Year-end tax planning is seldom a simple proposition. And it is especially complicated as 2013 draws to a close, mainly due to two important pieces of federal legislation.

First, the Patient Protection and Affordable Care Act of 2010 (the PPACA), which was generally upheld by the U.S. Supreme Court last year, includes several significant tax provisions for both individuals and employers. Certain changes in the PPACA, including imposition of a new 3.8% Medicare surtax on investment income, take effect this year.

Congress enacted the American Taxpayer Relief Act of 2012 (ATRA).

Second, in culmination of legislative efforts at the end of last year, Congress enacted the American Taxpayer Relief Act of 2012 (ATRA), signed into law early in 2013. This new law creates numerous tax-saving opportunities for individuals and small-business owners, but also includes several potential pitfalls to watch out for, especially for upper-income taxpayers. Notably, ATRA raises tax rates on ordinary income and capital gains, while reducing tax benefits for itemized deductions and personal exemptions for certain taxpayers. On a positive note, it provides greater certainty in estate planning through permanent extensions of generous estate- and gift-tax provisions and modifications of others.

Keeping all that in mind, we have prepared the following **2013 Year-End Tax-Planning Letter**. For your convenience, the letter has been divided into three sections:

- **Financial Tax Planning**
- **Individual Tax Planning**
- **Business Tax Planning**

Be aware that the tax-planning concepts discussed within this letter are intended only to provide an overview. It is recommended that you review your situation with a tax professional.

FINANCIAL TAX PLANNING

3.8% Medicare Surtax

Beginning in 2013, the 3.8% Medicare surtax applies to the lesser of your “net investment income” (NII) or the amount by which your modified adjusted gross income (MAGI) exceeds $200,000 for single filers and $250,000 for joint filers. The definition of NII includes interest, dividends, capital gains, income from passive activities, but not other items such as Social Security benefits, tax-exempt interest and distributions from qualified retirement plans and IRAs.

Year-end action: Take steps to reduce exposure to the 3.8% surtax. For instance, depending on your situation, you might use one or more of the following techniques.

Take steps to reduce exposure to the 3.8% medicare surtax.

- Add municipal bonds (“munis”) to your portfolio. Munis do not count toward NII or MAGI.
- Establish a charitable remainder trust (CRT). With a CRT, you qualify for a current tax deduction while the income is sheltered from the surtax.
- Become active in a passive activity. For example, if you own a business and meet the tax law requirements for “material participation,” the business income may be exempted from the surtax.
- Consider an investment in a tax-deferred annuity that “leapfrogs” your highest-earning years when the 3.8% surtax is likely to apply.

Of course, these decisions should not be made in a vacuum. Coordinate tax-related tax-saving strategies with other financial aspects.

Capital Gains and Losses

Capital gains and losses are used to offset each other. If you have a net loss, the excess may offset up to $3,000 of ordinary income. Any remaining loss is carried over to next year.

Traditionally, investors focus on “harvesting” capital losses from securities sales before year-end to offset prior gains. Conversely, if you are showing a net capital loss, you might realize capital gains at the end of the year that will be offset by prior losses.

Year-end action: Depending on your situation, harvest capital gains or losses. For 2013 and thereafter, the maximum tax rate on long-term capital gains is 20% (up from 15%) for single filers with taxable income above $400,000 and joint filers above $450,000. Therefore, you might realize long-term capital gains if you still benefit from the 15% rate this year or realize long-term capital losses to absorb capital gains that would be taxed at the 20% rate.

Note that taxpayers in the lowest two regular income tax brackets of 10% and 15% can benefit from a 0% tax on long-term capital gains. Thus, these individuals may also harvest capital gains before 2014. Of course, all the relevant economic factors should be considered.

Municipal bonds may be subject to the alternative minimum tax (AMT) and state or local taxes, and federal taxes would apply to any capital gains distributions. With tax-deferred annuities, there may be surrender fees as well as an early withdraw penalty if funds are withdrawn before the owner turns 59 1/2.

Required Minimum Distributions

As a general rule, you must receive “required minimum distributions” (RMDs) from qualified retirement plans and IRAs after you have reached age 70½. The amount of the distribution is based on special life-expectancy tables.

Year-end action: Arrange for RMDs before the end of the year to avoid potential problems. If you don’t take a timely RMD, you may owe a penalty equal to 50% of the required amount.

However, be aware of this special exception. If you are still working and not a 5%-or-more owner of the employer, you can postpone RMDs from the employer’s qualified plan until retirement. This rule does not apply to RMDs from IRAs.

Note that RMDs are not treated as NII for purposes of the 3.8% Medicare surtax in 2013. Nevertheless, an RMD may still increase your MAGI in the surtax calculation.

Roth IRA Conversions

There are two main types of Individual Retirement Accounts (IRAs): traditional IRAs and Roth IRAs. In brief, contributions to traditional IRAs may be tax deductible, but deductions are phased out for “active participants” in employer-sponsored retirement plans. Future distributions are taxed at ordinary income rates.

Conversely, Roth IRA contributions are never tax deductible, but qualified distributions from a Roth in existence five years are 100% tax-free. This includes distributions made after age 59½, on account of death or disability, and first-time homebuyer expenses (up to a lifetime limit of $10,000). Other distributions may be taxable under special “ordering rules.”

Year-end action: Consider converting some or all of the funds in a traditional IRA to a Roth. The transfer is currently taxable, but can provide future tax-free benefits. This is especially important if you expect to be in a higher tax bracket in the next few years.

Note that a Roth IRA conversion increases your MAGI for purposes of both regular income tax and the surtax calculation. Therefore, to reduce your overall tax liability, you might initiate a series of Roth IRA conversions over several years instead of converting all the funds this year. Your professional advisers can provide assistance.

Estate and Gift Taxes

Under a 2001 law, the top federal estate-tax rate was reduced from 55% to 45%, beginning in 2002, while the estate-tax exemption increased from $1 million to $3.5 million until the estate tax was repealed in 2010. Subsequently, a 2010 law reinstated the estate tax with a top rate of 35% and an exemption of $5 million (indexed to $5.12 million in 2012). Other related tax breaks, including portability of estate-tax exemptions between spouses, were included in the 2010 law.

Among other provisions, ATRA establishes a permanent top tax rate of 40% and estate-tax exemption of $5 million (indexed to $5.25 million in 2013). See the following chart.

Year	Top estate-tax rate	Exemption amount
2002	50%	$1 million
2003	49%	$1 million
2004	48%	$1.5 million
2005	47%	$1.5 million
2006	46%	$2 million
2007–2008	45%	$2 million
2009	45%	$3.5 million
2010	Repealed	Not applicable
2011	35%	$5 million
2012	35%	$5.12 million
2013	40%	$5.25 million

Year-end action: Ensure that your estate plan reflects the latest developments. For instance, ATRA permanently retains the portability provision for married couples, so wills and trusts may be revised to take this into account. Seek guidance from your professional advisers.

In any event, be aware that you still may reduce the size of your taxable estate through a series of lifetime gifts to family members. Under the annual gift-tax exclusion, you can give each recipient up to $14,000 in 2013 (up from $13,000 in 2012). The annual exclusion is doubled to $28,000 for joint gifts by a married couple.

Miscellaneous

- Under the "wash sale rule," you cannot deduct a loss on securities sales if you acquire substantially identical securities within 30 days. The simplest way to avoid this result is to wait at least 31 days before you repurchase the same or similar securities.
- Increase 401(k) plan contributions at year-end to boost retirement savings. The maximum deferral in 2013 is $17,500 ($23,000 if age 50 or older). For instance, you might defer more dollars to your 401(k) account after you clear the 2013 Social Security wage base of $113,700. This will not reduce your take-home pay if only the payroll tax savings are allocated to the 401(k) deferrals.
- An individual aged 70½ or older may transfer funds of up to $100,000 directly from an IRA to a qualified charity without paying any tax on the distribution. This provision, which has been extended before, is currently scheduled to expire after 2013.
- Consider investments in dividend-paying stocks. As with net long-term capital gains, the maximum tax rate on qualified dividends received in 2013 is generally 15% (20% for certain high-income taxpayers) while lower-income taxpayers may benefit from a 0% rate.

Dividends are not guaranteed and must be authorized by the company's board of directors.

Alternative Minimum Tax

Although ATRA provides some relief from the alternative minimum tax (AMT), millions of taxpayers will still be snared by this “stealth tax.” To determine if you will be liable for the AMT, you must use a special calculation involving “tax preference items,” technical adjustments and an exemption amount. After comparing the result to your regular income tax liability, you effectively pay the higher of the two.

The 2013 rate is 26% for AMT income up to $179,500 (up from $175,000 in 2012). Any amount above $179,500 is taxed at a 28% rate. Thus, the top AMT rate is significantly lower than the new top 2013 regular income tax rate of 39.6%.

Congress had approved temporary “patches” in the AMT exemption amounts for several years, but ATRA finally establishes a permanent solution. The chart below shows the recent trend.

Filing status	2010	2011	2012	2013
Joint filers	$72,450	$74,450	$78,750	$80,800
Single filers	$47,450	$48,450	$50,600	$51,900
Married filing separately	$36,225	$37,225	$39,375	$40,400

Exemption amounts are reduced for high-income taxpayers, but at slightly higher levels in 2013 than before. The reduction is equal to 25 cents for each dollar of AMT income above $153,900 for joint filers; $115,400 for single filers; and $76,950 for married couples filing separately.

Year-end action: Don’t wait until tax return time for an assessment. Have an estimate of your AMT liability for 2013 made now. Depending on the outcome, you may shift tax preference items to 2014 to avoid or reduce AMT liability for 2013. Alternatively, you might accelerate income into 2013 if you expect your regular top 2014 tax rate to be higher than your 2013 AMT rate.

Charitable Donations

Generally, you can deduct cash (or cash-equivalent) donations made to qualified charitable organizations if you meet the strict substantiation requirements in the tax law. Furthermore, if you donate appreciated property held for more than one year, you can generally deduct the property’s current fair market value. However, be aware that other limits may apply to charitable deductions.

Year-end action: Assuming you can deduct the full amount of your donations, step up charitable giving at year-end. For instance, if you charge a charitable gift by credit card in December, it is deductible on your 2013 return, even if you don’t pay the charge until January or later.

Conversely, if you expect to be in a higher tax bracket in 2014 than 2013, you might postpone large gifts to 2014 when they will be more tax-beneficial. However, this decision may be affected by a new rule for itemized deductions (more to follow).

Itemized Deductions/Personal Exemptions

Not all the individual income tax changes in ATRA are favorable. In particular, high-income taxpayers may be adversely affected by the reinstatement of two key provisions:

1. Under the "Pease rule" (named for the Congressman who originally introduced it), most itemized deductions—including those for charitable gifts, state and local taxes, and mortgage interest—are reduced by 3% of the excess above $250,000 of adjusted gross income (AGI) for single filers and $300,000 for joint filers (but not by more than 80% overall). These limits will be adjusted for inflation in future years.

2. The personal exemption phaseout (PEP) rule requires you to reduce personal exemptions by 2% for every $2,500 of AGI (or fraction thereof) above $250,000 for single filers and $300,000 for joint filers.

Year-end action: Due to the return of the Pease and PEP rules, you should analyze your situation at the end of the year. When appropriate, time certain deductions to your tax advantage. For example, you might postpone large charitable gifts to next year if you expect that your itemized deductions will be reduced under the Pease rule in 2013, but not in 2014.

Note that certain itemized deductions—typically, those with built-in floors—are not affected by the Pease rule. However, all personal exemptions, including those claimed for dependents, are subject to the PEP rule.

Family Income-splitting

Family income-splitting is even more meaningful in 2013. ATRA adds a new top tax rate of 39.6%, up from 35%, while the rate for taxpayers in the lowest income tax bracket is still only 10%. Thus, the tax rate differential between you and a low-taxed family member, like your child, could be 29.6%, not even counting the 3.8% Medicare surtax (more on this later).

Year-end action: Shift interests in income-producing property, such as securities, to other family members through direct gifts or trusts. Remember, however, that you are giving up control over those assets.

Also, be aware of the "kiddie tax." Unearned income above $2,000 received in 2013 by a child younger than 19 or a full-time student younger than 24 is generally taxed at the top marginal tax rate of the child's parents. Thus, if you're contemplating a shift of income-producing property to your child, don't forget to take the kiddie tax into account.

Medical Expense Deductions

Under the PPACA, the rules for deducting medical expenses are even tougher for young and middle-aged taxpayers. Beginning in 2013, you can deduct only unreimbursed expenses in excess of 10% of your AGI. Previously, the limit was 7.5% of your AGI. The limit remains at 7.5% of AGI through 2016 for taxpayers aged 65 or older.

Frequently, you have no control over timing of medical or dental expenses. In other cases, however, you may be able to schedule visits like physical examinations or dental cleanings.

Year-end action: Move non-emergency expenses into the optimal tax year for claiming deductions. For instance, if you are near or already over the 10%-of-AGI threshold for 2013, you may accelerate expenses into this year. Otherwise, you might as well delay expenses to 2014, when you could have a chance at a deduction.

Move non-emergency expenses into the optimal year for claiming deductions.

For this purpose, you may count the unreimbursed expenses you pay for your immediate family as well as other tax dependents such as an elderly parent or in-law. Paying these expenses may qualify you for a deduction or boost an existing deduction.

Miscellaneous

- It usually makes sense to prepay state and local taxes due on January 1 of the next year to increase your deduction for the current year. However, if you expect to be in a higher tax bracket in 2014 than you are in 2013, you might bypass this common tax strategy.
- When state law permits, you may consolidate outstanding personal debts into a home equity debt. Interest on personal debts is not tax-deductible, but you can deduct mortgage interest paid on the first $100,000 of home equity debt, no matter how the proceeds are used. Remember that the debt must be secured by your home, so use this technique judiciously.
- Miscellaneous expenses are deductible only in excess of 2% of your AGI. As with medical expenses, you might arrange to pay qualified expenses (e.g., tax assistance fees) before 2014 to increase your deduction for 2013.
- Parents may claim one of two credits, the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC) or a tuition deduction for a child's qualified higher education expenses. However, the tax benefits are phased out for high-income taxpayers. The enhanced AOTC, reinstated by ATRA and extended through 2013, is generally more favorable than the LLC.
- You may be liable for an "estimated tax penalty" if you fail to pay enough tax through any combination of withholding or quarterly installments. But you can avoid the penalty by paying enough to satisfy a "safe harbor" of 90% of current tax liability or 100% of the previous year's tax liability (110% if your AGI was above $150,000).
- A taxpayer may qualify for a 10% credit for the cost of installing energy-saving improvements in the home (subject to certain other limits). The credit, which had expired after 2011, was reinstated and extended through 2013 by ATRA. But there is a lifetime $500 cap on this credit.
- ATRA revives the optional states sales tax deduction and extends it through 2013. The deduction, which may be claimed in lieu of deducting state and local income taxes, may be based on an IRS table. You can add sales tax on certain big-ticket items, such as cars and boats, to the table amount.

BUSINESS TAX PLANNING

Section 179 Deductions

Under Section 179 of the tax code, a business may currently deduct, or "expense," the cost of qualified property placed in service during the year, up to a maximum amount. The deduction phases out on a dollar-for-dollar basis for amounts above an annual threshold. For 2013, ATRA preserves a generous $500,000 maximum deduction, with a $2 million phaseout level. But the deduction is scheduled to drop to only $25,000 for 2014, with a $200,000 threshold. See the chart below showing the recent trend.

Tax year	Deduction limit	Phaseout threshold
2007	$125,000	$500,000
2008–2009	$250,000	$800,000
2010–2013	$500,000	$2 million
2014 (scheduled)	$25,000	$200,000

Year-end action: Acquire qualified property in 2013 to benefit from the higher Section 179 deduction. Make sure that the property is actually placed in service in 2013 to qualify for a current deduction.

Note that the Section 179 deduction is available for used, as well as new, business equipment. However, the deduction cannot exceed your taxable income from business activities. Keep this rule in mind when you make year-end purchases.

Bonus Depreciation

Generally, a business may write off the cost of qualified property over a specified cost recovery period (commonly known as "depreciation" deductions) based on the type of property. In addition, recent tax legislation has authorized a "bonus" depreciation deduction. For 2013, 50% bonus depreciation is available for qualified property. Qualified property includes property with a cost-recovery period of 20 years or less and certain software, leasehold improvements and water utility property.

Year-end action: Cash in on this tax break by placing qualified property in service before 2014. Under current law, bonus depreciation is generally not available after 2013.

Bonus depreciation may be claimed in conjunction with Section 179 and regular depreciation under the Modified Accelerated Cost Recovery System (MACRS). However, unlike deductions claimed under Section 179 (see above), bonus depreciation is not available for used property.

Finally, MACRS deductions are generally reduced if business property (other than real estate) placed in service during the last quarter of the year (October 1 through December 31) exceeds 40% of the cost of assets placed in service during the entire year. Be aware of this potential tax trap as the end of the year nears.

Business Bad Debts

During difficult times, your business may have difficulty obtaining payments for goods or services it provides. At least you may be able to salvage some tax relief for business bad debts on a 2013 tax return.

Year-end action: Step up your collection activities before 2014. For instance, you may issue a series of dunning letters to debtors before the end of the year. If you are still unable to collect the unpaid amount, you may be able to write it off as a business bad debt.

Generally, business bad debts are deducted from taxable income in the year they become worthless. To qualify as a business bad debt, a loan or advance must have been created or acquired in connection with your business operation and result in a loss to the business entity if it cannot be repaid.

Finally, keep detailed records of all your collection activities—including letters, telephone calls, e-mails and efforts of collection agencies—in your files. This documentation can help support your position based on the worthlessness of the debt if the IRS ever challenges the bad debt deduction.

Business Start-up Costs

Under current law, a business owner may claim a first-year deduction of up to $5,000 of qualified start-up costs. Any remainder must be amortized over 180 months. However, the $5,000 write-off is phased out on a dollar-for-dollar basis for start-up costs exceeding $50,000.

Generally, start-up costs are expenses that would normally be deductible as business expenses. This includes investigatory expenses such as the following:

- an analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- advertisements for the opening of the business
- salaries and wages for both employees who are being trained and their instructors
- travel and other necessary costs for securing prospective distributors, suppliers, or customers or clients
- salaries and fees for executives and consultants or for similar professional services

Year-end action: Make sure that you are officially "open for business" before the end of the year. Otherwise, you will not be entitled to the current $5,000 deduction in 2013. The actual event that triggers an opening will vary according to the type of business and the particular circumstances.

The election for start-up costs must be made by the tax return due date. If a timely election for 2013 is not made, the expenses must be capitalized.

Make sure that you are officially "open for business" before the end of the year.

Repairs and Improvements

From a tax perspective, there is a difference between "repairs" and "improvements." While expenses spent on making repairs are currently deductible, the cost of improvements to business property must be capitalized. The IRS issued new regulations in 2013 clarifying the distinctions between repairs and improvements.

As a general rule of thumb, a repair keeps property in efficient operating condition while an improvement prolongs the life of the property, enhances its value or adapts it to a different use. For example, fixing a broken window is a repair, but the addition of a new wing to business building is treated as an improvement.

Year-end action: When appropriate, schedule minor repairs to be made before the end of the year. The deductions can offset taxable income of your business in 2013.

If you make repairs and improvements at the same time, the IRS may group the cost of the repairs with the improvements as part of a "general rehabilitation plan." Therefore, if you prefer a current deduction for repairs, it may be better to handle them at a different time.

When appropriate, schedule minor repairs to be made before the end of the year.

Miscellaneous

- Purchase routine business supplies before the end of the year. Your company can generally deduct the costs in 2013 even if the supplies will not be used until 2014.
- Losses claimed by S corporation shareholders are limited to the basis in the stock plus outstanding debt. Thus, shareholders might make a capital contribution or loan money to the corporation before year-end to increase the basis for loss deduction purposes.
- A company may deduct 100% of business travel costs and 50% of entertainment and meal expenses. To increase your current deduction, accelerate trips planned for 2014 into 2013. Note that a company can deduct 100% of the cost of a holiday party as long as the entire workforce is invited.
- If you buy an SUV for business driving, you may be able to claim a first-year deduction of up to $25,000. The usual "luxury car limits" don't apply to certain heavy-duty vehicles.
- When you qualify for home office deductions, you may deduct certain expenses incurred in connection with the business use of the home. Beginning in 2013, the IRS has approved a new simplified home office deduction, capped at $1,500.
- Under the PPACA, a qualified "small business" may claim a tax credit of up to 35% of the cost of contributions to purchase health insurance for its employees. The credit begins to phase out for employers with more than 10 employees with average annual wages above $25,000. The credit is scheduled to increase to 50% of contributions in 2014 and thereafter.
- When it makes sense, defer compensation, like a year-end bonus, to 2014. Besides regular income tax, "earned income" above $200,000 for single filers and $250,000 for joint filers is subject to a new 0.9% Medicare surtax in 2013 and thereafter (not to be confused with the following surtax).

2014 PLANNING ITEMS

Information Just Released

Social Security Cost of Living increase will be 1.5%. Based on that increase, the maximum amount of earnings subject to Social Security tax will increase from $113,700 to $117,000.

Retirement Plan Contribution Limits will remain the same for 2014:

	IRA / ROTH IRA	401(k), 403 (b), 457	Simple IRA / Simple 401(k)
Under 50 Years of Age	$5,500	$17,500	$12,000
Over 50 Years of Age	$6,500	$23,000	$14,500

CONCLUSION

This year-end tax-planning letter is based on the prevailing federal tax laws, rules and regulations. Of course, it is subject to change, especially if major tax reform provisions are enacted before the end of the year.

Finally, remember that the letter is intended only as a general guideline. Your personal circumstances will likely require greater examination. We will be glad to schedule a meeting with you to provide assistance with all your tax-planning needs.

The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation. Any opinions are those of Center for Finacial Planning, Inc. and not necessarily those of RJFS or Raymond James.

This year-end tax-planning letter is published for our clients, friends and professional associates. It is designed to provide accurate and authoritative information with respect to the subject matter covered. IRS Circular 230 requires us to inform you that the information contained in this letter is not intended or written to be used for the purpose of avoiding any penalties that may be imposed under federal tax law and cannot be used by you or any other taxpayer for the purpose of avoiding such penalties. Before any action is taken based on this information, it is essential that competent, individual, professional advice be obtained.

Please note, changes in tax laws may occur at any time and could have a substantial impact upon each person's situation. While we are familiar with the tax provisions of the issues presented herein, as Financial Advisors of Raymond James Financial Services, Inc., we are not qualified to render advice on tax or legal matters. You should discuss tax or legal matters with the appropriate professional.

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