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December 2013

To Our Clients and Friends:

As we approach year-end, it's again time to focus on last-minute moves you can make to save taxes – both on your 2013 return and in future years.

For most individuals, the ordinary federal income tax rates for 2013 will be the same as last year: 10%, 15%, 25%, 28%, 33%, and 35%. However, the fiscal cliff legislation, passed early this year, increased the maximum rate for higher-income individuals to 39.6% (up from 35%). This change affects taxpayers with taxable income above $400,000 for singles, $450,000 for married joint-filing couples, and $425,000 for heads of households. In addition, the new 0.9% Medicare tax and 3.8% Net Investment Income Tax (NIIT) potentially kick in when modified adjusted gross income (or earned income in the case of the Medicare tax) goes over $200,000 for unmarried or $250,000 for married joint-filing couples, which can result in higher-than-advertised federal tax rate for 2013.

Despite these tax increases, the current federal income tax environment remains relatively favorable by historical standards. This letter presents a few tax-saving ideas to get you started. As always, you can call on us to help you sort through the options and implement strategies that make sense for you.

Ideas for Your Business

Take Advantage of Tax Breaks for Purchasing Equipment, Software, and Certain Real Property. If you have plans to buy a business computer, office furniture, equipment, vehicle, or other tangible business property or to make certain improvement to real property, you might consider doing so before year-end to capitalize on the following generous but temporary tax breaks.

- *Bigger Section 179 Deduction.* Your business may be able to take advantage of the temporarily increased Section 179 deduction. Under the Section 179 deduction privilege, an eligible business can often claim first-year depreciation write-offs for the entire cost of new and used equipment and software additions. (However, limits apply to the amount that can be deducted for most vehicles.) For tax years beginning in 2013, the maximum Section 179 deduction is $500,000. For tax years beginning in 2014, however, the maximum deduction is scheduled to drop to $25,000.

- *Section 179 Deduction for Real Estate.* Real property costs are generally ineligible for Section 179 deduction privilege. However, an exception applies to tax years beginning in 2013. Under the exception, your business can immediately deduct up to $250,000 of qualified costs for restaurant buildings and improvements to interiors of retail and leased nonresidential buildings. The $250,000 Section 179 allowance for these real estate expenditures is part of the overall $500,000 allowance. This temporary real estate break will not be available for tax years beginning after 2013 unless Congress extends it.

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Note: Watch out if your business is already expected to have a tax loss for the year (or be close) before considering any Section 179 deduction, as you cannot claim a Section 179 write-off that would create or increase an overall business tax loss. Please contact us if you think this might be an issue for your operation.

- *50% First-year Bonus Depreciation.* Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software placed in service by December 31 of this year. For a new passenger auto or light truck that's used for business and is subject to the luxury auto depreciation limitations, the 50% bonus depreciation break increase the maximum first-year depreciation deduction by $8,000 for vehicles placed in service this year. The 50% bonus depreciation break will expire at year-end unless Congress extends it.

Note: First-year bonus depreciation deductions can create or increase a Net Operating Loss (NOL) for business's 2013 tax year. You can then carry back a 2013 NOL to 2011 and 2012 and collect a refund of taxes paid in those years. Please contact us for details on the interaction between asset additions and NOLs.

Evaluate Inventory for Damaged or Obsolete Items. Inventory is normally valued for tax purposes at cost or the lower of cost or market value. Regardless of which of these methods is used, the end-of-the-year inventory should be reviewed to detect obsolete or damaged items. The carrying cost of any such items may be written down to their probable selling price (net of selling expenses). [This rule does not apply to businesses that use Last in, First out (LIFO) method because LIFO does not distinguish between goods that have been written down and those that have not].

To claim a deduction for a write-down of obsolete inventory, you are not required to scrap the item. However, in a period ending not later than 30 days after the inventory date, the item must be actually offered for sale at the price to which the inventory is reduced.

Employ Your Child. If you are self-employed, don't miss one last opportunity to employ your child before the end of the year. Doing so has tax benefits in that it shifts income (which is not subject to the Kiddie tax) from you to your child, who normally is in a lower tax bracket or may avoid tax entirely due to the standard deduction. There can also be payroll tax savings since wages paid by sole proprietors to their children age 17 and younger are exempt from both social security and unemployment taxes. Employing your children has the added benefit of providing them with earned income, which enables them to contribute to an IRA. Children with IRAs, particularly Roth IRAs, have a great start on retirement savings since the compounded growth of the funds can be significant.

Remember a couple of things when employing your child. First, the wages paid must be reasonable given the child's age and work skills. Second, if the child is in college, or is entering soon, having too much earned income can have a detrimental impact on the student's need-based financial aid eligibility.

Final Repair Regulations. The IRS has issued long-awaited regulations on the treatment of costs to acquire, produce, or improve tangible property. Taxpayers will need to apply these regulations going forward to determine whether they can deduct costs as repairs and maintenance under Code Sec. 162 or must capitalize the costs and depreciate or amortize them over a period of years under Code Sec. 263.

As expected, the regulations take effect January 1, 2014. Some provisions apply only to amounts paid or incurred in tax years beginning on or after January 1, 2014. The IRS is not expected to delay these effective dates, since taxpayers were informed of the impending changes in the rules almost two years ago. Complying with the final regulations will require significant time and effort, despite several taxpayer-friendly changes. Every business, especially those with significant fixed assets, must develop an understanding of the regulations and their requirements.

The regulations will provide simplification and reduce controversy to the extent they allow taxpayers to follow their financial accounting ("book") policies. For example, the de minimis rules provide a $5,000 safe harbor per item, provided taxpayers have a policy on their books to deduct items within the safe harbor and issue financial statements. The rules for repairs and maintenance also allow taxpayers to follow their book policies.

While the final regulations take effect January 1, 2014, taxpayers can choose to apply them retroactively for their 2012 or 2013 tax years. Taxpayers can also choose to apply the 2011 regulations to 2012 or 2013. The IRS must provide additional guidance for taxpayers to change their methods of accounting to elect to apply either set of regulations retroactively and to comply with the 2014 effective date. Some accounting method changes will require taxpayers to make adjustments under Code Sec. 481(a), in effect, applying the regulations to past years calculating the impact on income.

The IRS did not finalize every portion of the 2011 regulations. To address some problems with the temporary regulations on the disposition of depreciable property, the IRS issued new proposed regulations. The new proposed regulations relieve many taxpayers of the requirement to set up general asset accounts and make retroactive elections so that they can deduct the cost of building components and other portions of property that they replace.

Among the significant provisions in the final regulations are the following:

- Materials and supplies - The threshold for deducting materials and supplies was increased from $100 to $200. Materials and supplies include many items that are expected to be consumed in 12 months or less, or that have an economically useful life of 12 months or less.

- De minimis safe harbor - The final regulations eliminate a controversial ceiling on the use of this safe harbor. Taxpayers with financial statements can apply the safe harbor to an item that costs $5,000 or less. The regulations extend the safe harbor to taxpayers without a financial statement, but only for property that costs $500 or less. Taxpayers must have written book policies in place at the beginning of the year to use this safe harbor. This puts a premium on taxpayers developing a policy by the beginning of 2014.

- Routine maintenance and improvements - The final regulations retain controversial unit of property rules that apply the rules for real property to eight separate building systems, as well as to the overall structure. However, the rules do provide some relief by extending the routine maintenance safe harbor to real property and by providing a new safe harbor for small taxpayers. While the routine maintenance safe harbor usually looks at whether taxpayers will have recurring maintenance over the class life of the property, the regulations limit the measuring period to 10 years, rather than the 40-year class life, for real property.

- Capitalization election - The final regulations allow taxpayers to capitalize repair and maintenance costs if they are capitalized for financial accounting purposes. This is a significant simplification over the temporary regulations.

As you can see, the repair regulations are extensive and complex. Determining whether particular costs should be deducted or capitalized will be challenging, especially with the January 1, 2014 effective date looming. This firm stands ready to help you digest and understand the regulations, determine what accounting policies you may need, and make appropriate elections to comply with the regulations. Please contact our firm so that we can help you address these rules.

Idea for Maximizing Nonbusiness Deductions

One way to reduce your 2013 tax liability is to look for additional deductions. Here's a list of suggestions to get you started:

Make Charitable Gifts of Appreciated Stock. If you have appreciated stock that you've held more than a year and you plan to make significant charitable contributions before year-end, keep your cash and donate the stock (or mutual fund shares) instead. You'll avoid paying tax on the appreciation, but will still be able to deduct the donated property's full value. If you want to maintain a position in the donated securities, you can immediately buy back a like number of shares. (This idea works especially well with no load mutual funds because there are no transaction fees involved.)

However, if the stock is now worth less than when you acquired it, sell the stock, take the loss, and then give the cash to the charity. If you give the stock to the charity, your charitable deduction will equal the stock's current depressed value and no capital loss will be available. Also, if you sell the stock at a loss, you can't immediately buy it back as this will trigger the wash sale rules. This means your loss won't be deductible, but instead will be added to the basis in the new shares, unless you wait 31 days to buy it back.

Don't Lose a Charitable Deduction for Lack of Paperwork. Charitable contributions are only deductible if you have proper documentation. For cash contributions of less than $250, this means you must have either a bank record that supports the donation (such as a cancelled check or credit card receipt) or a written statement from the charity that meets tax-law requirements. For cash donations of $250 or more, a bank record is not enough. You must obtain, by the time your tax return is filed, a charity-provided statement that shows the amount of the donation and lists any significant goods or services received in return for the donation (other than intangible religious benefits) or specifically states that you received no goods or services from the charity.

Manage Your Adjusted Gross Income (AGI). Many tax breaks are only available to taxpayers with AGI below certain levels. Some common AGI-based tax breaks include the child tax credit (phase-out begins at $110,000 for married couples and $75,000 for heads-of-households), the $25,000 rental real estate passive loss allowance (phase-out range of $100,000-$150,000 for most taxpayers), and the exclusion of social security benefits ($32,000 threshold for married filers, $25,000 for other filers). In addition, for 2013 taxpayers with AGI over $300,000 for married filers, $250,000 for singles, and $275,000 for heads-of-households begin losing part of their personal exemptions and itemized deductions. Accordingly, strategies that lower your income or increase certain deductions, might not only reduce your taxable income, but also help increase some of your other tax deductions and credits.

Making the Most of Year-end Securities Transactions

For most individuals, the 2013 federal tax rates on long-term capital gains from sales of investments held over a year are the same as last year: either 0% or 15%. However, the maximum rate for higher-income individuals is now 20% (up from 15% last year). This change affects taxpayers with taxable income above $400,000 for singles, $450,000 for married joint-filing couples, $425,000 for heads-of-households, and $225,000 for married individuals who file separate returns. Higher-income individuals can also get hit by the new 3.8% NIIT on net investment income, which can result in a maximum 23.8% federal income tax rate on 2013 long-term gains.

As you evaluate investments held in your taxable brokerage firm accounts, consider the tax impact of selling appreciated securities (currently worth more than you paid for them). For most taxpayers, the federal tax rate on long-term capital gains is still much lower than the rate on short-term gains. Therefore, it often makes sense to hold appreciated securities for at least a year and a day before selling to qualify for the lower long-term gain tax rate.

Biting the bullet and selling some loser securities (currently worth less than you paid for them) before year-end can also be a tax-smart idea. The resulting capital losses will offset capital gains from other sales this year, including high-taxed short-term gains from securities owned for one year or less. For 2013, the maximum rate on short-term gains is 39.6% and the 3.8% NIIT may apply too, which can result in an effective rate of up to 43.4%. However, you don't need to worry about paying a high rate on short-term gains that can be sheltered with capital losses (you will pay 0% on gains that can be sheltered).

If capital losses for this year exceed capital gains, you will have a net capital loss for 2013. You can use that net capital loss to shelter up to $3,000 of this year's high-taxed ordinary income ($1,500 if you're married and file separately). Any excess net capital loss is carried forward to next year.

Selling enough loser securities to create a bigger net capital loss that exceeds what you can use this year might also make sense. You can carry forward the excess capital loss to 2014 and beyond and use it to shelter both short-term gains and long-term gains recognized in those years.

Identify the Securities You Sell. When selling stock or mutual fund shares, the general rule is that the shares you acquired first are the ones you sell first. However, if you choose, you can specifically identify the shares you're selling when you sell less than your entire holding of a stock or mutual fund. By notifying your broker of the shares you want sold at the time of the sale, your gain or loss from the sale is based on the identified shares. This sale strategy gives you better control over the amount of your gain or loss and whether it's long-term or short-term.

Secure a Deduction for Nearly Worthless Securities. If you own any securities that are all but worthless with little hope of recovery, you might consider selling them before the end of the year so you can capitalize on the loss this year. You can deduct a loss on worthless securities only if you can prove the investment is completely worthless. Thus, a deduction is not available, as long as you own the security and it has any value at all. Total worthlessness can be very difficult to establish with any certainty. To avoid the issue, it may be easier just to sell the security if it has any marketable value. As long as the sale is not to a family member, this allows you to claim a loss for the difference between your tax basis and the proceeds (subject to the normal rules for capital losses and the wash sale rules restricting the recognition of loss if the security is repurchased within 30 days before or after the sale).

Take Advantage of the 0% Rate on Investment Income

For 2013, the federal income tax rate on long-term capital gains is 0% to the extent they fall within the 10% or 15% federal income tax rate brackets. This will be the case to the extent your taxable income (including long-term capital gains and qualified dividends) does not exceed $72,500 if you are married and file jointly ($36,250 if you are single). While your income may be too high to benefit from the 0% rate, you may have children, grandchildren, or other loved ones who will be in one of the bottom two brackets. If so, consider gifting them some appreciated stock or mutual fund shares that they can then sell and pay 0% tax on the resulting long-term gains. Gains will be long-term as long as your ownership period plus the gift recipient's ownership period (before he or she sells) equals at least a year and a day.

Note: If you give securities to someone who is under age 24, the Kiddie Tax rules could potentially cause some of the resulting capital gains and dividends to be taxed at the parent's higher rates instead of at the gift recipient's lower rates, which would defeat the purpose. Also, if you give away assets worth over $14,000 during 2013 to an individual gift recipient, it will generally reduce your $5.25 million unified federal gift and estate tax exclusion. However, you and your spouse can together give away up to $28,000 without reducing your exclusion.

Ideas for Seniors Age 70 ½ Plus

Make Charitable Donations from Your IRA. IRA owners and beneficiaries who have reached age 70 ½ are permitted to make cash donations totaling up to $100,000 to IRS-approved public charities directly out of their IRAs. These so-called *Qualified Charitable Distributions*, or QCDs, are federal-income-tax-free to you, but you get no itemized charitable write-off on your Form 1040. That's okay because the tax-free treatment of QCDs equates to an immediate 100% federal income tax deduction without having to worry about restrictions that can delay itemized charitable write-offs. QCDs have other tax advantages, too. Contact us if you want to hear about them.

Be careful – to qualify for this special tax break, the funds must be *transferred directly* from your IRA to the charity, Also, this favorable provision will expire at the end of this year unless Congress extends it. So, this could be your last chance.

Take Your Required Retirement Distributions. The tax laws generally require individuals with retirement accounts to take withdrawals based on the size of their account and their age every year after they reach age 70 ½. Failure to take a required withdrawal can result in a penalty of 50% of the amount not withdrawn. There's good news for 2013 though – QCDs discussed above count as payouts for purposes of the required distribution rules. This means, you can donate all or part of your 2013 required distribution amount (up to the $100,000 limit on QCD) and convert taxable distributions into tax-free QCDs.

Also, if you turned age 70 ½ in 2013, you can delay your 2013 required distribution until April 1, 2014, if you choose. However, waiting until 2014 will result in two distributions in 2014 – the amount required for 2013 plus the amount required for 2014. While deferring income is normally a sound tax strategy, here it results in bunching income into 2014. Thus, think twice before delaying your 2013 distribution into 2014 – bunching income into 2014 might throw you into a higher tax bracket or have a detrimental impact on your other tax deductions in 2014.

Ideas for the Office

Maximize Contributions to 401(k) Plans. If you have a 401(k) plan at work, it's just about time to tell your company how much you want set aside on a tax-free basis for next year. Contribute as much as you can stand, especially if your employer makes matching contributions. You give up "free money" when you fail to participate to the max for the match.

Take Advantage of Flexible Spending Accounts (FSAs). If your company has a healthcare and/or dependent care FSA, before year-end you must specify how much of your 2014 salary to convert into tax-free contributions to the plan. You can then take tax-free withdrawals next year to reimburse yourself for out-of-pocket medical and dental expenses and qualifying dependent costs.

One added benefit - the old "use-it-or-lose-it" rule has been modified by IRS Notice 2013-71. Now employers can amend their cafeteria plan documents to provide for a new option which allows up to $500 to be carried over to the next year. This is effective for plan years starting in 2013. The up-to-$500 amount will not count toward the following year's $2,500 inflation-adjusted salary reduction limit.

Adjust Your Federal Income Tax Withholding. As stated at the beginning of this letter, higher-income individuals will likely see their taxes go up this year. This makes it more important than ever to do the calculations to see where you stand before the end of the year. If it looks like you are going to owe income taxes for 2013, consider bumping up the federal income taxes withheld from your paychecks now through the end of the year. When you file your return, you will still have to pay for any taxes due less the amount paid in. However, as long as your total payments (estimated payments plus withholdings) equal at least 90% of your 2013 liability or, if smaller, 100% of your 2012 liability (110% if your 2012 adjusted gross income exceeded $150,000; $75,000 for married individuals who filed separate returns), penalties will be minimized, if not eliminated.

Cell Phones Used in Your Business. The IRS has issued taxpayer friendly rules in Notice 2011-72 which allows employers to provide cell phones to their employees and deduct the cost of the phones as a business expense. The extensive substantiation requirements for listed property no longer apply to cell phones. Employer payment or reimbursement of cell phone costs to employees is deductible by the employer and non-taxable to the employee as long as the cell phones are provided primarily for non-compensatory business purposes (for example, the employer's need to contact the employee at all times for work-related emergencies, the employer's requirement that the employee be available to speak with clients at times when the employee is away from the office, and/or the employee's need to speak with clients outside normal work hours). If these conditions are met, the IRS will not require record-keeping of business use in order to receive this tax-free treatment. This is a good tax break for both employers and employees.

Watch Out for Alternative Minimum Tax

Recent legislation slightly reduced the odds that you'll owe the alternative minimum tax (AMT). Even so, it's still critical to evaluate all tax planning strategies in light of the AMT rules before actually making any moves. Because the AMT rules are complicated, you may want our assistance.

Planning for the 3.8% Medicare Surtax

For tax year beginning January 1, 2013, the tax law imposes a 3.8% surtax on certain passive investment income of individuals, estates, and trusts. For individuals, the amount subject to the tax is the lesser of (1) net investment income (NII) or (2) the excess of a taxpayer's modified adjusted gross income (MAGI) over an applicable threshold amount.

Net investment income includes dividends, rents, interest, passive activity income, capital gains, annuity income and royalties. Specifically excluded from the definition of net investment income are self-employment income, income from an active trade or business, gain on the sale of an active interest in a partnership or S corporation and IRA or qualified plan distributions. MAGI is generally the amount you report on the last line of page 1, Form 1040.

The applicable threshold amounts are $250,000 for married taxpayers filing jointly, $200,000 for single taxpayers, and $11,950 for estates and trusts.

A simple example will illustrate how the tax is calculated.

> *Example.* Al and Barb, married taxpayers filing jointly, have $300,000 of salary income and $100,000 of NII. The amount subject to the net investment income tax (NIIT) is the lesser of (1) NII ($100,000) or (2) the excess of their MAGI ($400,000) over their threshold amount of $250,000 for married taxpayers filing jointly ($400,000 - $250,000 = $150,000). Because NII is the smaller amount, it is the base on which the tax is calculated. Thus, the amount subject to the tax is $100,000 and the NIIT payable is $3,800 (.038 x $100,000).

This creates new planning alternatives to avoid or reduce the effect of this tax. A number of strategies can be used to reduce modified adjusted gross income (MAGI) and/or net investment income. These include (1) Roth IRA conversions in 2013, (2) shifting to tax exempt investments such as municipal bonds, (3) investing in tax-deferred annuities, (4) life insurance, (5) oil and gas investments since they produce losses from intangible drilling costs and depletion, (6) losses from rental real estate as a result of depreciation, (7) the use of charitable remainder trusts, and (8) the use of installment sales. Please contact us for more information and planning ideas.

Don't Overlook Estate Planning

For 2013, the unified federal gift and estate tax exemption is a historically generous $5.25 million, and the federal estate tax rate is a historically reasonable 40%. Even if you already have an estate plan, it may need updating to reflect the current estate and gift tax rules. Also, you may need to make some changes for reasons that have nothing to do with taxes. Giving away assets now can help to reduce the size of your taxable estate. Keep in mind that transferring assets during lifetime in excess of the annual exclusion amount, does not remove the entire value at your death. Instead, it removes all appreciation and income earned on the asset after the date of the gift. For property that is likely to appreciate, the sooner it is given away the better for minimizing estate taxes. Contact us for more information on the best ways to minimize estate taxes for someone in your situation.

Even if you are not comfortable giving away the full $5.25 million you can transfer lesser amounts and still benefit. In addition, you can also give away the $14,000 annual gift tax exclusion amount per donee and your spouse can join you in this gift for an additional $14,000. For example, if you have three children you want to gift the annual exclusion amount to, you and your spouse can gift up to $84,000 before 12/31/13 free of gift tax with no requirement to file a gift tax return. There are special rules for gifts made for medical care and education that can be a valuable component of a year-end tax strategy, especially for individuals who want to help a family member or friend. Monetary gifts given directly to a college to pay

tuition or to a medical service provider are tax-free to the person making the gift and the person benefitting from education or medical care.

If you are charitable minded, a charitable remainder trust can offer tax advantages including a charitable deduction for a portion of the amount contributed to the trust and removal of the assets from your estate, while enjoying the income from the gift during your lifetime. This may also have benefits in reducing the impact of the new 3.8% tax on net investment income.

Another popular strategy which is used for larger estates and especially businesses is to establish an intentionally defective grantor trust (IDGT) which is treated as being outside the donor's estate for estate tax purposes. For example Donor A gifts $5 million to the trust. The trust uses that money to purchase Donor A's business. The end result is that the business is now in the IDGT, which may distribute the business to Donor A's children in the future, hold it in trust for the children's benefit (safe from future creditors), or might even be held for multiple generations as a dynasty trust. The benefit of this arrangement is that all future appreciation of the business now occurs inside the IDGT and is not part of Donor A's estate, effectively freezing the current value of the business for estate tax purposes. For income tax purposes, Donor A is taxed on the income from the trust, since it contains certain clauses within the governing trust instrument. There is nothing really defective about this kind of trust - it is set up intentionally this way. The Donor has to pay the income taxes on the trust income, further reducing his estate. One caveat is that the recent proposals from President Obama have taken aim at the IDGT strategy so if you are considering this as part of your estate plan, it would be prudent to do it soon before any change in the tax laws.

One last item of caution - the current legislation allows the surviving spouse of a decedent dying after 2010 to use the decedent's unused exclusion amount in addition to the surviving spouse's own exclusion amount. This provision, commonly referred to as "portability", is designed to simplify estate planning by reducing the need for spouses to retitle property or create trusts solely for the purpose of making sure that each spouse would fully utilize his or her exclusion amount. However, in order to make use of this portability provision, the executor of the estate of the deceased spouse must file an estate tax return and make an election on that return to allow the surviving spouse to make use of the deceased spouse's unused exclusion amount. This is necessary even if the deceased spouse's estate is not otherwise required to file an estate tax return. Accordingly, it is important to determine if this election makes sense (and it will in many situations) and have the estate tax return filed in a timely manner.

Foreign Account Reporting

Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR") is used to disclose information about foreign bank and other accounts to the Treasury and is due annually on or before June 30 of the year following the calendar year being reported. This return must now be electronically filed. The FBAR rules apply to all U.S. individuals and organizations that hold accounts in foreign countries. In addition to the FBAR reporting, taxpayers owning specified foreign accounts above certain threshold amounts (for jointly filed tax returns this is above $100,000 on December 31 or above $150,000 at any time during the year) must file Form 8938 with their federal income tax return. Specified foreign accounts include checking, savings, or brokerage accounts maintained at a foreign financial institution as well as other foreign financial assets. Compliance with these rules is complex and penalties associated with failure to report these accounts can be severe. In light of the heightened compliance initiatives taken by the IRS in this area, if you have any foreign accounts, please contact use for assistance in the preparation of these required disclosures.

Social Security Tax

For 2014, the first $117,000 of wages or self-employment income will be subject to social security ($113,700 in 2013). Tax rates will be 6.20 percent for employees and for employers. Self-employed individuals will pay 12.40%. In addition, the 1.45% Medicare component (2.90% for self-employed) of the FICA is applied to all wages or self-employed income with no limit. Self-employed taxpayers will continue to be allowed a deduction of one-half of the self-employment tax.

Effective for tax years beginning after December 31, 2012, there is a new additional Medicare Tax of 0.9% imposed on wages or self-employed income in excess of $250,000 for joint filers, $125,000 for married filing separately, and $200,000 for single taxpayers and heads of household. The threshold amounts are not indexed for inflation. The tax will be paid in two ways:

- Each employer must begin to withhold the additional Medicare Tax on employee wages in excess of $200,000 during the calendar year.
- Calculate the additional Medicare Tax on Form 1040 and increase withholding, pay estimated taxes during the year, or pay the tax due with the tax return when filed.

It is possible that the employer withholding will be in excess of what you may owe for the year, especially if your wages are below the threshold amount. To account for that, there will be a reconciliation of the amount owed on Form 1040 to determine if there is a refund due for the year or if any additional Medicare Tax is owed.

Inflation and Other Adjustments for 2013

The IRS announced the annual inflation adjustments for a number of tax provisions effective January 1, 2014. These include the following:

- The annual gift tax exclusion remains at $14,000 for 2014.
- The amount used to reduce the net unearned income reported on a child's tax return subject to the "kiddie tax" remains at $1,000.
- The catch-up contribution limit for employees aged 50 and over who participate in qualified plans remains unchanged at $5,500.
- The exclusion amount for estates of decedents who die in 2014 is $5,340,000 (up from a total of $5,250,000 in 2013).
- The elective deferral limit for employees who participate in a 401(k), 403(b) or 457 plan remains unchanged at $17,500.

Affordable Care Act

The Patient Protection and Affordable Care Act (PPACA) was passed by Congress in 2010, but it delayed the effective date of many key provisions until 2014. Essentially the PPACA makes health insurance mandatory for most Americans. The goal of this new health law is to provide access to quality, affordable health care coverage and to enroll millions of presently uninsured citizens. In order to accomplish this, there are mandates for employers and for individuals to provide and/or obtain health insurance coverage or face penalties for non-compliance. For certain eligible small business employers, with fewer than 50 full time employees, there are tax credits available to help subsidize the cost of providing health insurance to all employees. For certain eligible individuals whose income is below a threshold amount, there are government provided premium assistance credits to subsidize the cost of individual health insurance.

On October 1, 2013 the new health care marketplaces opened, better known as federal or state health exchanges. Employers and individuals have a choice of public or private marketplace options and can shop around to find the best health plan for one's needs. Unfortunately, the federal health care exchange experienced many problems and access to the site, at **www.healthcare.gov** can be difficult. The government is working to fix the problems but many people will still have trouble until the web access is improved. Fortunately for those living in New York State, the NY exchange, called New York State of Health, is up and running (go to **www.nystateofhealth.ny.gov**).

Some items to note regarding PPACA requirements:

- Small business employers who employ less than 50 full time equivalents are not required to provide health insurance to their employees but can voluntarily do so;
- The small business tax credit is only available if health insurance is purchased through the exchange and if certain other factors are met;
- Large employers, defined as employers with 50 or more full time employees (employees who work on average 30 hours or more per week are considered full time), must provide health insurance coverage to their employees or face a penalty of $2,000 per employee, starting with the 31st employee. This is known as the Employer Mandate. This requirement was scheduled to be effective for 2014 but was recently delayed one year to 2015;
- Large employers must also file a report each year that details the health insurance coverage provided to each employee and a list of all full time employees. This reporting has also been delayed one year with the first report now due on March 1, 2016 to report on the year 2015. These reports are filed with the IRS and a copy is provided to each employee by January 31 of each year;
- The individual mandate, requires all individuals to have health insurance coverage (called minimum essential coverage) each month beginning January 1, 2014, qualify for an exemption, or be liable for a penalty. The penalty, also called the shared responsibility payment, starts at the greater of $95 per adult and $47.50 per child (up to $285 per family) or 1% of income for 2014 and increases to the greater of $695 per adult and $347.50 per child (up to $2,085 per family) or 2.5% of family income for 2016. After 2016, the penalty continues to increase annually based on the cost of living.

As you can see, the Affordable Care Act is quite complex and each of us must review all of our options to choose the appropriate health insurance plan.

Social Security Benefits

The retirement earnings test exempt amount (the point at which retirees begin to lose benefits in conjunction with their receipt of additional earnings) was eliminated for individuals age 65 and older as of January 2000. However, it remains in effect for individuals under full retirement age but at least age 62, and a modified test applies for the year in which an individual reaches full retirement age (age 66 on 2013). The retirement earnings test exempt amount increases to $41,400 for 2014 (up from $40,080 in 2013) for the year in which an individual attains full retirement age; the test applies only to earnings for months prior to reaching full retirement age. One dollar in benefits will be withheld for every $3 in earnings above the limit and no limit on earnings will be imposed beginning in the month of the individual's reaching full retirement age. For years prior to the year in which a retiree reaches full retirement age, the retirement earnings test exempt amount increases to $15,480 for 2014 (up from $15,120 in 2013), with $1 withheld for every $2 in earnings above the limit. Full retirement age has been gradually increasing from age 65 and will reach age 67 for retirees attaining age 62 in 2022 and after i.e., born 1960 and later.

New York State Tax Issues

The following is a summary of the tax changes approved by the NYS Legislature and Governor Cuomo as part of the 2013-2014 Budget:

StartUp New York. Beginning in 2014 there are new tax-free areas to be established around the State's colleges and universities. New businesses that are related to the school's academic mission or companies creating new jobs and/or relocating to New York State that do not compete with existing local businesses are eligible. The benefits of locating in these areas are no corporate income tax for the next 10 years, no sales tax on purchases of property or services for the next ten years, and no property taxes for the next ten years. Employees of the businesses will pay no income taxes on wages from the business for the next five years and will be exempt on the first $200,000 (if single) or $300,000 (if married) of wages for years 6-10. This is effective beginning in 2014 but does not apply to retailers, wholesalers, restaurants, real estate brokers, law firms, accounting firms, doctors, dentists and a number of other types of businesses. It seems to be designed for manufacturing and high technology businesses.

Family Tax Credit. The budget creates a new credit, the family relief credit, designed to benefit middle income taxpayers with children for the 2014 through 2016 tax years. Eligibility is based on the tax return filed two years before the tax year in question. To be eligible those returns must have been for a New York resident with one or more dependent children under the age of 17 on the last day of the tax year, had NY adjusted gross income of at least $40,000 but less than $300,000 and had a tax liability for that tax year. The tax department will determine a taxpayer's eligibility in advance and those taxpayers will receive a check for $350 on or before October 15 of the tax year in question. There will be a reconciliation on the tax return when actually filed to determine eligibility, and any taxpayer who receives the advance payment but is not entitled to the credit, will have to repay it to the tax department.

Tax Rates. The budget extends the current personal income tax rate regime until 2017. For corporations, qualified manufacturers (100 or fewer employees) rates have been reduced from 6.5% to 3.25% until 2015.

Small Business Tax Reduction. For small businesses and farms, an income tax subtraction modification has been created equal to 5 percent of net income to be phased in over a three year period (3% in 2014, 3.75% in 2015, and 5% in 2016 and thereafter). This exemption is available to businesses and farms that employ at least one person and have less than $250,000 in net business income.

Minimum Wage Reimbursement Credit. From 2014 until 2019, a credit is allowed for employers who pay minimum wages to students between the ages of 16 and 19 to encourage hiring of employees in that age group and to help offset some of the increase in the minimum wage as it rises from $7.25/hour to $9.00/hour during that time period.

Driver's License Suspension. The budget established a new program that suspends New York State driver's licenses of taxpayers with past-due tax liabilities of at least $10,000 including interest and penalty. The tax department is required to notify the taxpayer of the pending license suspension at least 60 days prior to any suspension. The suspension can be lifted once the tax due is paid or if the taxpayer enters into an installment agreement or similar arrangement. A restricted use license is available to allow those taxpayers to travel to work, school and medical appointments.

Estate Tax For Same Sex Marriage. As a result of federal changes to same- sex marriage rules, the New York taxable estate of an individual in a marriage with a same-sex spouse must be computed in the same manner as if the deceased individual was married for federal estate tax purposes. Thus the marital deduction and various elections are allowed for a same-sex married couple on the New York State estate tax return. This provision is effective for estates of decedents who died on or after July 24, 2011, thus filing an amended estate tax return to claim these benefits can still be done.

New York State Items Worth Repeating from Prior Year's Legislation

LLC's, LLP's, and partnerships have to pay their annual filing fee 60 days after the close of the tax year. This means that most LLC's, LLP's, and partnerships must pay their filing fee by March 1 (or February 29 during leap years). For LLC's and LLP's the fee ranges from $25 for an entity with less than $100,000 of New York source gross income to $4,500 for those with $25 million or more. For partnerships the fee applies if their New York source gross income in the preceding year is $1 million or more. The fees begin at $500 at the $1 million level and increase to $1,500 for gross receipts greater than $1 million up to $5 million with a maximum fee of $4,500 for gross receipts over $25 million.

Due to the U.S. Supreme Court decision in June 2013, all same-sex marriages are recognized for all federal tax return purposes. As a result, federal filing status will now conform to NYS filing status as required by the Marriage Equality Act.

For personal income taxes, previous legislation eliminated all itemized deductions except for 50% of charitable deductions for taxpayers with New York AGI exceeding $1 million and 25% of charitable deductions for taxpayers with New York AGIs over $10 million.

For tax years beginning on or after 1/1/03, no Section 179 expense is allowed on the NYS tax return for any sport utility vehicle that weighs over 6,000 pounds. Amounts required to be added to federal gross income are not allowed as a deduction in computing NYS adjusted gross income in future years. Therefore the federal Section 179 deduction for SUV's is permanently lost in computing NYS adjusted gross income.

A line will continue to be included on the personal income tax return for taxpayers to report unpaid sales and use taxes. These taxes apply in situations where NYS or local sales tax is not collected at the time a purchase of taxable property or a taxable service is made. The most common event that would cause this is the purchase of taxable property outside of NYS. In lieu of actual records, a table is available to compute the amount of tax to be reported here. The sales and use tax must be paid on or before the due date of the income tax return without regard to filing extensions(thus due by 4/15/14).

If you have employees who work in the Metropolitan Transportation District of NYS (mostly Westchester, NYC and Long Island), there is a payroll tax on wages. This also applies to self-employed taxpayers who work in the district. The tax rate is 0.34% and is due quarterly. Note that a recent court decision found this tax to be unconstitutional but the New York State Tax Department was successful in its appeal. It is possible that the case may be appealed again by Nassau County. Quarterly returns are still required to be filed until the appeal is decided. To receive all refunds if the tax is found to be unconstitutional, protective claim forms should be filed as soon as possible. These are available on the New York State Tax Department website.

Tax Preparation

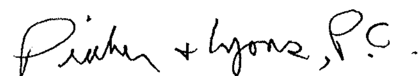
We again ask you to help us by getting your **complete** tax information to us as early in 2014 as possible. Certainly having your tax data here sometime between February 1 and March 1 will assist us in better handling our tax return load, and reduce the need for extensions. Our task becomes even more complicated due to the seemingly endless tax legislation and return preparer responsibilities imposed by the government. There are three items in this regard that are worth noting. First, as noted above, **New York State has enacted legislation that requires most tax preparers to e-file their clients' tax returns. As a result we are now mandated by law to e-file most of the tax returns we prepare.** This now includes individuals, partnerships, fiduciaries and corporations. Second, the IRS mandates that corporations, S-corporations and tax-exempt organizations e-file their 2013 tax returns due in 2014, if they have assets of $10 million or more and file 250 or more returns a year (941's, W-2's, 1099's and 1120 or 1120S). Affected organizations can request waivers from the electronic filing requirement where the taxpayer cannot meet the e-filing requirements due to technology constraints or where compliance would result in undue financial burden. In addition, the IRS has mandated the e-filing of all individual, trust and estate income tax returns. Third, there are disclosure rules for tax preparers. For certain positions taken on a tax return, preparers are required to disclose the tax position to the IRS or face a possible penalty. We will be discussing the effect, if any, on your situation when we prepare your 2013 tax return.

Conclusion

The foregoing discussion of these complex matters is not meant to be all-inclusive. There are many other areas affected by various tax legislation, which the constraint of space has not allowed us to develop. Through careful planning, it's possible your 2013 tax liability can still be significantly reduced. With advance preparation, it may also be possible to make a meaningful reduction in your 2014 tax liability. Don't wait until it's too late to cut your 2013 tax bill. Take time now, before year-end, to review your 2013 tax situation and consider tax saving strategies you still have time to implement. The ideas discussed in this letter are a good way to get you started with year-end planning, but they're no substitute for personalized professional assistance. Please don't hesitate to call us with questions this letter may have raised or for additional strategies on reducing your tax bill. And don't forget to check out our website, **www.pnlcpa.com**, for more tax tips and other information. We would be pleased to set up a planning meeting with you in the next few weeks or assist you in any other way that we can.

We are pleased to have served you in 2013. We look forward to our continued relationship in the years to come. We want to extend to you and your family best wishes for an enjoyable Holiday Season and may 2014 be a year full of peace, happiness, health and prosperity.

Sincerely,



PIAKER & LYONS, P.C.

To ensure our **CIRCULAR 230, FEDERAL TAX DISCLOSURE** compliance with certain U.S. federal tax regulations, we must inform you that, nothing contained in this communication (or any attachment hereto) relating to U.S. federal taxes was intended or written to be used, and cannot be used by any person for the purpose of (i) avoiding any federal tax penalties that may be imposed by the Internal Revenue Service or (ii) promoting, marketing or recommending to another party any matters addressed herein. In addition, any taxpayer should seek specific advice based on the taxpayer's particular circumstances from Piaker & Lyons, PC or an independent tax advisor with respect to any federal tax transaction or matter contained in this message.