a personal exemption phase-out (PEP) for taxpayers with Adjusted Gross Income (AGI) exceeding the following thresholds:
 - \$300,000 for joint filers and surviving spouses;
 - \$275,000 for heads of household;
 - \$250,000 for single filers; and

- \$150,000 for married taxpayers filing separately.
- Under this phase-out, the total amount of personal exemptions that can be claimed by a taxpayer is reduced by 2% for each \$2,500 (or portion thereof) by which the taxpayer's AGI exceeds the above threshold. These dollar amounts are inflation-adjusted for tax years after 2013. \$225,000 for married taxpayers filing separately.

Itemized deductions are limited for high earners.

- There is a limit on itemized deductions for 2013 (the "Pease" limitation) for taxpayers with AGI exceeding the following thresholds:
 - \$300,000 for joint filers and surviving spouses;
 - \$275,000 for heads of household;
 - \$250,000 for single filers; and
 - \$150,000 for married taxpayers filing separately.
- Thus, taxpayers subject to the "Pease" limitation will see their itemized deductions reduced by 3% of the amount by which their AGI exceeds the above threshold amounts. The reduction in itemized deductions may not to exceed 80% of the otherwise allowable itemized deductions. These dollar amounts, too, are inflation-adjusted for tax years after 2013.

A few final points...

Remember the time compression we all felt with the late start of the filing season last year? Be prepared for a repeat of that. Why?

- As a result of the government shutdown in October, the IRS has already announced a two week delay in the start of the 2014 filing season, and
- With 55 separate tax provisions scheduled to expire on December 31, we could easily see a repeat of last year's beyond-last-minute tax legislation which would push that delay back even further!

What would such delays mean to you?

With the pain of last year's high-stress filing season still fresh in many practitioners' minds, I would expect to see many more extensions filed than was the case last year.

While many taxpayers see filing an extension as a bad thing, the fact of the matter is that, when brokers are issuing corrected 1099s multiple times during the course of the year, with many coming after April 15 (some as late as September 15), extending one's return can actually improve the accuracy of the final completed product which may result in fewer notices or even a lower audit risk.

While many high earners will certainly pay more taxes this year than in the past, keep in mind that it's almost never too late to start participating in the tax planning process. **Even at this late date, a little planning may be surprisingly effective in minimizing one's taxes.**

Ready to explore your year-end tax options?

Contact **Howard Kass** and the tax professionals at Zinner & Co. LLP.
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Howard J. Kass has over 30 years experience and has cultivated particular expertise in individual and business income taxes, tax aspects of real estate investment, gift and estate taxes and tax exempt organizations. Howard applies his extensive knowledge and experience to a diverse client base of individuals and companies including closely held businesses in a variety of industries and ownership structures such as C Corporations, S Corporations, Partnerships, and LLCs. Industries served include real estate, manufacturing, retail establishments, insurance agencies, distributors and service companies.
