2013

YEAR-END YEAR-ROUND TAX PLANNING GUIDE

H&M

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2013

The enactment of The American Taxpayer Relief Act of 2012 (ATRA) at the start of 2013 has made year-end tax planning something of an exercise in "back to the future." ATRA made permanent some tax provisions that were set to expire, extended other expiring provisions, brought back some old rules that haven't applied in a few years, and kept some changes scheduled to go into effect in 2013.

As you read through *Year-End Tax Planning for 2013*, you'll find helpful explanations of the current federal tax rules, tax tables, and a worksheet you can use to make a preliminary estimate of your 2013 taxable income. Perhaps most important, the guide also offers dozens of tips for lowering your personal and business taxes.

We encourage you not to wait to do your tax planning. To be effective, most strategies discussed in the guide have to be implemented before the end of the year.

Because the federal tax law is complicated, however, you'll want to secure professional tax advice before acting on any of the ideas presented in the guide. The suggestions are general in nature and may or may not be right for your particular situation.

on the PERSONAL side

As an individual taxpayer, your first year-end tax planning step is to understand your personal tax situation. Take time to review your filing status, the number of personal exemptions you can claim, your marginal tax rate, and how the alternative minimum tax (AMT) may affect you.

Determine Your Filing Status

You need to know your filing status to determine your highest marginal tax bracket and whether you're eligible to claim certain deductions and credits. The filing statuses are single, married filing jointly, married filing separately, and head of household. A qualifying widow(er) with a dependent child may continue to use the joint return rates for two years after his or her spouse's death. (Requirements apply.)

You can see the 2013 tax brackets in the accompanying rate table. Because the tax rate schedules are graduated, you generally won't pay the same rate of tax on all of your income. Once you know your tax bracket, you can project the tax effect of various planning strategies.

Be Aware of New Taxes and Rates

Several tax law changes that took effect in 2013 could raise your effective tax rate. For example, ATRA added a 39.6% tax rate and increased the long-term capital gains rate from 15% to 20% for these higher income taxpayers. The Patient Protection and Affordable Care Act introduced a new 3.8% surcharge on investment income and an additional Medicare tax of 0.9% on certain earnings for 2013 and later. Both new taxes apply only to certain higher income taxpayers. Check our tax rate table to see if these changes apply to you.

2013 Tax Rates

Rate (%)	Single	Head of household	Married filing jointly (and surviving spouses)	Married filing separately
	Taxable income brackets			
10	$0 – 8,925	$0 – 12,750	$0 – 17,850	$0 – 8,925
15	$8,926 – 36,250	$12,751 – 48,600	$17,851 – 72,500	$8,926 – 36,250
25	$36,251 – 87,850	$48,601 – 125,450	$72,501 – 146,400	$36,251 – 73,200
28	$87,851 – 183,250	$125,451 – 203,150	$146,401 – 223,050	$73,201 – 111,525
33	$183,251 – 398,350	$203,151 – 398,350	$223,051 – 398,350	$111,526 – 199,175
35	$398,351 – 400,000	$398,351 – 425,000	$398,351 – 450,000	$199,176 – 225,000
39.6	Over $400,000	Over $425,000	Over $450,000	Over $225,000
	New taxes			
0.9	**Thresholds for additional Medicare tax on wages and self-employment earnings**			
	Over $200,000	Over $200,000	Over $250,000	Over $125,000
3.8	**Modified AGI thresholds for investment income surcharge**			
	Over $200,000	Over $200,000	Over $250,000	Over $125,000

Count Your Personal Exemptions

You generally can claim one personal exemption for yourself and one for your spouse if you're married and file a joint return. You're also allowed one exemption for each dependent (a qualifying child or qualifying relative who meets certain tests). In 2013, each exemption you can claim in full reduces your taxable income by as much as $3,900. However, a tax law provision phasing out higher income taxpayers' exemptions was reinstated for 2013 and later. (See table).

YOUR MOVE Consider whether you should forgo claiming a dependency exemption for a child in college. You might come out ahead if your income is too high to claim an education credit (see page 8) for tuition payments. Assuming your child has enough taxable income, having the child pay the tuition (even if the money comes from you) could allow your student to take the education credit on his or her own return. You'll have to pass up the exemption for your child, but dollar for dollar, the credit may save more taxes for your family.

Personal Exemption Phaseout

Filing status	Phaseout begins at AGI of	Exemption completely phased out at AGI of
Single	$250,000	$372,500
Head of household	$275,000	$397,500
Married filing jointly	$300,000	$422,500
Married filing separately	$150,000	$211,250

Tally and Time Your Income

You can use the accompanying worksheet to estimate your 2013 income. Consider your income sources and how much control you have over when you receive the income. The year in which you receive income can make a difference in how much tax you'll pay on the income.

Receive income now or later? If you can afford it, delaying the receipt of taxable income until after the end of the year may produce better tax results. By delaying income, you delay taxes on that income. This move can also keep you from losing tax breaks that are reduced or eliminated at higher income levels and prevent you from being pushed into a higher tax bracket in 2013. So it may be particularly helpful for taxpayers on the cusp of the new 39.6% bracket or 3.8% net investment income surcharge threshold. (See page 11 for more about the new 3.8% tax.)

Estimate Your 2013 Income

Wages, salaries, tips, etc.	$
Interest and dividends	$
Business income (loss)	$
Farm income (loss)	$
Capital gain (loss)	$
Rents, royalties, partnerships, S corporations, trusts, etc.	$
Unemployment compensation	$
Alimony received	$
Taxable Social Security benefits	$
Taxable distributions from IRAs, pensions, and annuities	$
Taxable refunds of state and local income taxes	$
Other income	$
Total estimated income	**$**

Here are two ways you might delay receiving income until a later tax year.

- Ask your employer to postpone paying your year-end bonus or a late-year commission until after the first of the year.
- Instead of taking a cash distribution from a former employer's retirement plan, roll the funds into an individual retirement account (IRA) or a new employer's plan if the distribution is rollover eligible. You'll avoid current income taxes on the distribution while continuing to build your retirement savings.

YOUR MOVE

If your employer offers a retirement savings plan — such as a 401(k), 403(b), 457(b), or SIMPLE plan — take advantage of it and increase your pretax contributions before year-end. Note that your plan may allow you to make additional catch-up contributions if you've reached age 50 and maximized your regular salary deferrals. Your contributions and investment earnings generally won't be taxed until you receive distributions from the plan. (See more on retirement plan accounts on page 9.)

But income deferral isn't for everyone. Some individuals can save taxes by accelerating taxable income into 2013 rather than deferring it to 2014, even though taxes will have to be paid earlier. This might be the case, for example, if you expect to be in a higher tax bracket in 2014.

Using an FSA can mean less of your earnings will be taxed. An employer-sponsored flexible spending account (FSA) lets you elect to pay qualified health or dependent care expenses on a pretax basis, thus reducing your taxable income. The plan account reimburses you for amounts you spend on expenses allowed by the plan. Some plans allow you to use a plan-provided debit or credit card to pay expenses directly. Starting in 2013, there's a $2,500 cap on the amount you can contribute to a health FSA.

Tax Savings for Working Parents

Are you faced with a choice between claiming the dependent care credit on your tax return and taking advantage of a dependent care FSA offered by your employer? If your top tax rate is greater than 15%, using an FSA generally is more tax advantageous than claiming the dependent care credit.

Under an FSA, you may contribute up to $5,000 ($2,500 if married filing separately) a year on a pretax basis to be used to pay dependent care costs. The FSA income exclusion saves you income taxes at your top rate, while the dependent care credit rate for taxpayers with adjusted gross income (AGI) greater than $43,000 is limited to 20%. Your FSA may also save you FICA (Social Security and Medicare) taxes because the amount you contribute to the FSA isn't included in your wages for FICA purposes.

Maximum tax savings (AGI greater than $43,000)	One child	Two or more children
With credit	$600 $3,000 in expenses × 20% credit	$1,200 $6,000 in expenses × 20% credit
With FSA	$1,632.50 ($5,000 contribution × 25% income-tax rate) + ($5,000 × 7.65% FICA tax rate)	

Example assumes: 20% credit rate, 25% marginal income-tax rate, all earnings are subject to Social Security tax, and that eligible child care expenses equal or exceed the amounts shown.

If you qualify for the credit's $6,000 limit because you pay child care for more than one child, you could contribute $5,000 to a dependent care FSA and also claim a dependent care credit for $1,000 of expenses for even greater savings.

Receiving additional income in 2013 could subject Social Security retirement benefits to tax. When your "provisional income" — modified AGI (including tax-exempt municipal bond interest) plus half of your Social Security benefits — exceeds certain levels, you must include a portion of your Social Security benefit in income for tax purposes. Review your planned year-end transactions to see if realizing additional income in 2013 will increase the amount of your benefits subject to income tax.

Knowing your AGI is helpful. We've already mentioned adjusted gross income a couple of times. Projecting yours can help you determine whether tax breaks you plan to take advantage of will be subject to AGI limitations that will make them less valuable. Then, you can look at ways to trim your AGI without cutting your actual income.

A good place to start is checking to see what above-the-line deductions you can claim. These are adjustments to income you can make whether or not you itemize your deductions. Use the worksheet on page 6 to compute your estimated AGI. It lists the most common above-the-line deductions.

YOUR MOVE To avoid or limit income tax on your Social Security benefits, consider taking additional income you may need in 2013 from a Roth IRA if you have one. Unlike taxable withdrawals from traditional IRAs, tax-free Roth IRA distributions aren't included in your income for purposes of determining whether Social Security benefits are taxable.

Tax Breaks Subject to AGI Limits

- Personal exemptions
- Individual retirement accounts:
  - — Deduction for traditional IRA contribution (if you or your spouse participates in an employer's plan)
  - — Ability to contribute to a Roth IRA (other than through a conversion)
- Overall itemized deductions
- Student loan interest deduction
- Medical expense deduction
- Miscellaneous itemized expense deduction
- Child credit
- Child care credit
- Adoption credit
- American Opportunity credit
- Lifetime Learning credit
- Mortgage insurance premium deduction

YOUR MOVE Here's another income-planning move for retirees. Individuals who have reached age 70½ can roll over money in IRAs to qualified charities on a tax-free basis through 2013. As much as $100,000 may be donated annually and can count against the IRA owner's required minimum distributions for the year. Tax-free charitable rollovers aren't deductible. But a rollover may be preferable to taking a taxable IRA distribution and then making a contribution, since deductions for charitable contributions are subject to income limits and the tax law's itemized deduction limitation.

Will Your Social Security Benefits Be Taxable?

On a joint return*	
If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $32,000	0%
Between $32,000 and $44,000	50%
Over $44,000	85%
On a single or head-of-household return	
If your provisional income is:	Up to this percentage of your benefits will be taxed:
Less than $25,000	0%
Between $25,000 and $34,000	50%
Over $34,000	85%

* The provisional income threshold is zero for married persons filing separately who do not live apart from their spouses for the entire year.

Estimate Your AGI

Your estimated income (from page 3)	$
Adjustments*	
Alimony paid	$
Traditional IRA contributions	$
Educator classroom expenses (maximum of $250; only through 2013)	$
Student loan interest	$
Moving expenses	$
Health savings account contributions	$
Self-employment tax deduction	$
Self-employed health insurance costs	$
Self-employed SEP, SIMPLE, and qualified retirement plan contributions	$
Penalty on early withdrawal of savings	$
Total adjustments	$
Adjusted gross income (AGI): (Total income minus total adjustments)	$

* This list is not all-inclusive, and various requirements and limitations apply.

Uncover Deductions and Credits

Every itemized deduction you can claim will help minimize your tax burden. Consequently, it's generally worth the effort to add up all of your deductions and compare the amount you could claim as itemized deductions with the standard deduction for your tax-filing status.

The limitation on itemized deductions has returned. You may remember that prior to 2010, itemized deductions were limited for higher income taxpayers. This limitation has been reinstated with new income thresholds. Your deductions will be affected if your AGI is over $250,000 (single), $300,000 (married filing jointly), $275,000 (head of household), or $150,000 (married filing separately).

Basically, deductions are reduced by 3% of the amount by which AGI exceeds the threshold. However, deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses are not subject to the limitation. And you can't lose more than 80% of the itemized deductions that are affected.

Timing deductions can help. Try to claim deductions in the tax year they will provide the most benefit. For example, if you expect your income to be higher in 2013 than it will be in 2014, see if you can pay any deductible expenses in 2013 that you'd normally incur and deduct in 2014 — and vice versa if you expect your income to be higher in 2014.

YOUR MOVE

The reinstated itemized deduction limitation creates a "marriage penalty" of sorts. Two single taxpayers earning $175,000 each would not be subject to the itemized deduction limitation, while two married taxpayers earning the same amounts who file jointly would have their deductions limited. If you are planning to marry in 2014, this "penalty" may be an impetus to look for deductible expenses you can pay in 2013 rather than 2014.

Compare Standard Deduction to Itemizing Deductions

Single filers	$6,100
Married filing jointly and surviving spouses	$12,200
Heads of household	$8,950
Married filing separately	$6,100
Anyone who can be claimed as a dependent by another taxpayer	The greater of (a) $1,000 or (b) $350 plus the individual's earned income, not to exceed the $6,100 regular standard deduction for single filers
Age 65 or older	An additional $1,200 (increased to $1,500 if unmarried and not a surviving spouse)

Accelerating or delaying deductible expenses can be a particularly valuable strategy when you're claiming deductions that are subject to "floor" amounts set by law. (See the table on page 7.) Only amounts over and above the floor are deductible. If you can "bunch" two years of expenses into one year so that you exceed the deduction floor, you'll gain a tax advantage.

Deductions Subject to "Floors"

Expense	Limited to amount over
Medical expenses	10% of AGI 7.5% of AGI if age 65 or older
Unreimbursed employee business expenses and miscellaneous expenses	2% of AGI

Now may be a good time to review the medical and miscellaneous expenses you've already incurred this year. If it looks like you'll exceed the applicable floor amount, paying additional deductible expenses before year-end may be beneficial.

Taxes paid may be a significant itemized deduction. For 2013, you can claim deductions for state and local income taxes, or you can choose to deduct state and local general sales taxes paid instead of income taxes. The deduction for sales taxes is slated to expire after 2013. You can also deduct real property taxes, state and local personal property taxes, and foreign income taxes. In lieu of deducting foreign income taxes, you may be able to claim the foreign tax credit.

To increase your deduction for taxes:

- Pay state or local income taxes early by making any January 2014 estimated tax payments in late 2013.
- Increase your state or local tax withholding for the remainder of the year.

Note: Accelerating tax payments may not be beneficial if you expect alternative minimum tax to be an issue for you in 2013. (See page 8.)

Year-end charitable contributions can help your favorite charities and your tax situation. A check mailed on December 31, 2013, can be counted as a 2013 contribution even though the organization doesn't receive it and it doesn't clear the bank until 2014. Two tips for increasing your itemized deduction for charitable contributions:

- Prepay planned 2014 contributions to charity in 2013 using a credit card, if you wish.
- Because you can't deduct a capital loss when you give a charity stock or other assets that are worth less than your cost basis, you'll generally obtain a better tax result if you sell the asset first, realize the loss, and then donate the sale proceeds.

YOUR MOVE You can carry over to future tax years the unused portion of many deductions that are subject to limits. If you have any carryovers from earlier years of charitable contributions, home office expenses, investment interest, and so on, try to use them in 2013.

Homeownership can generate substantial itemized deductions. You can deduct mortgage interest on up to $1 million ($500,000 if married filing separately) of debt incurred in acquiring, constructing, or substantially improving a qualified residence.

YOUR MOVE When making large personal purchases, such as a new car, you may want to consider using a home equity line of credit to finance the purchase. That way, you'll potentially be able to deduct your loan interest, assuming you meet the applicable tax law requirements.

Generally, you may also:

- Deduct interest on up to $100,000 ($50,000 if married filing separately) of home equity debt.
- Deduct mortgage "points" (prepaid interest) in full in the year you purchase or build your main home.
- Choose to spread out the deduction of purchase points over the life of the loan if, for example, you won't have enough deductible expenses to itemize deductions in 2013.
- Deduct in full, in the year you enter the loan, points paid on mortgage loans for home improvements.
- Deduct any points you pay to refinance an existing mortgage ratably over the life of the loan.

YOUR MOVE Members of the National Guard or military reserve can deduct unreimbursed travel expenses to drills or meetings. To qualify, you must travel more than 100 miles from home and stay overnight. You can deduct the cost of lodging, half the cost of your meals, and 56.5 cents per mile for driving (plus parking fees and tolls) or your actual driving expenses.

A credit can be more valuable than a deduction. Unlike a deduction, a tax credit offsets your tax liability dollar for dollar. So, take advantage of all of the credits you can. Among the credits you may be able to claim:

- A child tax credit of up to $1,000 for each qualifying child who is under age 17 on December 31. (Income limitations apply.)
- The household and dependent care credit if you pay child care expenses so you (and your spouse) can work. Your child must be under age 13 when the care is provided (see "Tax Savings for Working Parents" on page 4 for more details).
- Credits for higher education expenses (see table).
- An adoption tax credit for up to $12,970 in qualified adoption expenses. (Income limitations apply.)
- A credit of up to $500 for installing qualified energy-saving improvements in your home (available only through 2013; restrictions apply).

YOUR MOVE

Look at your Social Security tax payments if you changed jobs or held a second job in 2013 and your combined wages total more than $113,700, the Social Security taxable wage base for the year. You may have had too much FICA withheld and may be eligible to claim the excess as a tax credit.

Tuition Breaks for 2013

	American Opportunity Credit	Lifetime Learning Credit
Maximum credit	$2,500 per student	$2,000 per tax return
Qualifying education	First four years of undergraduate education	Undergraduate, graduate, job training courses
Income limits	No credit if modified AGI reaches $90,000 (unmarried) or $180,000 (married joint) Phaseout applies	No credit if modified AGI reaches $63,000 (unmarried) or $127,000 (married joint) Phaseout applies

Note: You may not claim both credits in the same year for the same student's expenses. Other restrictions apply.

Check for AMT Exposure

The deductions you claim, along with other factors, can affect whether or not you're subject to the alternative minimum tax (AMT) for the year. See the "AMT Triggers" table.

AMT Triggers, Rates, and Exemption Amounts

What are some of the items that can trigger alternative minimum tax?

- A large deduction for state income taxes
- The exercise of incentive stock options
- A higher-than-average number of dependency exemptions
- Significant amounts of tax-exempt interest from "private activity" municipal bonds
- A large capital gain
- A large deduction for unreimbursed employee business expenses or miscellaneous expenses
- Interest on home equity debt not used to buy, build, or improve your home

2013 AMT Rates and Exemption Amounts

Taxable AMT income	Rate
$1 to $179,500	26%
Over $179,500	28%
AMT exemption amounts	
$51,900 unmarried	
$80,800 married filing jointly	
$40,400 married filing separately	

The exemptions are phased out for higher income taxpayers.

when it comes to INVESTMENTS

Investing plays a part in reaching almost any financial goal. Reviewing your investments for possible tax breaks may help you on your way toward meeting your goals.

Use Tax-advantaged Accounts

What could be better than being able to sidestep taxes on money that you're investing for your goals?

Putting more away for retirement before year-end can cut 2013 taxes. With an employer-sponsored retirement savings plan — such as a 401(k), 403(b), or SIMPLE plan — your pretax contributions to the plan and any earnings on those contributions won't be subject to federal income taxes until you begin receiving funds from the plan. Some plans also allow employees to make after-tax Roth contributions that won't reduce current taxes but, along with earnings on those contributions, can be withdrawn tax free later if certain requirements are met.

Deductible contributions you make to a traditional IRA reduce your AGI. If you or your spouse participates in a retirement plan at work, your deduction for contributions to a traditional IRA may be subject to an income-based limitation. You or your spouse must have earnings from work to contribute to either a traditional or a Roth IRA.

Contributions to a Roth IRA aren't deductible, but account earnings accumulate tax deferred and can be withdrawn tax free once five tax years have passed and you've reached age 59½ (or in certain other situations). In 2013, the ability to contribute to a Roth IRA is phased out as modified AGI rises from $112,000 to $127,000 (unmarried filers), $178,000 to $188,000 (joint filers), and $0 to $10,000 (married filing separately).

If you're self-employed full-time or in a sideline business, you also have retirement saving options. You generally:

- May establish a **SIMPLE IRA** anytime between January 1 and October 1 to contribute for the year
- Have until the due date of your (or your firm's) income-tax return (including extensions) to set up a **Simplified Employee Pension (SEP)** plan for 2013

Solo 401(k) plans must be in place before the end of the year. With a solo 401(k), you can make a tax-deductible profit sharing contribution in addition to salary deferrals. (Limits apply.)

Retirement Plan Contribution Limits for 2013

Type of plan	Under age 50	Age 50 or older
Traditional/Roth IRA	$5,500	$6,500
401(k)/403(b), 457(b), SEP*	$17,500	$23,000
SIMPLE IRA	$12,000	$14,500

Note that not all employer plans permit participants who have reached age 50 to contribute the higher amounts indicated. And additional contribution limitations could apply.

* Only SEP plans established before 1997 (SAR-SEPs) may allow employees to make pretax contributions.

YOUR MOVE If you're retired and are subject to the new 3.8% surcharge on investment income (see page 11), you may want to tap your IRA or qualified retirement plan accounts, such as a 401(k) account, for your late-year income rather than selling an appreciated investment. Although withdrawals may be subject to regular tax, they are not included in your net investment income for purposes of the surcharge. A caution, though: Unless the withdrawal is nontaxable (for example, because it's a qualified withdrawal from a Roth account), it would increase your AGI and could increase your surcharge exposure.

A health savings account (HSA) allows you to invest for future health care expenses in a tax-advantaged manner. You can fund an HSA to pay for qualified medical expenses. Unlike an FSA, an HSA lets you carry forward your unused balance to future years. To contribute to an HSA, you must be covered by an eligible high-deductible health insurance plan. In 2013, your individual contributions up to $3,250 for self-only coverage or $6,450 for family coverage are tax deductible. An additional $1,000 catch-up contribution is allowed for individuals age 55 and older. Any contributions your employer makes to your HSA (up to the applicable limit) are free of income tax and Social Security and Medicare taxes. Non-medical withdrawals are allowed but are subject to income tax and a 20% penalty if taken before age 65, unless taken because of disability or death. If you have an HSA, try to bring your 2013 contribution up to the maximum before year-end.

Section 529 plans* and Coverdell education savings accounts (ESAs) are tax-advantaged ways to invest for a child's or grandchild's education. The money you contribute to a 529 plan potentially grows tax deferred. When the account beneficiary reaches college age, both your plan contributions and any earnings on those contributions can be withdrawn tax free to pay the beneficiary's qualified higher education expenses. Generally, you can invest as much as you want, up to the limit imposed by the plan you choose.

Earnings on ESA investments are also tax deferred while in the account. ESA funds — including earnings — can be used tax free to pay for certain elementary and secondary school expenses, as well as for qualified higher education costs. In 2013, ESA contributions are limited to $2,000 per beneficiary and are phased out as your AGI exceeds $95,000 ($190,000 for joint return filers).

Plan Gains and Losses

Planning gains and losses can help you retain more investment dollars to put toward your financial goals.

To encourage long-term investing, the tax rate on long-term capital gains and qualified dividends is lower than an investor's ordinary rate. (See the table.) For gains to be classified as long term, investments generally have to be held *more than one year* before sale. Most dividend income from domestic corporations and qualified foreign corporations qualifies for a lower rate if the underlying stock has been held for a specified period: generally, for more than 60 days during the 121-day period beginning 60 days before the stock's ex-dividend date (the date on which the stock began trading without rights to the most recently declared dividend).

Although taxes shouldn't be the only factor you consider when planning investment transactions, waiting until

Capital Gains Rates

Long-term gain and qualified dividends	
Most investments (if ordinary tax rate is 39.6%)	20%
Most investments (if ordinary tax rate is 25% to 35%)	15%
Most investments (if ordinary tax rate is 10% or 15%)	0%
Real estate (amount up to prior allowable depreciation; rest of gain is taxed the same as gain on most investments)	25%
Short-term gain and nonqualified dividends (taxed at ordinary income-tax rates)	As high as 39.6%

Higher income taxpayers would add the 3.8% investment income surcharge to these rates.

** Certain benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions and how they may be used. Before investing, consider the investment objectives, risks, and charges and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.*

you've met the long-term holding period before you sell an appreciated investment can save you taxes.

YOUR MOVE Consider delaying late-year mutual fund investments until after the fund's ex-dividend date. Otherwise, the most recently declared dividend will be credited and taxable to you. In effect, part of your investment will be returned to you immediately as taxable income.

A traditional approach to reducing taxes is to time capital losses to offset capital gains. Capital losses are fully deductible against capital gains. You can also deduct any excess losses against ordinary income of up to $3,000 ($1,500 if married filing separately) and carry forward losses you can't deduct in 2013 to future years.

If you have significant gains in 2013, you may want to realize some offsetting losses on investments you no longer want to hold. But be sure to weigh all relevant factors before making your decision.

YOUR MOVE To accelerate losses without significantly changing your investment position, consider selling securities, taking the loss, and replacing them with securities of another company in the same industry having similar prospects. This strategy avoids the wash-sale rules. Under these rules, if you sell securities at a loss and purchase substantially identical securities within 30 days before or after the sale, your loss will be disallowed.

Minimize Exposure to the 3.8% Surcharge

The new surcharge applies to the *lesser* of (1) the year's net investment income or (2) the excess of your modified AGI over the relevant threshold. (See page 2 for the threshold for your filing status.) For example, a single taxpayer has a modified AGI of $250,000 in 2013 and $40,000 of net investment income. Since $40,000 is less than $50,000 ($250,000 modified AGI – $200,000 threshold), the taxpayer's liability for the 3.8% tax is $1,520 (3.8% × $40,000).

Net investment income for surtax purposes includes gross income from interest, dividends, annuities, royalties, rents, net capital gain, and income earned from passive trade or business activities.

Tax-exempt municipal bond interest offers an opportunity to minimize the surtax. Income from these bonds is not included in net investment income for surtax purposes. While you're reviewing your investments for the year, you may want to consider replacing some of your corporate bonds, which pay interest subject to the surtax, with municipal bonds. This strategy may help you avoid the surcharge in future years.

Increasing involvement in trade or business activities before year-end could offer an opportunity for minimizing the surcharge. Assuming your business is profitable, putting in some more active work hours may allow you to show material participation in the activities so that your income from them won't be considered "passive" and won't be subject to the surcharge.

YOUR MOVE If you are considering selling a highly appreciated asset you've owned more than a year, such as a closely held business interest or growth stocks, to reinvest the proceeds for income, you might want to make a charitable gift of the asset through a charitable remainder trust (CRT) instead. A CRT allows you to make a substantial charitable gift but retain an income for life or for a set period.

Your gift could gain you several income-tax benefits. You'll be able to claim a 2013 charitable deduction for the present value of the trust interest that will eventually pass to the charity (subject to certain limitations and restrictions). Since a CRT is tax exempt, there won't be any immediate capital gains tax liability if the trustee sells the assets, leaving more money for reinvestment. Avoiding recognition of the capital gain will help minimize or avoid the 3.8% surcharge in 2013. Payments you receive from the trust in future years could expose you to the surcharge, but those payments would be smaller than the large gain you would have realized if you sold the asset yourself. Get professional advice about the tax aspects of a CRT before you make a commitment.

getting down to BUSINESS

For a business owner, tax planning is a year-round activity. But the last several months of the year may present specific opportunities to minimize taxes on your business income.

Review Earnings and Taxes

The structure of your business — C corporation, S corporation, partnership, limited liability company, or sole proprietorship — determines how your business income is taxed. Generally, the income, losses, deductions, and credits of an S corporation, partnership, or limited liability company (LLC) are passed through to the owners to be reported on their tax returns. Sole proprietors also report business income and deductions on their personal tax returns.

A regular C corporation pays tax on its income at corporate tax rates (see table). A C corporation's earnings are potentially subject to two layers of income tax — once at the corporate level and again if distributed to shareholders as dividends. Corporate earnings paid out to you as compensation are included in your taxable income but are deductible by the corporation. Thus, they are taxable only once — to you.

Before deciding to pay out earnings as compensation, though, remember that qualified dividends are taxed at a maximum rate of 20%. Your compensation will be taxed at rates as high as 39.6%, plus you'll owe FICA tax, which may include the additional 0.9% Medicare tax.

The IRS can assess a corporate accumulated earnings tax penalty on companies that accumulate excessive earnings and profits. This penalty is 20% in 2013. Generally a corporation can accumulate up to $250,000 of earnings ($150,000 in the case of certain service corporations) without penalty.

Larger corporations may find themselves subject to alternative minimum taxes. When it applies, the corporate AMT rate is 20%, and the exemption amount is $40,000 (subject to an income-based phaseout with alternative minimum taxable income between $150,000 and $310,000). Small corporations that meet a gross receipts test are exempt from AMT.

Corporate Tax Rates

If your company is a C corporation other than a personal service corporation,* you can estimate your corporation's regular 2013 federal income taxes using this table.

If taxable income is over	But not over	Your tax is	Of the amount over
$0	$50,000	15%	$0
$50,000	$75,000	$7,500 + 25%	$50,000
$75,000	$100,000	$13,750 + 34%	$75,000
$100,000	$335,000	$22,250 + 39%	$100,000
$335,000	$10,000,000	$113,900 + 34%	$335,000
$10,000,000	$15,000,000	$3,400,000 + 35%	$10,000,000
$15,000,000	$18,333,333	$5,150,000 + 38%	$15,000,000
$18,333,333		A flat 35%	

* Qualified personal service corporations pay a flat 35% tax.

YOUR MOVE If your closely held C corporation expects to have a profitable year, consider whether it makes business (as well as tax) sense to pay bonuses or make a tax-deductible profit sharing contribution this year to minimize corporate taxable income.

To qualify, your corporation's average annual gross receipts for all three-tax-year periods beginning after 1993 and ending before the current tax year generally can't exceed $7.5 million. (There's a lower $5 million threshold for the first three-tax-year period taken into account in the test.)

The tax accounting method your business uses determines when income must be recognized for tax purposes and when expenses are deductible. Cash-method taxpayers report income when it is actually or constructively received and generally deduct expenses when payments are actually disbursed. Accrual-method taxpayers report income in the year their right to it becomes fixed and the income amount can be determined with reasonable accuracy. Deductions are taken when all events have occurred creating the liability and the amounts can be determined with reasonable accuracy.

Here are some ways businesses using different accounting methods might time income to reduce taxes.

- If your business uses the cash method, you might defer income by delaying billing notices so that payment won't be received until early next year.
- As an accrual-method taxpayer, you might defer income by delaying shipping products or providing services until the beginning of your 2014 tax year.
- Also look into opportunities to defer certain advance payments received for services and the sale of goods (requirements apply).

A net operating loss can reduce taxes. No business owner welcomes a net operating loss (NOL). But, if it looks like your company will show a loss this year, use it to your best advantage. An NOL generally can be carried back two years. Doing so may secure your business a refund of income taxes paid for those years. Unused NOLs may be carried forward to offset future taxable income for as long as 20 years. A special election not to use the carryback period is also available.

Businesses can deduct other losses as well, including:

- Business bad debts
- Casualty and theft losses (including natural disaster losses)
- Capital losses
- Losses on the sale of business assets

Deduct the Cost of Asset Purchases

Businesses have several tax incentives to invest in machinery, equipment, and other fixed assets in 2013. Read through and see which ones may benefit your business.

Time is running short to take advantage of "bonus" first-year depreciation for machinery, equipment, and other fixed assets purchased by your business. In 2013, businesses can claim a first-year depreciation deduction equal to 50% of the adjusted basis (or cost) of qualified new property acquired and placed in service during the year. This tax break expires on December 31, 2013, for most types of property. The 50% bonus depreciation is subtracted from the property's cost basis before the regular first-year depreciation deduction is computed.

YOUR MOVE Since bonus depreciation generally won't be available for 2014 purchases, consider purchasing new fixed assets (with a loan if necessary) that you'll need next year if you'll be able to claim 50% bonus depreciation (or the Section 179 deduction discussed below) for those assets in 2013.

Section 179 "expensing" offers businesses an alternative to depreciating assets over time. Under Section 179 of the tax code, your business may be able to currently deduct ("expense") the cost of qualifying new or used assets. For 2013, the Section 179 expensing limit is generally $500,000. The amount of the available expensing election is reduced dollar for dollar as annual asset purchases rise from $2,000,000 to $2,500,000. Looking ahead to 2014, the expensing limit is scheduled to drop to $25,000 of purchases, and the phaseout will begin once 2014 asset acquisitions exceed $200,000.

You can't expense more than the amount of your taxable income from active trades or businesses, and any part of an asset's cost that is expensed can't also be depreciated. Although real property generally doesn't qualify for expensing, up to $250,000 of certain leasehold improvements, retail improvements, or restaurant property placed in service during the 2013 tax year is eligible for the election.

YOUR MOVE Take best advantage of expensing. If you plan to elect Section 179 expensing for only some of your company's asset purchases and depreciate others, it may make sense to use the Section 179 election for the assets with the longest lives.

Did you purchase both new and used fixed assets? If your purchases will exceed the Section 179 expensing limit, use the 50% first-year depreciation bonus for some of the new assets and the Section 179 election for the used assets.

Claiming regular depreciation under the Modified Accelerated Cost Recovery System (MACRS) can be more advantageous than claiming bonus depreciation or electing Section 179 treatment in some situations. When might you want to elect out of bonus depreciation or forgo Section 179 expensing? It might be to your benefit if you want to preserve depreciation deductions for future years when you expect your business income to be taxed at a significantly higher rate. (Be sure to do a present value analysis first.)

Claim Other Deductions

Finding as many deductions as possible may be a key part of your tax-lowering strategy. Don't overlook any in this section that your business may be able to claim.

Your employee benefit program can provide tax deductions that will lower your business taxes. You can also build up funds for your own retirement by maximizing contributions to a tax-favored retirement plan. Our table on page 15 shows the 2013 contribution and deduction limits.

Offering benefits through a tax-favored cafeteria plan could be advantageous for you and your employees. The plan can offer health insurance only, or it can offer other benefits as well, such as medical expense reimbursement, group term life insurance of up to $50,000, and dependent care reimbursement, among others.

Self-employed individuals can deduct 100% of health and dental insurance costs for themselves and their spouses, dependents, and children younger than age 27 at year-end. Your deduction can't be more than your earned income from the trade or business for which you established the health coverage. (Other requirements apply.) The deduction is taken as an adjustment to gross income, rather than as an itemized deduction, so it may help you qualify for other tax benefits that are subject to AGI-based limits.

YOUR MOVE If you are one of the many individuals who have gone into business for yourself after retiring, be aware that you can deduct the Medicare premiums you pay. Note that you can't claim the deduction if you are eligible to be covered under a subsidized employer-provided health plan (e.g., if you have another job or your spouse's employer has a plan).

For eligible companies, the "domestic production activities deduction" can reduce taxes — and increase after-tax profits — without any additional outlay of cash. To claim this deduction, you have to be involved in domestic manufacturing, construction, engineering or architectural services related to construction projects, or other eligible production activities. For 2013, the maximum deduction is 9% of the lesser of: (1) qualified production activities income or (2) taxable income before taking the deduction into account. (Sole proprietors use their AGI, with certain modifications, instead of their taxable income.) The deduction may not exceed 50% of W-2 wages allocable to domestic production gross receipts.

MACRS Depreciation Asset Classes

Property class	Assets included
3-year	Tractor units for over-the-road use
5-year	Automobiles, trucks, computers and peripheral equipment
7-year	Office furniture and fixtures, farm machinery and equipment
10-year	Vessels, barges, tugs
15-year	Certain land improvements
20-year	Farm buildings (other than certain single-purpose structures)
25-year	Water utility property
Residential rental property (27.5-year)	Apartment buildings, single-family rental properties
Nonresidential real property (39-year)	Office buildings, stores, warehouses

The lists of property included in each class aren't all-inclusive.

Comparing Retirement Plans

	401(k)	Profit sharing	Simplified employee pension (SEP)	SIMPLE IRA
Employee contributions allowed?	Yes: see page 9 for 2013 deferral limits	No	No (except for certain plans established before 1997)	Yes: see page 9 for 2013 deferral limits
Employer contribution required?	No — however, employer contributions are allowed	Yes — contributions can be discretionary	Yes — discretionary contributions	Yes — must match employee deferrals up to 3% of pay or contribute 2% of pay for all eligible employees
Maximum annual contribution	Smaller of $51,000 or 100% of participant's compensation	Same as 401(k)	Smaller of $51,000 or 25% of participant's compensation	Employee deferral plus required employer contribution
Maximum deduction	25% of all participants' compensation plus employee deferrals	25% of all participants' compensation	Same as profit sharing plan	Same as maximum contribution

Compensation is generally limited to $255,000 in 2013. Calculating the contribution limit for a self-employed individual's profit sharing contribution involves a special computation. SIMPLE IRAs are available only to small employers.

New businesses get a special tax break. If you're launching a new business this year, you may incur expenses before the business actually begins operating. Examples include the costs of conducting market surveys, traveling to find customers or suppliers, advertising, and training employees. You may elect to deduct up to $5,000 of these expenses in 2013 as long as the business is up and running by year-end. (The $5,000 limit is reduced dollar for dollar once total start-up costs exceed $50,000.) The remainder of your start-up costs can be deducted ratably over a 180-month period.

YOUR MOVE Businesses can also reap tax benefits from being charitable. If you are in the grocery business, food services, or another industry that is in a position to have food inventory, consider donating items to a charitable organization that will use them for the care of the ill, needy, or infants. You can claim an enhanced deduction for such a donation. ATRA extended this special break, but only through 2013.

Accelerating deductible expenses into 2013 can increase your business deductions and lower taxes. Here are a few ideas:

- You might have equipment or vehicle repairs done or purchase supplies before year-end if these expenses would be incurred in 2014 anyway.
- If you're an accrual-method taxpayer, you have a little more freedom to accelerate deductions. Look at deducting employee bonuses that you don't plan to pay until early next year (within the first 2½ months of 2014). But note that you generally can't use this strategy for employees who own a greater-than-50% interest in the business, and other restrictions may apply.
- You also may be able to deduct vacation pay that is vested at year-end and will be paid within 2½ months after year-end.
- To deduct charitable contributions your accrual-method C corporation will make in the first 2½ months of 2014, make sure you note the charitable obligation in the corporate minutes before the end of 2013 (assuming the company uses a calendar year).
- Increasing business use of a car that you drive for both business and personal purposes can boost your total write-off for the vehicle. When actual expenses are deducted, your deduction depends on the ratio of business miles to total miles driven. If you use the standard mileage rate, increasing business mileage will give you a higher deduction.

Reduce Self-employment Taxes

Self-employed individuals generally have to pay self-employment (SE) taxes — the counterpart of the Social Security and Medicare (FICA) taxes paid by employees and their employers. If you're self-employed, SE taxes can represent a significant expense. In 2013, the 12.4% Social Security part of the tax applies to self-employment earnings of up to $113,700. The 2.9% Medicare tax applies to all of your self-employment income. Plus, you'll owe an additional 0.9% Medicare tax on earnings over $200,000 ($250,000 of combined self-employment income on a joint return and $125,000 if married filing separately).

The deduction available for SE taxes can give you a two-fold benefit. Self-employed individuals can deduct one half of their SE taxes (other than the additional 0.9% Medicare tax) as an above-the-line deduction. By claiming the deduction, you reduce your AGI, which in turn may help free up other deductions and credits that are limited or eliminated at higher AGI levels.

Certain strategies may help reduce your SE tax burden. Here are two possibilities:

- Make sure trade or business expenses are properly classified as such. For example, professional fees should be claimed as a business expense to the extent they're business related.
- Hire your school-age child to work for you part-time. Provided the pay rate is reasonable, the amount you pay your child for work actually performed will be deductible as a business expense. The deduction will lower your self-employment income — and your SE taxes.

Take Advantage of Tax Credits

Several business credits were extended by ATRA. Make sure you don't miss out on them or any other credits your business is eligible to claim.

Many business credits fall under the general business credit. Some that may be available to you:

- Investment credit
- Work opportunity credit (extended through 2013)
- Research credit (extended through 2013)
- Disabled access credit
- FICA tip credit
- Small employer health insurance credit
- Small employer pension start-up credit
- Employer-provided child care credit
- Energy credits (some extended through 2013 only)

The small employer health care credit is changing after 2013. If your company offers employee health benefits, see if you can qualify for a tax credit for a portion of your cost. The credit is available to employers with no more than 25 full-time (or full-time equivalent) employees earning, on average, not more than $50,000 annually in 2013. You generally must contribute at least 50% of the total premium cost. For 2013, the maximum credit is 35% of the employer's contribution. The 35% credit phases out for employers with more than 10 employees and/or average wages of $25,000 or more.

YOUR MOVE

Review your new hires for 2013 to see if any of them can qualify your business for the work opportunity tax credit (WOTC). The credit is available for a percentage of wages paid to members of specified "target" groups. In 2013, the maximum WOTC is generally $2,400, and the maximum credit for hiring a qualified veteran can be as high as $9,600.

Starting in tax year 2014, eligible small businesses that purchase coverage through a state-based Small Business Exchange may qualify for a credit of up to 50% of their contribution toward the coverage. The employer must contribute at least 50% of the total premium cost. The credit will be available to a qualifying employer for up to two tax years after 2013.

Talk with Us

Now may not be the most convenient time for tax planning. However, it can be one of the most rewarding. By beginning your year-end planning as early as possible, you'll have the time to better accomplish your tax-saving goals.

Why not make an appointment to come in and talk with us soon? As skilled professionals, we have the experience and knowledge to help you with all of your planning needs. For more information about any of our services, contact us today.

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