Wealth Planning Services

Tax Update # 14: 2013 Year-End Individual Income Tax Planning

Year-end 2013 brings many new planning opportunities, along with the traditional year-end tax planning strategies. It also brings challenges, for both individuals and businesses. There is much for taxpayers and their tax advisors to consider in taking action before 2013 ends, including the important changes made by the American Taxpayer Relief Act of 2012 (ATRA) (signed into law on January 2, 2013), the provisions in the Patient Protection and Affordable Care Act of 2010 (PPACA) (scheduled to take effect in 2013 and 2014), the Supreme Court's decision on same-sex marriage, and the release of significant new IRS rules on many pressing issues. There is also the prospect of comprehensive tax reform in 2014, which will require some "crystal ball" forecasting as to what Congress may or may not do in the coming year. On top of everything, the IRS shutdown in October could delay the start of the 2014 filing season, although the long-term effects have yet to be determined.

This summary explores some of the **2013 year-end income tax planning opportunities available to individual taxpayers**, especially as the result of provisions that are new-for-2013 and those that at the moment are scheduled to expire after 2013. Of course, every taxpayer's situation is unique and a year-end planning strategy, whether for an individual, family, or business, should be customized in consultation with a qualified professional. Harbour Capital Advisors (HCA) stands ready to assist clients with year-end planning issues and opportunities.

For a summary of 2013 business income tax-savings opportunities, please request a copy of our separate **Tax Update # 15: 2013 Year-End Business Income Tax Planning**. For a summary of 2013 estate and gift tax-savings opportunities, please request a copy of our separate **Tax Update # 16: 2013 Year-End Estate and Gift Tax Planning**. Please note that all tax information contained herein is general in nature, is provided for informational and educational purposes only, and should not be construed as legal or tax advice.

2013 Contrasted with 2012

The approach of year-end 2013 brings more certainty to tax planning than in 2012 because of ATRA. In addition to the permanent extension of certain Bush-era tax cuts for lower and middle income taxpayers, ATRA also revived the 39.6% tax bracket (at new levels) for higher income individuals, revived the personal exemption phase-out (PEP) and limitation on itemized deductions (Pease limitation) (at new levels), increased the maximum tax rate on qualified dividends and capital gains, and made many additional changes. And, as already noted, PPACA brings two additional considerations that need to be factored into year-end planning by higher-income taxpayers for the first time in 2013, the net investment income surtax and the new additional Medicare tax on earned income.

General Filing Requirements

Income tax returns can be filed as married filing jointly, head of household, single, and married filing separately. A married couple may elect to file one return reporting combined income, computing the

tax liability using the tax tables or rate schedules for "Married Persons Filing Jointly." If a married couple files separate returns, under certain situations they can amend and file jointly, but they cannot amend a jointly filed return and file separately. A joint return may be filed even though one spouse has neither gross income nor deductions. If one spouse dies during the year, the survivor may file a joint return for the year in which the spouse died. Certain married persons who do not elect to file a joint return may be entitled to use the lower head-of-household tax rates. Generally, in order to qualify as a head of household, you must not be a resident alien, you must satisfy certain marital status requirements, and a "qualifying person" must live with you in your home for more than half the year.

Basic Numbers You Need To Know

Since many tax benefits are tied to (or limited by) adjusted gross income (AGI), a key aspect of tax planning is to estimate both 2013 and 2014 AGI. Also, when considering whether to accelerate or defer income or deductions, you should be aware of the impact on AGI and your ability to maximize deductions that are tied thereto. Your 2012 tax return and 2013 pay stubs and other income- and deduction-related materials are a good starting point for estimating AGI.

2013 individual income tax brackets are as follows:

Tax Rate	Single Filers	Married Filing Jointly or Qualifying Widow(er)	Married Filing Separately	Head of Household	Trusts and Estates
10%	Up to $8,925	Up to $17,850	Up to $8,925	Up to $12,750	
15%	$8,926 - $36,250	$17,851 - $72,500	$8,926- $36,250	$12,751 - $48,600	Up to $2,450
25%	$36,251 - $87,850	$72,501 - $146,400	$36,251 - $73,200	$48,601 - $125,450	$2,451 - $5,700
28%	$87,851 - $183,250	$146,401 - $223,050	$73,201 - $111,525	$125,451 - $203,150	$5,701 - $8,750
33%	$183,251 - $398,350	$223,051 - $398,350	$111,526 - $199,175	$203,151 - $398,350	$8,751 - $11,950
35%	$398,351 - $400,000	$398,351 - $450,000	$199,176 - $225,000	$398,351 - $425,000	
39.6%	$400,001 or more	$450,001 or more	$225,001 or more	$425,001 or more	$11,951 or more

2014 individual income tax brackets are as follows:

Tax Rate	Single Filers	Married Filing Jointly or Qualifying Widow(er)	Married Filing Separately	Head of Household	Trusts and Estates
10%	Up to $9,075	Up to $18,150	Up to $9,075	Up to $12,950	
15%	$9,076 - $36,900	$18,151 - $73,800	$9,076 - $36,900	$12,951 - $49,400	Up to $2,500
25%	$36,901 - $89,350	$73,801 - $148,850	$36,901 - $74,425	$49,401 - $127,550	$2,501 - $5,800
28%	$89,351 - $186,350	$148,851 - $226,850	$74,426 - $113,425	$127,551 - $206,600	$5,801 - $8,900
33%	$186,351 - $405,100	$226,851 - $405,100	$113,426 - $202,550	$206,601 - $405,100	$8,901 - $12,150
35%	$405,101 - $406,750	$405,101 - $457,600	$202,551 - $228,800	$405,101 - $432,200	
39.6%	$406,751 or more	$457,601 or more	$228,801 or more	$432,201 or more	$12,151 or more

Note that, because the highest rate for estates and trusts starts at a relatively low level of taxable income ($11,950 in 2013 and $12,150 in 2014), executors and trustees should consider making distributions, where allowed, to beneficiaries before year-end, which generally will pass that amount of

taxable income through to those beneficiaries and bypass tax at the comparatively high estate/trust level.

For 2013 and later years, an additional 0.9 percent Medicare tax is imposed on wages, compensation, and self-employment earnings above a threshold amount. Once the threshold is reached, the tax applies to all wages that are currently subject to Medicare Tax, to the Railroad Retirement Tax Act, or to the Self-Employment Compensation Act. The threshold amounts are as follows:

Filing Status	Threshold Amount
Married Filing Jointly (Combined Income)	$250,000
Married Filing Separately	$125,000
Single, Head of Household, Qualifying Widow(er)	$200,000

IRA and Retirement Savings Rules for 2013

Tax-saving opportunities continue for retirement planning due to the availability of Roth IRAs, changes that make regular IRAs more attractive, and other retirement savings incentives.

Traditional IRAs: Individuals who are not active participants in an employer pension plan may make deductible contributions to an IRA. The annual contribution limit for an IRA for 2013 and 2014 is $5,500. For 2013 and 2014, a $1,000 "catch-up" contribution is allowed for taxpayers age 50 or older by the close of the taxable year, making the total limit $6,500 for these individuals. Individuals who are active participants in an employer pension plan also may make deductible contributions to an IRA, but their contributions are limited in amount depending on their AGI. For 2013, the AGI phase-out range for deductibility of IRA contributions is between $59,000 and $69,000 of modified AGI for single persons (including heads of households) and between $95,000 and $115,000 of modified AGI for married filing jointly. For 2014, the AGI phase-out range for deductibility of IRA contributions is between $60,000 and $70,000 of modified AGI for single persons (including heads of households) and between $96,000 and $116,000 of modified AGI for married filing jointly. Above these ranges, no deduction is allowed.

In addition, an individual will not be considered an "active participant" in an employer plan simply because the individual's spouse is an active participant for part of a plan year. Thus, you may be able to take the full deduction for an IRA contribution regardless of whether your spouse is covered by a plan at work, subject to a phase-out if your joint modified AGI is $178,000 to $188,000 for 2013 (or $181,000 to $191,000 for 2014). Above these ranges, no deduction is allowed.

The deadline for 2013 IRA contributions (whether traditional or Roth) is April 15, 2014.

Spousal IRA: For 2013 and 2014, if an individual files a joint return and has less compensation than a spouse, the IRA contribution is limited to the lesser of (i) $5,500 plus age 50 catch-up contributions or (ii) the total compensation of both spouses reduced by the other spouse's IRA contributions (traditional and Roth).

Roth IRA: This type of IRA permits nondeductible contributions of up to $5,500 a year (for both 2013 and 2014). Earnings grow tax-free, and distributions are tax-free provided no distributions are made

until more than five years after the first contribution and the individual has reached age 59.5. Distributions may be made earlier in the event of the individual's disability or death. The maximum contribution is phased out in 2013 for persons with an AGI above certain amounts: $178,000 to $188,000 for married filing jointly, $112,000 to $127,000 for single taxpayers (including heads of households), and $0 to $10,000 for married filing separately who lived with the spouse during the year. The maximum contribution is phased out in 2014 for persons with an AGI above certain amounts: $181,000 to $191,000 for married filing jointly, $114,000 to $129,000 for single taxpayers (including heads of households), and $0 to $10,000 for married filing separately who lived with the spouse during the year.

Roth IRA Conversion Rule: Funds in a traditional IRA (including SEPs and SIMPLE IRAs), §401(a) qualified retirement plan, §403(b) tax-sheltered annuity, or §457 government plan may be rolled over into a Roth IRA. Such a rollover, however, is treated as a taxable event, and you will pay tax on the amount converted to the extent that it exceeds your tax basis in the IRA (reported on Form 8606). No penalties will apply if all the requirements for such a transfer are satisfied. For 2013, taxpayers will be able to make Roth IRA conversions without regard to their AGI. Also, if you already made a conversion earlier this year, you have the option of undoing the conversion (known as a "recharacterization"). This is a useful strategy if the investments have gone down in value so that if you were to do the conversion now, your taxes would be lower. This is a complicated calculation, however, so you should consult with us if you wish to explore a recharacterization further.

In addition, for 2013 and 2014, if your §401(k) plan, §403(b) plan, or governmental §457(b) plan has a qualified designated Roth contribution program, a distribution to an employee (or a surviving spouse) from an account under the plan that is not a designated Roth account is permitted to be rolled over into a designated Roth account under the plan for the individual; provided, however such a rollover is treated as a taxable event, and you will pay tax on the amount converted to the extent that it exceeds your tax basis in the account that is not a designated Roth account. Other rules related to employer plan account Roth conversions are similar to those for Roth IRA conversions.

401(k) Contribution: The §401(k) elective deferral limit is $17,500 for 2013 and 2014. If your §401(k) plan has been amended to allow for catch-up contributions for 2013 and you will be 50 years old by December 31, 2013, you may contribute an additional $5,500 to your §401(k) account, for a total maximum contribution of $23,000 ($17,500 in regular contributions plus $5,500 in catch-up contributions). The catch-up amount will remain unchanged in 2014.

SIMPLE Plan Contribution: The SIMPLE plan deferral limit is $12,000 for 2013 and 2014. If your SIMPLE plan has been amended to allow for catch-up contributions for 2013 and you will be 50 years old by December 31, 2013, you may contribute an additional $2,500. The catch-up amount will remain unchanged in 2014.

Catch-Up Contributions for Other Plans: If you will be 50 years old by December 31, 2013, you may contribute an additional $5,500 to your §403(b) plan, SEP, or eligible §457 government plan. The catch-up amounts will remain unchanged in 2014.

Saver's Credit: A nonrefundable tax credit is available based on the qualified retirement savings contributions to an employer plan made by an eligible individual. For 2013, only taxpayers filing joint returns with AGI of $59,000 or less, head of household returns with AGI of $44,250 or less, or single returns (or separate returns filed by married taxpayers) with AGI of $29,500 or less, are eligible for the credit. For 2014, only taxpayers filing joint returns with AGI of $60,000 or less, head of household returns with AGI of $45,000 or less, or single returns (or separate returns filed by married taxpayers) with AGI of $30,000 or less are eligible. The amount of the credit is equal to the applicable percentage (10% to 50%, based on filing status and AGI) of qualified retirement savings contributions up to $2,000.

Required Minimum Distributions: For 2013 and 2014, taxpayers must take their required minimum distribution from IRAs or defined contribution plans (§401(k) plans, §403(a) and (b) annuity plans, and §457(b) plans that are maintained by a governmental employer).

Maximize Retirement Savings: In many cases, employers will require you to set your 2014 retirement contribution levels before January 2014. If you did not elect the maximum 401(k) contribution for 2013, you can increase your amount for the remainder of 2013 to lower your AGI in order to take advantage of some of the tax breaks described above.

Deferring Income to 2014

If you expect your marginal tax rate to be lower in 2014, you may benefit by deferring income (and accelerating deductions) into 2014. Some ways to defer income include:

Delay Billing: If you are self-employed and on the cash-basis, delay year-end billing to clients so that payments will not be received until 2014.

Interest and Dividends: Interest income earned on Treasury securities and bank certificates of deposit with maturities of one year or less is not includible in income until received. To defer interest income (and assuming that your investment program otherwise calls for such investments), consider buying short-term bonds or certificates that will not mature until next year. If you have control as to when dividends are paid, arrange to have them paid to you after the end of the year.

Accelerating Income into 2013

On the other hand, you may want to try to accelerate income (and defer deductions), if you expect your marginal tax rate to be higher in 2014. If accelerating income will be beneficial, here are some ways to accomplish this:

Accelerate Collection of Accounts Receivable: If you are self-employed and report income and expenses on a cash basis, issue bills and attempt collection before the end of 2013. Also see if some of your clients or customers might be willing to pay for January 2014 goods or services in advance. Any income received using these steps will shift income from 2014 to 2013.

Year-End Bonuses: If your employer generally pays year-end bonuses after the end of the current year, ask to have your bonus paid to you before the beginning of 2014.

Retirement Plan Distributions: If you are over age 59.5 and you participate in an employer retirement plan or have an IRA, consider making any taxable withdrawals before 2014. You may also want to consider converting a traditional IRA to a Roth IRA, as discussed above.

Other Income: Other types of income over which individuals may have control of timing include consulting or other self-employment income and U.S. Treasury Bill income.

Deduction Planning: Individuals

Deduction timing is also an important element of year-end tax planning. Deduction planning is complicated, however, by factors such as AGI levels and filing status. If you are a cash-method taxpayer, remember to keep the following in mind:

Deduction in Year Paid: An expense is only deductible in the year in which it is actually paid. Under this rule, if your marginal tax rate is going to increase in 2014, it is usually a smart strategy to postpone deductions (where possible) until 2014.

Payment by Check: Date checks before the end of the year and mail them before January 1, 2014 if you want to be able to take the deduction in 2013.

Promise to Pay: A promise to pay or providing a note does not permit you to deduct an expense. But you can take a deduction if you pay with money borrowed from a third party. For example, if you pay by credit card in 2013, you can take the deduction even though you don't pay the credit card bill until 2014.

AGI Limits: For 2013, the overall limitation on itemized deductions (Pease limitation) applies for taxpayers whose AGI exceeds $300,000 for a married couple filing a joint return or a surviving spouse, $275,000 for a head of household, $250,000 for an unmarried individual, and $150,000 for a married individual filing a separate return. For 2014, the limitation applies for taxpayers whose AGI exceeds $305,050 for a married couple filing a joint return or a surviving spouse, $279,650 for a head of household, $254,200 for an unmarried individual, and $152,525 for a married individual filing a separate return. In addition, certain deductions may be claimed only if they exceed a percentage of AGI: 10% for medical expenses (7.5% for certain older taxpayers), 2% for miscellaneous itemized deductions, and 10% for casualty losses.

ATRA also revived and modified the personal exemption phase- out (PEP). The threshold adjusted gross income amounts for the PEP for 2013 and 2014 mirror those of the revived Pease limitation reviewed above. Under the phase-out, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 ($1,250 for married couples filing separate returns) or portion thereof by which the taxpayer's adjusted gross income exceeds the applicable threshold level.

Standard Deduction Planning: Deduction planning is also affected by the standard deduction. For 2013 returns, the standard deduction is $12,200 for married taxpayers filing jointly, $6,100 for single taxpayers, $8,950 for heads of households, and $6,100 for married taxpayers filing separately. For 2014 returns, the deduction is $12,400 for married taxpayers filing jointly, $6,200 for single taxpayers, $9,100 for heads of households, and $6,200 for married taxpayers filing separately. If your itemized deductions

are relatively constant and are close to the standard deduction amount, you will likely obtain little or no benefit from itemizing your deductions each year. But simply taking the standard deduction each year means you lose the benefit of your itemized deductions. To maximize the benefits of both the standard deduction and itemized deductions, consider adjusting the timing of your deductible expenses so that they are higher in one year and lower in the following year (otherwise known as "bunching"). You can do this by paying in 2013 deductible expenses, such as mortgage interest due in January 2014.

Medical Expenses: For 2013 and 2014, medical expenses, including amounts paid as health insurance premiums, are deductible only to the extent that they exceed 10% of AGI (7.5% for taxpayers age 65 or older). This is an increase from 2012 when it was 7.5% for all taxpayers.

State Taxes: If you anticipate a state income tax liability for 2013 and plan to make an estimated payment, consider making the payment before the end of 2013, provided you can still avoid AMT exposure. Note that the option to elect to deduct as an itemized deduction state and local sales taxes instead of state and local income taxes is scheduled to expire at the end of 2013.

Charitable Contributions: Consider making your charitable contributions by the end of the year. This will give you use of the money during the year and simultaneously permit you to claim a deduction for that year. You can use a credit card to charge donations in 2013 even though you will not pay the bill until 2014. A mere pledge to make a donation is not deductible, however, unless it is paid by the end of the year. Note, however, for claimed donations of cars, boats, and airplanes of more than $500, the amount available as a deduction will significantly depend on what the charity does with the donated property, not just the fair market value of the donated property. If the organization sells the property without any significant intervening use or material improvement to the property, the amount of the charitable contribution deduction cannot exceed the gross proceeds received from the sale.

To avoid capital gains and still maximize your deductions, you may want to consider donating long-term appreciated property to charity. For example (subject to certain exceptions), gifts of long-term appreciated marketable securities to a public charity can be deducted at their fair market value on the date of the gift, subject to a 30%-of-AGI deduction limitation. Any overage may be carried forward for up to five additional tax years. And none of the inherent capital gains should be realized. So if your AGI is $500,000 and you want to contribute your $60,000 of IBM stock (that you purchased years ago and which has a tax cost basis of $10,000) to a public charity (*e.g.,* the American Red Cross), you should be able to do so without running into the 30%-of-AGI limitation and while avoiding recognition of the inherent long-term capital gain.

Regarding charitable contributions, please remember the following rules: (1) no deduction is allowed for charitable contributions of clothing and household items if such items are not in good used condition or better; (2) the IRS may deny a deduction for any item with minimal monetary value; and (3) the restrictions in (1) and (2) do not apply to the contribution of any single clothing or household item for which a deduction of $500 or more is claimed if the taxpayer includes a qualified appraisal with his or her return. Taxpayers run the risk of having deductions for charitable contributions, regardless of the amount, denied, unless the donor maintains a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization and the date and amount of the contribution.

A special provision gives taxpayers the ability to distribute tax-free to charity up to $100,000 from a traditional or Roth IRA maintained for an individual whose has reached age 70.5. Note that this provision is scheduled to expire at the end of 2013.

Other Expenses: Other types of expenses over which individuals may have control of timing include property taxes, mortgage interest, and margin interest. Note, however, that prepaid expenses can be deducted only in the year to which they relate. For example, you can prepay (by Dec. 31) property taxes due next year that relate to this year and deduct the payment on this year's return. But you generally can't prepay property taxes that relate to next year and deduct the payment on this year's return.

Education and Child Tax Benefits

Child Tax Credit: A tax credit of $1,000 per qualifying child under the age of 17 is available on this year's return. In order to qualify for 2013, the taxpayer must be allowed a dependency deduction for the qualifying child (who must be younger than the taxpayer). The credit is phased out at a rate of $50 for each $1,000 (or fraction of $1,000) of modified AGI exceeding the following amounts: $110,000 for married filing jointly; $55,000 for married filing separately; and $75,000 for all other taxpayers. A portion of the credit may be refundable. For 2013 and 2014, the threshold earned income level to determine refundability is set by statute at $3,000. Legislation in early 2013 made the per-child credit amount of $1,000 permanent.

Credit for Adoption Expenses: For 2013, the adoption credit limitation is $12,970 ($13,190 in 2014) of aggregate expenditures for each child, except that the credit for an adoption of a child with special needs is deemed to be $12,970 ($13,190 in 2014) regardless of the amount of expenses. The credit ratably phases out for taxpayers whose income is between $194,580 and $234,580 in 2013 ($197,880 and $237,880 in 2014). Legislation in early 2013 made the adoption credit permanent for all types of adoptions.

American Opportunity Tax Credit and Lifetime Learning Credit: The maximum American Opportunity tax credit for 2013 and 2014 is $2,500 (100% on the first $2,000, plus 25% of the next $2,000) for qualified tuition and fees paid on behalf of a student (*i.e.,* the taxpayer, the taxpayer's spouse, or a dependent) who is enrolled on at least a half-time basis. The credit is available for the first four years of the student's post-secondary education. For 2013 and 2014, the credit is phased out at modified AGI levels between $160,000 and $180,000 for joint filers and between $80,000 and $90,000 for other taxpayers. Forty percent of the credit is refundable, which means that you can receive up to $1,000 even if you owe no taxes. The term "qualified tuition and related expenses" includes expenditures for "course materials" (books, supplies, and equipment needed for a course of study whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance). One way to take advantage of the credit for 2013 is to prepay the spring 2014's tuition. In addition, if your child's books for the spring semester are known, those can be bought and the costs qualify for the credit.

The Lifetime Learning credit maximum in 2013 and 2014 is $2,000 (20% of qualified tuition and fees up to $10,000). A student need not be enrolled on at least a half-time basis so long as he or she is taking post-secondary classes to acquire or improve job skills. As with the American Opportunity tax credit, eligible students include the taxpayer, the taxpayer's spouse, or a dependent. For 2013, the Lifetime

Learning credit is phased out at modified AGI levels between $107,000 and $127,000 ($108,000 and $128,000 in 2014) for joint filers and between $53,000 and $63,000 ($54,000 and $64,000 in 2014) for single taxpayers.

Coverdell Education Savings Account: For 2013 and 2014, the aggregate annual contribution limit to a Coverdell education savings account is $2,000 per designated beneficiary. The limit is phased out for individual contributors with modified AGI between $95,000 and $110,000 and joint filers with modified AGI between $190,000 and $220,000. The contributions to the account are nondeductible but the earnings grow tax-free. Legislation in early 2013 made the contribution amount and AGI phase-out amounts permanent.

Student Loan Interest: You may be eligible for an above-the-line deduction for student loan interest paid on any "qualified education loan." The maximum deduction is $2,500. The deduction for 2013 is phased out at a modified AGI level between $125,000 and $155,000 ($130,000 and $160,000 in 2014) for joint filers and between $60,000 and $75,000 ($65,000 and $80,000 in 2014) for individual taxpayers. Legislation in early 2013 made certain rules permanent that keep the student loan interest deduction at its current levels.

Kiddie Tax: For 2013, the kiddie tax applies to: (1) children under 18; (2) 18-year old children who have unearned income in excess of the threshold amount, do not file a joint return, and who have earned income, if any, that does not exceed one-half of the amount of the child's support; and (3) children between the ages of 19 and 23 if, in addition to the above rules, they are full-time students. For 2013 and 2014, the first $1,000 of unearned income a child or college student earns will be offset by the $1,000 standard deduction (assuming the child has no earned income), and the next $1,000 of such unearned income will be taxed at the child's tax rate. All of the child's unearned income in excess of $2,000 is taxed at the parent's tax rate.

Energy Incentives

Residential Energy Efficient Property Credit: Until 2016, tax incentives are available to taxpayers who install certain energy efficient property, such as photovoltaic panels, solar water heating property, fuel cell property, small wind energy property and geothermal heat pumps. A credit is available for the expenditures incurred for such property up to a specific percentage, except that a cap applies for fuel cell property. The property purchased cannot be used to heat swimming pools or hot tubs. If you have made improvements to your home or plan to by the end of 2013, please contact us and/or your tax accountant to discuss the amount of the credit for which you may qualify.

Investment Planning

The following rules apply in 2013 and 2014:

- Capital gains on property held one year or less (and non-qualified dividends) are taxed at an individual's ordinary income tax rate at the Federal level.
- Capital gains on property held for more than one year (and qualified dividends) are taxed at a maximum Federal rate of 20% (0% if an individual is in the 10% or 15% marginal tax

bracket; 15% for individuals in the 25%, 28%, 33% and 35% brackets). The rate increase as compared to 2012 rates for those in the top bracket resulted from legislation enacted in early 2013.

[Qualified dividends include dividends received from domestic and certain foreign corporations.]

For 2013 and future years, a new 3.8% net investment income surtax is now levied on certain unearned income. The tax is levied on the lesser of net investment income or the amount by which modified AGI exceeds certain dollar amounts ($250,000 for joint returns and $200,000 for individuals). Investment income is: (1) gross income from interest, dividends, annuities, royalties, and rents (other than from a trade or business); (2) other gross income from any business to which the tax applies; and (3) net gain attributable to property other than property attributable to an active trade or business. Investment income does not include distributions from a qualified retirement plan or amounts subject to self-employment tax. This rule applies mostly to passive businesses and the trading in financial instruments or commodities. With this additional tax, the maximum net capital gains rate at the Federal level is 23.8% in 2013 and 2014.

Timing of Sales: You may want to time the sale of assets so as to have offsetting capital losses and gains. Capital losses may be fully deducted against capital gains and also may offset up to $3,000 of ordinary income ($1,500 for married filing separately). In general, when you take losses, you must first match your long-term losses against your long-term gains, and short-term losses against short-term gains. If there are any remaining losses, you may use them to offset any remaining long-term or short-term gains, or up to $3,000 (or $1,500) of ordinary income. HCA will, by early December, report short-term and long-term realized and unrealized gains and losses in taxable accounts managed by HCA to its clients so as to provide them with information that may be helpful in addressing year-end tax planning issues.

Selling Your (Underwater) Home: If you are currently "under water" on your home and you would like to sell or obtain a loan modification, you should consider finalizing the transaction(s) in 2013. Legislation enacted in early 2013 excludes qualified mortgage debt relief of up to $2,000,000 provided by your lender (resulting in a discharge of indebtedness in 2013) from income. However, if Congress and the Administration fail to extend this tax benefit, any debt discharged on or after January 1, 2014 will be considered income.

Social Security: Depending on the recipient's modified AGI and the amount of Social Security benefits, up to 85% of Social Security benefits may be taxed. To reduce the percentage, it may be beneficial to defer receipt of other retirement income. One way to do so is to elect to receive a lump sum distribution from a retirement plan and to roll that distribution into an IRA. Alternatively, it may be beneficial to accelerate income so as to reduce the percentage of your Social Security taxed in 2014 and later years. HCA stands ready to assist with such an acceleration-v.-deferral analysis.

Health Care Planning

Individual Mandate: Under PPACA, beginning in 2014, there is an "individual mandate" requiring individuals and their dependents to (i) have health insurance that is "minimum essential coverage" or (ii) pay a penalty (unless exempt). Many individuals already have qualifying coverage, which can be

obtained through the individual market, an employer-provided plan or coverage, a government program such as Medicare or Medicaid, or an "exchange." For lower-income individuals who obtain health insurance through such an exchange, a premium tax credit and cost-sharing reductions may be available to offset the costs.

Health Care Savings Accounts: The 2013 annual deduction limit for contributions to an HSA for an individual with self-only coverage under a high-deductible health plan (HDHP) will be $3,250 (increasing to $3,300 for 2014). For an individual with family coverage under an HDHP in 2013, the limit will be $6,450 (increasing to $6,550 for 2014). For both 2013 and 2014, an HDHP will need to have an annual deductible that is not less than $1,250 for self-only coverage or $2,500 for family coverage. In addition, for 2013, the annual out-of-pocket expenses (deductibles, copayments, and other amounts, but not premiums) may not exceed $6,250 for self-only coverage or $12,500 for family coverage (increasing to $6,350 and $12,700 respectively in 2014). For 2013 and 2014, individuals age 55 and older who are covered by an HDHP can make additional "catch-up" contributions each year until they enroll in Medicare. By statute, the catch-up contribution limit for individuals who will attain age 55 or older in the 2013 and 2014 taxable year will be $1,000.

Beginning in 2013, PPACA caps annual contributions to health flexible spending arrangements (health FSAs) at $2,500. Any salary reductions in excess of $2,500 will subject an employee to tax on distributions from the health FSA. The $2,500 maximum amount is indexed for inflation after 2013. Rules issued October 31, 2013 now permit cafeteria plans to be amended to allow up to $500 of unused amounts remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, subject to certain exceptions.

Long-term Care Insurance Premiums: Long-term care insurance premiums qualify as deductible "medical care" costs up to certain limits for a taxable year. The applicable inflation-adjusted limits for 2013 and 2014 are:

Age Attained Before End of Taxable Year	Deductible Premium Limit (2013)	Deductible Premium Limit (2014)
40 or less	$360	$370
More than 40 but not more than 50	$680	$700
More than 50 but not more than 60	$1,360	$1,400
More than 60 but not more than 70	$3,640	$3,720
More than 70	$4,550	$4,660

Self-Employed Health Insurance Premiums: Self-employed individuals are allowed to claim 100% of the amount paid during the taxable year for insurance that constitutes medical care for themselves, their spouses, and dependents as an above-the-line deduction, without regard to the general 10%-of-AGI floor.

Alternative Minimum Tax

As a result of legislation enacted in early 2013, the alternative minimum tax (AMT) exemption amounts for 2013 are: (1) $80,800 for married individuals filing jointly and for surviving spouses; (2) $51,900 for

unmarried individuals other than surviving spouses; and (3) $40,400 for married individuals filing a separate return. The exemption amounts for 2014 are: (1) $82,100 for married individuals filing jointly and for surviving spouses; (2) $52,800 for unmarried individuals other than surviving spouses; and (3) $41,050 for married individuals filing a separate return. Also, for 2013 and 2014, as a result of the extension of prior year rules, nonrefundable personal credits can offset an individual's regular tax and AMT, and capital gains will be taxed at the lower favorable rates noted above for AMT purposes.

Some of the standard year-end planning ideas will not reduce tax liability if you are subject to the AMT, since different rules apply. Due to the complexity of the AMT, you may want to request that HCA analyze your potential AMT exposure.

Same-Sex Marriage

On June 26, 2013, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act in *E.S. Windsor, 2013-1 ustc 50,400*. The Court held that Section 3, which had defined marriage for Federal purposes as the union of one man and one woman, was unconstitutional. Subsequently, the IRS announced a general rule in Rev. Rul. 2013-17 recognizing same-sex marriages nationwide.

Place-of-Celebration Approach: All same-sex marriages are recognized for all Federal tax purposes, regardless of whether or not a couple resides in a jurisdiction that recognizes same-sex marriage. All legally-married same-sex couples will be treated as married for all Federal tax purposes, including for income and gift and estate tax purposes.

Under the place-of-celebration approach used by the IRS, a couple that marries in a state that recognizes same-sex marriage and subsequently moves to a state that does not recognize same-sex marriage will continue to be treated as married for all Federal tax purposes. The IRS has taken the same approach to common law marriages for over 50 years.

Note that the Supreme Court did not strike down Section 2 of DOMA, which provides that states do not have to recognize same-sex marriages recognized in other states. The result is a patchwork of laws, with some states recognizing same-sex marriage and others not.

Filing Status: The IRS announced different rules for different tax years:

- **Tax Year 2013 and Subsequent Years**. For tax year 2013 and beyond, same-sex spouses generally must file using a married filing separately or jointly filing status.

- **Prior Tax Years**. For tax year 2012, and all prior tax years, same-sex spouses who file an original tax return on or after September 16, 2013 (the effective date of Rev. Rul. 2013-17) generally must file using a married filing separately or jointly filing status. For tax years 2011 and earlier, same-sex spouses who filed their tax returns timely may choose, but are not required, to amend their Federal tax returns to file using a married filing separately or jointly filing status, provided the period of limitations for amending the return has not expired.

Married same-sex couples should explore the potential benefits of filing amended returns for open tax years. Generally, the limitations period for filing a refund claim is three years from the date the return was filed or two years from the date the tax was paid, whichever is later. Some taxpayers may have filed protective claims to keep the limitations period open for certain years.

Along with filing status, IRS recognition of same-sex marriage nationwide allows same-sex couples to take advantage of many tax incentives that include special rules for married filing jointly taxpayers, such as the adoption credit.

Employee Benefits: As a result of DOMA, taxpayers may have paid taxes on the fair market value of employer-provided health care coverage for their same-sex spouse. In Notice 2013-61, the IRS announced two optional special administrative procedures for employers to make claims for refunds or adjustments of employment taxes for certain benefits paid to same-sex spouses. Under the first procedure, employers may use the fourth quarter 2013 Form 941, Employer's Quarterly Federal Tax Return, to correct any overpayments of employment taxes for the first three quarters of 2013. Under the second procedure, employers may file one Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, for the fourth quarter of 2013 to correct any overpayments of FICA taxes for all quarters of 2013.

Domestic Partners: IRS recognition of same-sex marriage does not apply to registered domestic partners, individuals in a civil union, or similar relationships. Taxpayers in these types of relationships must continue to file their Federal income tax returns as single individuals, even if they may be able to file state returns jointly. Registered domestic partners may not file as married filing jointly or married filing separately, because the individuals are not considered married or spouses for Federal tax purposes.

A registered domestic partner can itemize his or her deductions regardless of whether his or her partner itemizes or claims the standard deduction. Although Code Sec. 63(c)(6)(A) prohibits a taxpayer from itemizing deductions if the taxpayer's spouse claims the standard deduction, this provision does not apply to registered domestic partners because they are not considered married for Federal tax purposes.

Conclusion

While we are getting very close to the end of the year, there is still time to implement strategies to minimize your 2013 tax liability. If you have questions about topics reviewed above or other tax planning matters, please contact Hunter Payne at 703.992.6485.

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