Professional, Personal & Financial Management

Since 1980

Issue 158 January 21, 2013

2013 is a REAL GAME CHANGER

When It Comes To The Management Of Ones Investments

(This is not Tax Advice- I'm doing the best I can with the current interpretations of the New Tax Act, also consulting with Craig Ludin, CPA) What you are about to read is a **much simplified** version of the Act. Even many "experts" disagree on many of the details as the rules themselves are much more complicated than this.

WOW!! There are now very significant changes that, in my opinion place the person managing or advising you on your investments having to wear two hats, both an Investment Person and a Knowledgeable Tax Person. Why? Things just got a lot more complicated. In the past we always worked on reducing or eliminating a clients' Realized Short Term Capital Gains by taking Short Term Losses. Although that takes some time, it's been no problem for us to do it. Now it is really different. There is still the one old item but also four new items that should be addressed:

1. Reducing or eliminating short term capital gains (as we had done in the past).
2. Addressing the LONG TERM CAPITAL GAINS and DIVIDENDS. The tax is based upon your **Taxable Income** to determine at what rate your gains will be taxed. Could be 0%, 15% or 20% on a graduated scale.
3. Limitation of itemized deductions based upon your **Adjusted Gross Income**. (PEASE AMENDMENT)
4. Phaseout of Personal Exemptions based upon **Adjusted Gross Income**.
5. The new 3.8% Affordable Care Act Tax, based upon Investment Income, rents, etc., based upon **AGI.**

There are things that can be done to reduce your tax bite, but they MUST be done before the year is over, NOT when the tax return is done. Keep in mind I am primarily addressing things that can be done with your investments, not your entire tax picture. That is up to your very knowledgeable accountant.

Typical questions that might be asked:

1. Should I take extra money from my IRA which would raise my AGI and cause additional taxes?
2. Should I sell some stocks in which I have long term losses to drop my AGI and Taxable Income?
3. What can I do to lower my AGI which would save me extra taxes generated by all 5 items above? If I need money, where should I take it from?
4. Last year I made the maximum gift of my Lifetime Exclusion. Since it is indexed it is now $130,000 greater. Shouild I make an additonal tax free gift?
5. Can I still pay for my grandchild's medical and educational bills? If so, can I make the gift to my children and have them pay these expenses?
6. Is there any reason to change my investment asset allocation?
7. Can I still make 5 years worth of gifts to someone's 529 Plan?
8. Which items of both Income and Expense affects my Adjusted Gross Income?

IN MY OPINION (and at this point, maybe only mine) IF YOUR INVESTMENT PERSON DOESN'T ASK TO SEE YOUR PREVIOUS YEAR'S TAX RETURN, AND EITHER KNOWS OR DISCUSSES WITH YOU AND YOUR ACCOUNTANT, YOUR ESTIMATED DEDUCTIONS, OTHER INCOME, CHANGES SINCE LAST YEAR, ETC. **<u>YOU HAD BETTER GET A NEW INVESTMENT PERSON.</u>** (Fortunately, Steven majored in Accounting in College and Arthur did also and he went on to pass the CPA exam.)

Let me just give you an example of one thing that can be done that might save you a lot of money, and after that you may or may not want to read more details that follow. Let's say you are 70 1/2 or greater this year and have an IRA. You also donate to charity and your TOTAL Adjusted Gross Income exceeds $200,000. (AGI is all Income, regardless how taxed, including IRA withdrawals, and BEFORE your allowable deductions.) If your income is high enough, you can lose 80% of your Deductions (Including Charitable Deductions). This year only, you could make your Charitable Contribution out of your IRA up to the lower of your Required Minimum Distribution, or $100,000. This would give you the advantage of, in essence, making your charitable contribution fully deductible, while also lowering your Adjusted Gross Income which might let you deduct more of your expenses, therefore lowering your Taxable Income which also might lower your tax rate on Long Term Gains and Dividends, and might lower the threshold for taxing some of the 3.8% Affordable Care Act Tax, as well as possibly being able to deduct more of your personal exemptions. If you've had enough, read no further, but please know that we are knowledgeable on how the tax code will affect your investments and will try as best we can to minimize your tax bite when it comes to Investments.

Now let me address more details (First of all, for the typical Revocable Trust, which many people may have, there is no difference here. Gains, losses, dividends, interest are all just put on your personal Income Tax Return.):

(continued on page 2)

(continued from page 1)

First, the Taxpayer Relief Act (although where the word Relief came from is well beyond me). (In these examples I am disregarding all deductions and exemptions.) First total all of your income from sources other than Investments. On this non-investment income you would pay whatever tax bracket you fell into. Then there are two Threshold Amounts related to your Investment Income (which I will define as Long Term Capital Gains and Qualified Dividends, for this Act). These Thresholds are $72,500 joint ($36,500 single) and $450,000 joint ($400,000 single). Let's use the joint thresholds. Now for example you had non investment Income of $60,000 and Investment income of $500,000. (For this example let's not do any calculations on your non Investment Income.) Your tax rate on your investment income would be 0% on the first $12,500 (the first Threshold of $72,500 minus $60,000s), 15% on the next $377,500 ($450,000 minus $72,500 - the amount below the second threshold and above the first) and 20% on $110,000 (the amount above the second threshold).

Another Example: Non Investment Income of $300,000 and the same Investment Income of $500,000. Your tax on Investment Income would be 15% on $150,000 ($450,000 minus $300,000 - Second Threshold minus Non Investment Income) and 20% on the $350,000 above the upper threshold. So you don't think that this just doesn't apply to upper income folks: Non Investment Income of $30,000 and Investment Income of $50,000. No tax on $42,500 ($72,500 minus $30,000) and 15% tax on $7,500. Keep in mind of course that if your Non Investment Income totals over $450,000, all of your Investment Income would be taxed at 20%. (Now, keep in mind I said "qualified dividends." This category is pretty broad, however the underlying stock must be held for at least 61 days within a specified 121-day period.)

You must keep in mind that the limitation on your allowable deductions is based upon your Adjusted Gross Income, which includes **all** Income which includes Investment Income as well. *Now* it gets even more confusing!

Second ***Pease Limitation*** which affects itemized deductions. That threshold for married couples is $300,000. Therefore your otherwise deductible itemized deductions will be reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds the threshold. Certain items, such as medical expenses are excluded. (Remember if you are over 70 ½, you can basically keep your charitable deduction by making your contributions from your IRA.) Your gift from your Uncle Sam? Your Itemized Deductions cannot be reduced more than 80%. Thank You!

Third there is also a phaseout of ***Personal Exemptions*** which goes into effect for married taxpayers if the threshold of $300,000 of Adjusted Gross Income is exceeded. To make things even more complicated, the Pease Limitation and the phaseout of Personal Exemptions is based on ADJUSTED GROSS INCOME (bottom number on page 1). The threshold for capital gains and dividends is TAXABLE INCOME (middle of page 2, the amount on which the tax is calculated).

Fourth is the additional tax generated by the ***Affordable Care Act***. First, the current Medicare Tax is 2.9% of your salary and Self Employment Income. 1.45% paid by the employee and 1.45% paid by the employer. That goes up by 0.9% to 3.8% with the additional amount paid solely by the employee on salary and self employment income over $200,000 (single) and $250,000 (joint). That total of 3.8% is now to be paid by all taxpayers on Investment Income (that's new). This is based on Adjusted Gross Income and is paid on the Investment Income (as defined above, but in this case **includes** not only dividends and long term gains, but also Rental Income (Schedule E) and Passive K-1 partnership income) which exceeds the AGI threshold of $200,000 for singles and $250,000 for married couples.

Don't get excited, AMT, Alternative Minimum Tax didn't go away.

It ain't over Friends. If you are involved with a TRUST, you get stuck with the increase from 15% to 20% but the THRESHOLD AMOUNT IS $11,950. For Trusts, the same threshold amount is used for the 3.8% Affordable Care Act. This could easily create a situation whereas you could reduce the Investment Income to the Trust which could lower the Investment Income which falls above the Trust Threshold to the Personal Tax Return that may not be in the Personal 20% Bracket.

OKAY, where to go from here. At the Aranda Group we can take care of everything. We will consult with your accountant, and attorney if necessary and you of course. Once we are all in agreement, we can execute whatever it is agreed to do with your investments. PLEASE REMEMBER this is not something that is just done for the tax preparation but it is done during the year. By next April it is too late to do any of the things that can be done. We really can't address this in December. We MUST have an ongoing grasp of what is going on.

Did we know the details of what was coming? NO. But since we have been working to try and save our clients' money when it comes to taxes. YES, WE ARE MOST DEFINITELY READY. It is just a further refinement of what we do. I realize that our Newsletters are passed around. I reiterate. Your Investment Person MUST be aware of the changes in the tax code and be prepared to act accordingly, DURING THE YEAR. I believe this is the first time there have so many different Thresholds which happen to generate so many ways to save or waste your tax dollars.

STAFF

Arthur Rosenberg............................Chairman
Steven Rosenberg..............President & CEO
Jacki Simmons.....................Vice President
Tom Gallagher.............Investment Assistant
Joanne Keller...............Investment Assistant
Allen Hefner........................Client Services
Erica Gurian.......................Client Services
Bill Harbison.............................Accounting
Denise Secora........................Client Services
Patrick Crean..........................Client Services

THE ARANDA GROUP
The Aranda Building
724 Old York Road
Jenkintown, PA. 19046-2833
Phone - 215-576-6666
Toll Free- 877-272-4033
Fax- 215-884-0356
Web Site
www.arandagroup.com