



Federal Tax Update

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Federal Tax Update Agenda

- I. New Legislation**
- II. Medicare Tax on Net Investment Income (NII)**
- III. Tax Planning – Tax Rates are Going Up!!**



American Taxpayer Relief Act of 2012

Overview

- Signed by President Obama on January 2, 2013
- Averted the tax side of the so-called “fiscal cliff”
- All individual tax rates extended, except for the highest marginal tax bracket
- Dividends and long-term capital gains rate increase
- One-year extension of numerous business tax provisions
- Several extensions retroactive to beginning of 2012



American Taxpayer Relief Act of 2012

Business Tax Extenders (through 2013)

- 50% bonus depreciation
- Increased limits for Sec. 179 expense (\$500k with \$2M investment limit)
- Research tax credit
- Work opportunity tax credit
- Qualified leasehold/retail improvement property (15 year recovery period)
- Reduced recognition period to 5 years for S-corp built-in gains tax



American Taxpayer Relief Act of 2012

Individual Tax Extenders (through 2013)

- Deduction for state and local sales taxes
- Mortgage insurance premium deduction
- Increased contribution limit for capital gain property for conservation purposes
- IRA distributions to charity (maximum of \$100k per year)
- Exclusion of COD on principal residence



American Taxpayer Relief Act of 2012

Individual Tax Rates

- Bush-era tax rates are made permanent for 2013 and after
- Income > \$400k for single (\$450k MFJ) increase from 35% to 39.6%

| Tax Bracket | Single | MFJ or HoH | MFS |
|--------------|-----------------------|-----------------------|-----------------------|
| 10% | \$0 – \$8,925 | \$0 – \$17,850 | \$0 – \$8,925 |
| 15% | \$8,925 – 36,250 | \$17,851 – 72,500 | \$8,925 – 36,250 |
| 25% | \$36,251 - \$87,250 | \$72,501 - \$146,400 | \$36,251 - \$73,200 |
| 28% | \$87,251 –\$183,250 | \$146,401 –\$223,050 | \$73,201 –\$111,525 |
| 33% | \$183,251 – \$398,350 | \$223,051 – \$398,350 | \$111,526 – \$199,175 |
| 35% | \$398,351 – \$400,000 | \$398,351 – \$450,000 | \$199,176 – \$225,000 |
| 39.6% | \$400,001 – | \$450,001 – | \$400,001 – |



American Taxpayer Relief Act of 2012

Dividend Tax Rates

- Increases maximum rate from 15% to 20%
- Top rate applies to the extent income exceeds the top tax bracket
- All others continue to enjoy previous enacted tax rates
 - 15% for taxpayers in the 25% to 35% tax brackets
 - 0% for taxpayers in the 10% and 15% tax brackets

Capital Gains Tax Rates

- Increases maximum rate from 15% to 20%
- 25% and 28% rates for unrecaptured IRC §1250 gain and collectibles remain unchanged
- Installment gain payments are taxed in year of payment, not in year of sale



American Taxpayer Relief Act of 2012

AMT Patch

- Increases exemption amount for 2012 to \$78,750 MFJ (\$50,600 single)
- Made permanent by allowing 2012 amounts to be adjusted for inflation in later years
- Permits all nonrefundable personal credits to full extent of taxpayer's regular tax and AMT liability

Pease Limitation

- Restores "Pease" limitation for itemized deductions
- Reduces itemized deductions by 3% of amount over threshold
 - \$250k for single and \$300k for MFJ (\$150k MFS)

Personal Exemption Phase-out

- Restores phase-outs with same income thresholds as Pease Limitation
 - Reduction of 2% for every \$2,500 (1,250 MFS) AGI > income thresholds



American Taxpayer Relief Act of 2012

Child Related Tax Relief

- Basic child tax credit of \$1,000 per qualifying child made permanent
- Child and dependent care credit
 - 35% maximum credit rate and \$3k expense cap (\$6k for 2 or more) are made permanent

Education Related Tax Relief

- American Opportunity Tax Credit extended through 2017
 - Maximum credit of \$2,500 per eligible student
- Qualified tuition deduction extended through 2013
 - Above-the-line deduction
 - Maximum of \$4,000 for taxpayers with AGI less than \$65k



Additional Medicare Taxes (beginning in 2013)

- Medicare payroll tax increase
 - Additional 0.9% hospital insurance (HI) tax
 - Applies to earned income in excess of \$200K for individuals (\$250K MFJ)
- Additional 3.8% “unearned income Medicare contributions” tax
 - Applies to lesser of:
 - Net investment income, or
 - Modified AGI in excess of \$200k (\$250K MFJ)
- Also applies to estates and trusts
 - Undistributed net investment income



3.8% Medicare Tax on Net Investment Income

IRC § 1411(c)(1)(A) – Definition of Net Investment Income (3 buckets)

- *(i)* – Gross income from interest, dividends, annuities, royalties, and rents, other than such income which is derived in the ordinary course of a (non-passive) trade or business
- *(ii)* – Gross income from a passive activity (within the meaning of Section 469) with respect to the taxpayer, or a trade or business of trading in financial instruments or commodities (as defined in section 475(e)(2))
- *(iii)* - Net gain attributable to the disposition of property other than property held in a non-passive trade or business (i.e., not described in paragraph (ii))
- Reduced by the deductions which are properly allocable to such gross income or net gains



Final and Proposed Regs on 3.8% Medicare Tax

Final Regulations TD 9644

- Clarifications and revisions from proposed regulations:
 - Utilization of losses in excess of gains to offset other investment income
 - Utilization of NOLs to offset NII
 - Methods for determining allocable investment expenses (state taxes, investment interest and misc. investment expenses)
 - Real estate professionals – rental activities will be treated as active trade or business income (assuming 750 and 500-hours tests are met)
 - Self-charged interest and rental income not subject to the NII tax
 - Foreign tax credit not allowed to offset NII tax
 - Regular estimated tax rules apply to NII tax
- Fresh-start grouping election available for purposes of Section 469
 - Must be subject to NII tax to qualify for regrouping
- Final Regs generally apply to tax years beginning after 12/31/13



Final and Proposed Regs on 3.8% Medicare Tax

Proposed Regulations REG-130843-13

- Dispositions of partnership interests and S-corp stock
 - NII tax applies only to the extent of gain attributable to assets subject to the NII tax
- Treatment of partnership payments
 - §707 (guaranteed payments)
 - §736 (retired partner payments)
- Treatment of capital loss carryforwards
- Special rules for CRTs and common trust funds

Areas of No Further Guidance

- What represents a “trade or business” (as opposed to a rental activity)?
- Material participation of estates and trusts



TAX PLANNING

Tax rates are going up in 2013!



INDIVIDUAL INCOME TAX: OUTLOOK BASED ON CURRENT LAW

| | WAGE INCOME | CAPITAL GAINS | DIVIDENDS |
|-----------------------------------------------------------------------------------------------------------|----------------|------------------|-----------|
| 2013 TOP RATES | | | |
| BASE: BUSH TAX RATES | 35.00% | 15.00% | 15.00% |
| ADDITIONAL TAX UNDER ATRA TAX RATE SCHEDULE | 4.60% | 5.00% | 5.00% |
| | 39.60% | 20.00% | 20.00% |
| INCREASE IN MARGINAL RATE DUE TO REINSTATEMENT OF ITEMIZED DEDUCTION PHASEOUT (3% x 39.6%) | 1.20% | 1.20% | 1.20% |
| NEW HEALTH CARE REFORM TAXES | | | |
| MEDICARE HOSPITAL INSURANCE TAX (HI TAX ON EARNED INCOME) | 0.90% | N/A | N/A |
| UNEARNED INCOME MEDICARE CONTRIBUTION | N/A | 3.80% | 3.80% |
| 2013 TOP MARGINAL TAX RATES | 41.70% | 25.00% | 25.00% |
| TOTAL INCREASE IN 2013 TAX RATES OVER 2012 TAX RATES | 6.70% | 10.00% | 10.00% |



Outlook for Upper Income Ohioans

| <u>Adjusted Gross Income</u> | <u>2012 Tax</u> | <u>2013 Tax</u> | <u>Increase (Decrease)</u> | <u>%</u> |
|--------------------------------------------------|-----------------|--------------------------------------------|--------------------------------|----------|
| \$ 250,000 <i>(Incl \$10k Div & CG)</i> | \$ 44,900 | \$ 44,100 | \$ (800) | (1.8%) |
| \$ 500,000 <i>(Incl \$30k Div & CG)</i> | \$ 125,000 | \$ 127,800 <i>(Incl \$3k Med taxes)</i> | \$ 2,800 | 2.2% |
| \$ 750,000 <i>(Incl \$50k Div & CG)</i> | \$ 189,200 | \$ 204,100 <i>(Incl \$6k Med taxes)</i> | \$ 14,900 | 7.9% |
| \$ 1,000,000 <i>(Incl \$75k Div & CG)</i> | \$ 253,500 | \$ 291,900 <i>(Incl \$9k Med taxes)</i> | \$ 39,000 | 15.1% |



Take Advantage of Expiring Tax Provisions

Business Tax Provisions

- 50% Bonus Depreciation
- \$500,000 §179 Expensing
- Research Tax Credit
- Work Opportunity Tax Credit

Individual Tax Provisions

- State and local sales tax deduction
- Mortgage insurance premiums deduction
- Qualified tuition deduction



Plan for Capital Gains and Dividends

- Avoid short-term capital gains – taxed as ordinary income
- Hold capital assets for more than 12 months (if no loss c/f's)
- Avoid spikes in cap gains & dividends
 - Increases could push you into higher cap gain and dividend brackets
 - Brackets: 0% 15% 18.8% 23.8%
 - Spread cap gains between 2013 & 2014
- Consider installment sales or like-kind exchanges
- Consider the after-tax return on investment
 - Rebalance portfolios for tax-exempt investments



Plan to avoid the 3.8% Net Investment Income (NII) Tax

- Keep income below threshold amounts (\$250k MFJ)
 - Review “one-time” events such as Roth IRA conversions and large assets sales
 - Spread income over number of years (i.e. installment sales)
 - Accelerate investment income if MAGI expected to be less than \$250k MFJ
- Gift assets that generate investment income to a donee whose MAGI is below threshold amount
 - Gift directly to beneficiary, not trusts
- Re-group passive activities with non-passive activities
 - Regrouping election is available for 2013
- Evaluate impact of selling partnership or S-corp interests
- Make year-end withholding adjustment on W-2 to avoid any underpayment of estimated taxes caused by the NII tax



General Tax Planning

– *Accelerate Deductions into 2013*

- Take full advantage of Section 179 expense and bonus depreciation by placing assets in service prior to year end
- Ensure adequate tax basis and at-risk basis to claim losses from pass-through entities
- Prepay state and local taxes (watch out for AMT)
- Cash-basis businesses - prepay expenses before year-end
- Elect to carryforward NOLs



General Tax Planning

- *Defer Income until 2014 and beyond*
 - Sell appreciated assets after year-end
 - Postpone dividends from C-corporations
 - Watch out for mutual fund purchases - “don’t buy a dividend”
 - Cash-basis businesses - delay receipts until after year-end



General Tax Planning

- ***Review Accounting Methods***
 - Overall method - Cash vs. accrual method
 - Inventory methods - LIFO, FIFO, etc.
 - Revenue recognition methods
 - Expense & capitalization methods (opportunities under Final Regs)
 - Cost Segregation Studies
- ***Maximize retirement plan contributions***
 - IRAs, 401ks and self-employed plans
- ***Review Choice of Entity - Pass-Through Entity vs. C Corporation***
 - Policy trend is toward higher individual tax rates and lower corporate rates



Questions?

