Give Yourself the Gift of Tax Planning

Legal Alert

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As the leaves turn golden, most of us are thinking about football and the approaching holiday season. The last few months of the year are a prime time for putting planning strategies into place to reduce tax liabilities, perhaps one of the nicest gifts you can give yourself.

High Income Earners

High income earners—large wage earners, pass-through business owners or investors—need to be aware and wary of a number of changes to the tax law in 2013.
High income earners can expect higher tax bills for 2013 as a result of new taxes, deduction phase-outs and a slew of varying income thresholds to track tax changes. These include:

- For joint filers over $450,000, the top tax rate on ordinary income is 39.6% (up from 35%) and on capital gains is 20% (up from 15%).
- For joint filers with taxable income over $250,000, there is an additional .9% Medicare tax on wages and the new 3.8% Medicare tax on "net investment income," including income and gains from disposition from passive activities (e.g., interest, dividends, net rent, capital gains).
- For earners with adjusted gross income ("AGI") of over $300,000, itemized deductions and personal exemptions are now phased out (up to 80%). Permitted medical expenses will only be deducted in excess of 10% of AGI and FSA contributions are capped at $2,500.

High income individuals can potentially reduce taxable income by controlling the timing of income and expense recognition and holding investments to ensure long-term gain treatment. In some circumstances, it is possible to exchange assets through tax-free transactions that defer taxable income to future years. Current year opportunities and planning include:

- Individual taxpayers with multiple pass-through business activities can take advantage of a one-time opportunity to possibly group and re-cast their activities as active activities that would not be subject to the new Medicare tax on net investment income.
- Because these new taxes and thresholds apply to estates and trusts, executors and trustees should consider permissible distributions to beneficiaries at lower taxable income levels to reduce the overall tax burden.
- Strategic income deferral and expense acceleration.

Business Taxation

While the playing field keeps shifting, there are several tax savings ideas that business owners should be aware of, including expiring tax incentives and opportunities to defer or minimize taxable income recognition.

- Consider taking advantage of business tax incentives that expire in 2013 including:
  - the 50% first year bonus depreciation,
  - the increased $500,000 limit on §179 deductions,
  - several renewable energy credits, and
  - the shortened 5 year (rather than 10 year) recognition period for S corporation built-in gains.
- Consider tax-free or tax-deferred structures (e.g., installment sales, reorganizations, ESOPs, sales to defective grantor trusts) in conjunction with strategic business objectives.

Estate and Gifting Opportunities

Taxpayers with federal taxable estates can leverage the $5,250,000 applicable exclusion amount (AEA), using trusts or family partnerships/LLCs to effectively transfer wealth from one generation to the next. This exclusion was made permanent by the American Taxpayer Relief Act of 2012 with adjustments for inflation. Other opportunities for tax reductions and wealth transfer include:

- For 2013, gifts of up to $14,000 per person can be made to an unlimited number of people without incurring any gift tax. Because the exclusion can be used every year, it is a great way to reduce a taxable estate over time.
- Unlimited medical and educational expenses of another person may be paid, provided the payments are made directly to the medical provider or educational institution.

Taxpayers in Pennsylvania or New Jersey who do not have a federal taxable estate still face significant state estate/inheritance taxes. In many cases, strategies used for larger estates can be used to reduce or eliminate state estate/inheritance tax liability.
Attention should also be paid to strategies to reduce the income tax consequences of estate plans.

- For example, gifting appreciated stock to someone in a lower income tax bracket could significantly reduce or eliminate income tax liability on the sale of the stock for those planning to leave assets to their heirs.
- Keep in mind that the kiddie tax, which applies to a child under the age of 19 as of year end or under age 24 with earned income less than one-half of their support, could apply.
- Income tax liability may also be reduced or eliminated by making gifts of appreciated property to charity. This strategy is a big bang for the buck because the donor can take a charitable deduction for the fair market value of the property on the date it was gifted, and avoid capital gains on the appreciation on the property donated. Check to ensure you are eligible to claim the charitable donation as a deduction before making this type of transfer.

Conclusion

The end of the year is a great time to assess your financial health and implement strategies to limit or minimize your tax exposure. You should consult a tax professional to explore and implement tax strategies prior to year end. If you have any questions or would like more information on the issues discussed in this article, please contact Shareholders, Renee Vidal or Steve Poulathas.

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