



Tax changes for 2013

Topics

- Medicare tax on net investment income
- Medicare tax on earned income
- Significant income tax changes
- Other items
 - Foreign investment account reporting
 - IRAs
- Recommendations

Medicare taxes on net investment income and earned income

- Enacted through Health Care and Education Reconciliation Act of 2010
- Expected to raise \$60 billion estimated to be similar to Medicaid expansion cost
- **3.8%** of net investment income exceeding total income of \$250,000 MFJ, \$200,000 Single
- **.9%** of earned income exceeding \$250,000 MFJ, \$200,000 Single . This is in addition to regular Medicare tax of 1.45% as employee or 2.9% as self-employed.
- In effect creates third system of tax

Categories of investment income

1. Interest , dividends, annuities, royalties and rents. Does not included pension or IRA distributions
2. Certain income from trades and businesses
3. Net gain from the sale of property such securities, real estate, and etc.

Expenses deducted to determine net investment income

- Rental expenses
- Allocable investment expenses
- Allocable state income tax
- Net losses from sale of property are not included

Passive activities

- Rental income
- Trade or business income that is not actively engaged
- Flow through entities
 - Publicly traded partnerships
 - S corporations
 - Limited liability companies and partnerships
 - Trusts

Rentals to actively engaged businesses

- Rentals usually are on a triple net basis – expenses paid by business
- A grouping election may be made with active business to assist in avoiding tax
- Election is one time and permanent

Installment sales are allowed

- Helps reduce regular tax
- May keep net investment income under the threshold
- May be better to elect out if income is unusually low

Sales of interests in S corporations and partnerships

- Requires look through of interest to determine FMV of assets sold
- Any premium is investment income
- Difficulty in obtaining information to calculate

Real estate professional

- Not deemed to be a trade or business
- Elections to group properties need to be reviewed
- Sales of properties may be includible

Working capital income is net investment income for pass through entities

- Temporary CDs
- Money market accounts
- Overnight repo investing

Trusts

- Income passed to beneficiary is taxed to beneficiary
- Income retained by trust in excess of maximum tax bracket (\$11,950 for 2013) is subject to tax
- Usually capital gains are retained by trust
- Will impact overall trust cash flow and accumulation

Medicare tax on earned income

Applies to earned income in excess of \$250,000 MFJ and \$200,000 Single. Examples are:

- Salary
- Schedule C earnings
- Pass through self-employed income from partnerships

Significant income tax changes

Federal

- New tax bracket of 39.6% when income exceeds \$450,000 MFJ or \$400,000 Single
- When income exceeds the above thresholds qualified dividends and long term capital gains are tax at 20% not 15%
- Itemized deductions are reduced by 3% of income in excess of \$300,000 MFJ and \$250,000 Single. Maximum reduction of itemized deductions is 80%. Medical expenses are not reduced.

Federal

- Loss of 2% of exemptions for every \$2,500 above \$300,000 MFJ and \$250,000 Single
- Trust tax rate for ordinary income is 39.6% above \$11,950 of income

Significant income tax changes

State of Maine

- Total itemized deductions are capped at \$27,500
- Maximum tax rate reduced from 8.5% to 7.95%
- Many miscellaneous credit changes that apply to a very few

Other items – Foreign investment account

- Accounts greater than \$10,000 must file form 114
- Accounts greater than \$100,000 MFJ and \$50,000 Single on last day of year or highest of \$150,000 MFJ and \$75,000 Single must file form 8938
- US owners of foreign corporations must file 5471
- Other filing may be necessary
- \$10,000 penalties for each omission

Other items - IRAs

- If reduced income year due to economy, accelerated depreciation or etc consider conversion of taxable IRAs to Roth
- If no taxable IRA use non deductible with conversion to Roth
- Review all pension and IRA beneficiary designation

Recommendations

- Maximize pretax fringe benefits
- Use installment sales
- Maximize pension plan contributions
- Utilize accelerated depreciation or section 179 where possible for businesses
- Consider Roth conversions in low tax brackets

Recommendations

- Use appreciated stock for contributions
- Use IRA for 2013 to contribute to charities
- Use tax free exchanges if possible
- Review wills and estate plans

Questions

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