Goldburd & Co. LLP
Certified Public Accountants

TAX TALK

Winter 2013

It's that time of year where we should think about preparing an estimate of your current year tax liability or calculate the expected taxable income or loss of your business and determine if there is anything we can do before the end of the year to mitigate or reduce any potential tax liability for 2013.

Individuals

There are several things to consider when doing year-end tax planning: taking advantage of expiring tax provisions, deferring income into the following year or accelerating income into the current year, and accelerating expenses into the current year or deferring them into the following year. The proper strategy depends on whether or not you anticipate a significant change in income or expenses next year.

In addition, the following are some changes in the law that took effect this year, as well as some popular deductions and credits to which you may be entitled.

Increase in Top Tax Rate

Beginning in 2013, a new top tax rate of 39.6 percent takes effect. This rate applies to taxable income in excess of $450,000 (joint returns and surviving spouses), $425,000 (heads of household), $400,000 (unmarried other than head of household and surviving spouse), and $225,000 (married filing separately).

Increased Tax Rate on Certain Capital Gains and Dividends

While the favorable tax rates in effect before 2013 for capital gains and dividend income were generally made permanent by the American Taxpayer Relief Act of 2012, a new 20-percent rate applies to amounts which would otherwise be taxed at the 39.6-percent rate. Thus, tax rates of 0, 15, and 20 percent apply to capital gain and dividend income, depending on your tax bracket. These rates apply for alternative minimum tax purposes also.

New Taxes Take Effect in 2013

There are a couple of new taxes that take effect in 2013: a 3.8 percent tax on net investment income above a threshold amount, and a .9 percent additional tax on wages and self-employment income above a threshold amount. For both taxes, the threshold amount is $200,000 ($250,000 if married filing jointly or $125,000 for married filing separately). Income taken into consideration in calculating net investment income includes most rental income and net gain attributable to the disposition of property other than property held in a trade or business. Thus, this generally covers sales of interests in a partnership or S corporation.

Increased Threshold for Deducting Medical Expenses

Medical and dental expenses that exceed a certain percentage of your adjusted gross income (AGI) for the year are deductible. For years before 2013, that percentage was 7.5 percent. For 2013 and later years, the deduction floor is increased to 10 percent. However, for any tax year ending before January 1, 2017, the floor is 7.5 percent if you or your spouse has reached age 65 before the end of that year.

Reduction in Personal Exemptions and Itemized Deductions for High-Income Taxpayers

In addition, there is a reduction in personal exemptions and itemized deductions for taxpayers with adjusted gross income over $250,000 (unmarried other than head of household and surviving spouse), $300,000 (joint returns), $275,000 (head of household), and $150,000 (married filing separately), which will have the effect of increasing taxes on affected taxpayers. We need to consider whether these new taxes affect you and, if so, whether you have paid a sufficient amount of taxes through withholdings and estimated tax payments so as to avoid any underpayment of estimated tax penalty.

Deduction for Eligible Teacher Expenses

Another provision that expires this year is the deduction for eligible teacher expenses. For tax years beginning before 2014, eligible educators (i.e., teachers) can deduct from gross income up to $250 of qualified expenses they paid during the year. If spouses are filing jointly and both were eligible educators, the maximum deduction on the joint return is $500. However, neither spouse can deduct more than $250 of his or her qualified expenses.

Expiring Energy-Related Tax Credits

There are two expiring energy-related tax credits that may be worth looking at. One such credit is the residential energy credit, which is available only through the end of 2013. If you are contemplating energy improvements to your home, you may want to accelerate the improvements into 2013. The credit is 10 percent of the amounts paid or incurred for qualified energy efficiency improvements installed during the tax year and the amount of residential energy property expenditures paid or incurred during the tax year, up to a maximum credit of $500.

Another "green" credit due to expire at the end of the year is the credit for qualified two- or three-wheeled plug-in electric vehicles. The credit is equal to the lesser of 10 percent of the cost of such a vehicle or $2,500.

Student Loan Interest Deduction

If you had any student loans during the year and your modified adjusted gross income (MAGI) is within certain limits, you may

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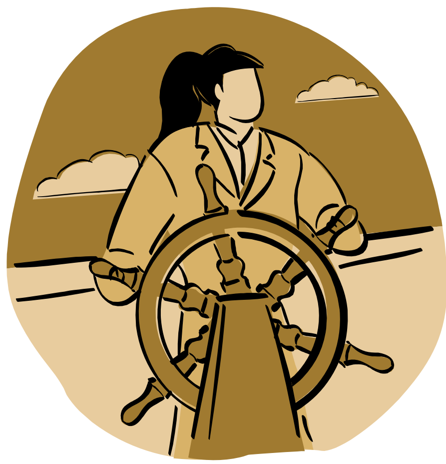
deduct up to $2,500 of interest paid on that loan in computing adjusted gross income. For 2013, the deductible amount is phased out if your MAGI is between $60,000 and $75,000 ($125,000 and $155,000 if filing a joint return). You cannot take a student loan interest deduction if your MAGI is $75,000 or more ($155,000 or more if filing a joint return). The deduction is not available if your filing status is married filing separately.

American Opportunity Tax Credit

If you paid any qualified education expenses during the year, you may be eligible for the American Opportunity tax credit. The maximum credit amount is $2,500 per year for each eligible student. The amount of the credit for each student is calculated as 100 percent of the first $2,000 of qualified education expenses paid for the student and 25 percent of the next $2,000 of such expenses paid. The credit may be reduced, however, depending on your modified adjusted gross income (MAGI).

For 2013, MAGI between $80,000 and $90,000 ($160,000 and $180,000 for joint filers) is used to determine if there is any reduction. If your MAGI is in excess of $80,000 ($160,000 for joint filers), the amount of the credit is phased out by multiplying the otherwise allowable credit by a fraction, the numerator of which is the amount by which your MAGI exceeds $80,000 ($160,000 for joint filers), and the denominator of which is $10,000 ($20,000 for joint filers). No credit is allowed if your MAGI is $90,000 or more ($180,000 or more for joint filers).



Transfers to Roth Accounts

New in 2013 is an expansion of the option for a taxpayer with a 401(k) plan that includes a qualified Roth contribution program to transfer an amount from his or her regular (pretax) elective deferral account into a designated Roth account in the same plan. In 2012, this was allowed only for participants who were at least 59-1/2 years old. That age limitation does not apply in 2013 and, while the transfer is subject to regular income tax, no early distribution penalty applies. Subsequent distributions from the Roth account, assuming applicable requirements are met, will be tax free.

Qualified Principal Residence Debt Exclusion

Generally, you recognize income when debt is discharged. However, there is a special rule for the discharge of qualified principal residence debt (i.e., mortgage debt). The discharge of such debt is generally excludable from gross income for discharges through 2013. Qualified principal residence debt is debt that is incurred to buy, build, or substantially improve your principal residence and that is secured by that residence. It also includes debt secured by your principal residence that is used to refinance qualified principal residence debt, but not in excess of the outstanding principal amount of the debt that is refinanced.

Alternative Minimum Tax

If you are subject to the alternative minimum tax (AMT), your deductions may be limited. Thus, if we anticipate that you will be subject to the AMT, we need to consider the timing of deductible expenses that may be limited under AMT.

Other Steps to Consider Before the End of the Year

The following are some of the additional actions we should review before year end to see if they make sense in your situation. The focus should not be entirely on tax savings. These strategies should be adopted only if they make sense in the context of your total financial picture.

Accelerating Income into 2013

Depending on your projected income, it may make sense to accelerate income into 2013. Besides harvesting gains from your investment portfolio, other options for accelerating income include:
(1) if you own a traditional IRA or a SEP IRA, converting it into a Roth IRA and recognizing the conversion income this year;
(2) taking IRA distributions this year rather than next year;
(3) selling stocks or other assets with taxable gains this year;
(4) if you are self employed with receivables on hand, trying to get clients or customers to pay before year end; and
(5) settling lawsuits or insurance claims that will generate income this year.

Deferring Income into 2014

There are also scenarios (for example, if you think that your income will decrease substantially next year) in which it might make sense to defer income into the 2014 tax year or later years. Some options for deferring income include:
(1) if you are due a year-end bonus, asking your employer to pay the bonus in January 2014;
(2) if you are considering selling assets that will generate a gain, postponing the sale until 2014;
(3) delaying the exercise of any stock options you may have;
(4) if you are selling property, considering an installment sale;
(5) consider parking investments in deferred annuities;
(6) establishing an IRA, if you are within certain income requirements; and
(7) if your employer has a 401(k) plan, consider putting the maximum salary allowed into it before year end.

Deferring Deductions into 2014

Once again, if we expect tax rates to increase next year, or if you anticipate a substantial increase in taxable income, we may want to explore deferring deductions into 2014 by looking at the following:
(1) postponing year-end charitable contributions, property tax payments, and medical and dental expense payments, to the extent you might get a deduction for such payments, until next year; and
(2) postponing the sale of any loss-generating property.

Accelerating Deductions into 2013

If you expect your income to decrease next year, we should accelerate what deductions we can into the current year to offset the higher income this year. Some options include:
(1) consider prepaying your property taxes in December;
(2) consider making your January mortgage payment in December;
(3) if you owe state income taxes, consider making up any shortfall in December rather than waiting until your return is due;
(4) since medical expenses are deductible only to the extent they exceed 10 percent (7.5 percent if you or your spouse are 65 before the end of the year) of your adjusted gross income (AGI), if you have large medical bills not covered by insurance, bunching them into one year may help overcome this threshold;
(5) making any large charitable contributions in 2013, rather than 2014;

(6) selling some or all of your loss stocks; and
(7) if you qualify for a health savings account, consider setting one up and making the maximum contribution allowable.

Miscellaneous Items

Finally, these are some additional miscellaneous items to consider:
(1) If you have a health flexible spending account with a balance, remember to spend it before year end (unless your employer allows you to go until March 15, 2014, in which case you'll have until then).
(2) We should also consider if there is any income that could be shifted to a child so that the tax is paid at the child's rate.
(3) If you have any foreign assets, there are reporting and filing requirements with respect to those assets. Noncompliance carries stiff penalties.
(4) If you've gotten married or divorced, had a birth or death in the family, lost or changed jobs, or retired during the year, we need to discuss the tax implications of these events.

Business

There are a number of tax breaks that are set to expire this year unless Congress works together to extend these tax breaks, which seems unlikely at this time. However, the focus should not be entirely on tax savings, but rather on whether or not an action otherwise makes good financial sense for your business.

In addition, new rules have come out with respect to the acquisition and disposition of business property that are quite favorable to businesses, but may require some revisions to your fixed asset policies. Depending on your current policies, it may be possible to recoup refunds by filing amended returns for prior years.

Section 179 Expensing Deduction

One of the biggest deductions available to all businesses, and one that will be dramatically reduced in 2014, is the Section 179 expensing election. This is the last year for expensing up to $500,000 of Section 179 property. It is also the last year in which the maximum amount that may be expensed is reduced where the taxpayer places into service more than $2 million of Section 179 property.

For tax years beginning after 2013, the maximum amount that may be expensed drops to $25,000, and this amount is reduced where the taxpayer place into service more than $200,000 of Section 179 property. Thus, if you are anticipating any large purchases in the next several months, it may be advantageous to accelerate such purchases into the current year to take advantage of this deduction. (Note: despite the higher overall expensing limit in 2013, a $25,000 limitation applies to purchases of sport utility vehicles (SUVs) and certain other vehicles.)

Bonus Depreciation

Another deduction that expires at the end of 2013 is the bonus depreciation deduction. Under the bonus depreciation provisions, taxpayers can elect to claim a special additional depreciation allowance to recover part of the cost of certain qualified property placed in service during the tax year. The allowance applies only for the first year the property is placed in service and is an additional deduction taken after any Code Sec. 179 deduction and before calculating regular depreciation for the year. There is no cap on the total bonus depreciation that may be deducted during the year.

Although the bonus depreciation deduction is generally scheduled to disappear after 2013, it will continue through 2014 for certain long-lived property and transportation property.

Shorter Recovery Period for Certain Leasehold Improvements, Restaurant Buildings and Improvements, and Qualified Retail Improvements Ends

Special provisions in the law allow qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property to be depreciated over a 15-year recovery period rather than the normal 39-year recovery period used for nonresidential real property. Those provisions expire at the end of 2013. Thus, if your business is contemplating any such purchases or improvements, placing such buildings or improvements in service in 2013 would significantly increase your depreciation deductions.

Special S Corporation Basis Rules for Charitable Contributions of Property

For 2013, the decrease in an S shareholder's stock basis by reason of a charitable contribution of property equal to the shareholder's pro rata share of the adjusted basis of such property. This favorable rule expires for contributions made in tax years beginning after 2013. As a result, for contributions made in tax years beginning after 2013, the amount of the basis reduction is the shareholder's pro rata share of the fair market value of the contributed property.

Expiration of Reduced Recognition Period for S Corporation Built-in Gains

An S corporation may owe the tax if it has net recognized built-in gain during the applicable recognition period. Generally, the applicable recognition period is 10 years. However, for purposes of determining the net recognized built-in gain for tax years beginning in 2012 or 2013, the recognition period was reduced from 10 to five years. Thus, no tax is imposed on the net recognized built-in gain of an S corporation if the fifth tax year in the recognition period preceded 2012 or 2013. This favorable rule applies separately with respect to any C corporation asset transferred in a carryover basis transaction to the S corporation.

After 2013, the recognition period returns to 10 years. Thus, to escape gain recognition on property with built-in gain, you will have to hold the property for more than 10 years.

New Rules Apply to Property Purchased by Businesses

The IRS recently issued new rules that affect all businesses that acquire, produce, or improve tangible property. Thus, few businesses are unaffected by these rules. While these new rules apply to tax years beginning after 2013, businesses can adopt them for certain earlier years. Because these rules are quite taxpayer-friendly, retroactive adoption of these rules could result in significant refunds to your business. A new de minimis rule allows items to be expensed without question, up to a certain amount. However, taxpayers must have, at a minimum, a written capitalization policy that they follow for book purposes in order to take advantage of this rule. If this is something your business does not currently have, we can help you establish a policy. However, we need to have a policy in place before the beginning of your next tax year. The new rules also contain several taxpayer-friendly elections that we need to discuss to see if they would be a good fit with your business.

Work Opportunity Credit

For 2013, a business is eligible for a 40 percent credit for qualified first-year wages paid or incurred during the tax year to individuals who are members of a targeted group of employees. This credit is not available after 2013.

Generally, this credit is equal to 40 percent of the qualified first-year wages of members of a targeted group of employees who worked 400 or more hours during the year for the employer. The credit is reduced to 25 percent of the qualified first-year wages for employees who worked between 120 and 400 hours for the employer. No credit is available for the qualified first-year wages for employees who worked less than 120 hours.

Patient Protection and Affordable Care Act "ObamaCare"

The Patient Protection and Affordable Care Act (PPACA) includes several provisions that may affect you as an employer, including the so-called shared responsibility provisions, also known as the "employer mandate." Originally, this employer mandate was supposed to take effect on January 1, 2014. However, this has been delayed and the shared responsibility provisions will not take effect until January 1, 2015. Under the employer mandate, a penalty is imposed on certain large employers that do not offer health insurance coverage, offer health insurance coverage that is unaffordable, or offer health insurance coverage that consists of a plan under which the plan's share of the total allowed cost of benefits is less than 60 percent. The penalty is assessed for any month in which a full-time employee is certified to the employer as having purchased health insurance through a state exchange with respect to which a premium tax credit or cost-sharing reduction is allowed or paid to the employee.

For these purposes, a large employer is an employer (including a predecessor employer) that employed an average of at least 50 full-time employees during the preceding calendar year. An employer is not treated as employing more than 50 full-time employees if the employer's workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year and the employees that cause the employer's workforce to exceed 50 full-time employees are seasonal workers. A seasonal worker is a worker who performs labor or services on a seasonal basis, including retail workers employed exclusively during the holiday season and workers whose employment is, ordinarily, the kind exclusively performed at certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year.

A qualified small employer may be eligible for a credit for contributions to purchase health insurance for its employees. The amount of the credit increases from 35 percent (25 percent for tax-exempt organizations) of eligible premium payments in 2013 to 50 percent (35 percent for tax-exempt organizations) in 2014. The tax credit is subject to a reduction if you have more than 10 full-time employees or if average annual full-time employee wages exceed $25,000.

Finally, employers must report the cost of employer-sponsored group health plan coverage on employee W-2s.

Give us a call

All of the tax opportunities and considerations at this time of year can be a lot to remember, and the details of all these provisions can make it even more complicated. Fortunately, you won't have to remember all of them by yourself – that is why you hired us. The two most important pieces of tax advice for any year are to keep good records and ask questions. We look forward to hearing from you.

If you are projected to owe additional income tax, a tax projection can help determine which tax-minimizing strategies should be used before the end of the year to reduce or eliminate any tax due. If you are due a refund, we can ensure your tax return is filed as early as possible to allow you to receive your refund and enjoy your money more quickly.

If you need additional information on any of the above items or wish to speak with us directly about your tax picture for 2013, please do not hesitate to contact us at (212) 302-8970.

In addition if you feel that your friend or business associates could benefit from this newsletter, please feel free to pass it on to them.

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