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# Tax Planning in 2013 for Individuals and Small Business Owners

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Congress has given us some stability and guidance for tax purposes in the form of the American Tax Relief Act of 2012 (ATRA 2012). Personal and tax planning are more important than ever. Begin early to implement tax savings plans and manage your assets.

## Plan for the New Income Tax Thresholds

Summary of Provisions: ATRA extended the 10% income tax bracket on income up to $17,850, and the 15% to 35% individual tax brackets on taxable income at or below certain thresholds: $400,000 (individual filers), $425,000 (heads of households), $450,000 (married filing jointly and surviving spouses), and $225,000 (married filing separately). The thresholds will be adjusted annually for inflation. On the portion of income above these thresholds, the marginal tax rate on ordinary income rose from 35% to 39.6%. The top tax rate on long term capital gains and qualified dividends rose from 15% to 20%, which are also considered 'investment income' subject to the 3.8% Medicare surcharge.

ATRA preserves personal exemptions and itemized deductions without reduction for taxpayers with an adjusted gross income under $250,000 ($300,000 for married couples filing jointly). Above that threshold, the personal exemptions phase out and itemized deductions are subject to reduction.

Our thoughts:

- You or your business may benefit from participating in a higher deductible health savings account medical insurance plan. Many taxpayers are not aware that these accounts grow tax free, and provide long term savings opportunities.
- Adjusting taxable investments towards growth, equity or municipal bond vehicles should help reduce tax.
- If you are a business owner, within the parameters of your business needs, evaluate whether you have implemented the most tax advantageous qualified retirement plan that allows you to save as much pre-tax retirement savings as possible. In doing so, beware of get-rich-quick schemes and be sure to get reliable advice.
- The spread between ordinary income and the top tax rate on long term capital gains has never been greater. Put another way, even at 20% (plus the 3.8% Medicare surcharge) the

top capital gains and qualified dividend tax rate is historically low compared to the highest income tax rate.

## Estate and Legacy Planning after ATRA

ATRA made permanent the $5M personal estate tax exemption adjusted annually for inflation. Oregon, Washington and many other states continue to impose a state estate tax. Here in the Pacific NW, we must still consider the impact of the state estate taxes, with rates beginning at 10% above the personal exemption amount. Assets in the gross estate above the exemption, which is $2M in Washington and $1M in Oregon, remain subject to the unlimited marital deduction and marital trust planning to preserve the exemption for both spouses.

Summary of Provisions: The estate, gift and generation-skipping transfer tax regime that became familiar after TRA 2010 is made permanent. Gift, estate and generation-skipping transfer tax exemptions are unified, by keeping the exemption (applicable exclusion amount) at $5 million (as adjusted for inflation in multiples of $10,000 after 2011). For 2013, the exemption is $5,250,000. The gift and estate tax rate is 40%. Portability of the unused exemption of a deceased spouse was made permanent, allowing the executor to preserve the unused gift and estate tax exemption of a deceased spouse.

Our Thoughts:

- For those of you who completed gifts in 2012, you have permanently removed the appreciation of those assets from your estate for gift and estate tax purposes. For many of you, even if the current law is sufficiently ‘permanent’ to survive your lifetime, you have successfully reduced the estate and gift tax that would otherwise be owed on those assets.
- Whether you have used up your lifetime gift tax exemption or not, the annual gift tax exclusion is still law. In 2013, you can make annual gifts of $14,000 ($28,000 for a married couple) per person per year. You can also make unlimited tax free gifts through direct payments of qualified tuition and medical expenses.
- Some of our clients made gifts that exhausted their lifetime estate and gift tax exemption based on the law applicable in 2012, and they still have federal estate tax exposure. Annually, those taxpayers can make a tax free gift of the annual inflation increase. For example, if you made a gift of $5.12M in 2012, you can make a gift of another $130,000 ($260,000 for a married couple) in 2013.
- We still recommend trust planning for non-tax reasons such as creditor protection, protection against elder financial abuse and family squabbling. A child or grandchild’s divorcing spouse is the most likely family creditor. A good irrevocable trust can be written with income tax planning in mind. In the modern world, without a plan we are at risk of loss of financial and emotional security.
- ATRA did not address perceived estate and gift tax “loop holes” such as discounting for fractional interests gifts, grantor retained annuity trusts, or other estate tax savings strategies. Therefore, a window still exists to utilize various planning techniques for larger taxable estates.



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