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CERTIFIED PUBLIC ACCOUNTANTS

Plan Now to Prepare for the Looming Fiscal Cliff of 2013

As a taxpayer, you are facing what is perhaps an unprecedented set of circumstances – the expiration of the tax rates enacted in 2001, the expiration of more than 150 tax provisions, and a tax increase of more than $500 billion overall – that could result in a much higher tax liability when you file your next return.

If Congress and the President do not make changes, the combined effect could result in an average tax hike of around $3,500 per household for up to 90% of Americans. We want to inform you of possible tax increases and loss of tax benefits that could negatively impact your finances. We encourage you to **contact us** to start planning now – there may be some steps you can take immediately to soften the impact on your bottom line.

We have come to the edge of a "fiscal cliff," as it is being called, because of several events that will have an impact all at once:

- Tax cuts enacted during the Bush Administration are set to expire at year-end.
- A new 3.8% Medicare surtax on some investment income will become effective Jan. 1, 2013.
- A 2% reduction in the payroll taxes that fund Social Security expires on Dec. 31, 2012.
- Changes to some itemized deductions could increase the rate on ordinary income to an effective rate that is as much as 44.6% for some taxpayers.
- A possible increase on long-term capital gains could push rates from 15% to 20% and the rate on qualified dividends could jump to an effective 44.6% from 15% today.
- A rise in the estate tax rate from 35% to 55%, and a cut in the exclusion amount for what is subject to estate taxes from $5.12 million to $1 million.
- A reduction in the Alternative Minimum Tax Exemption that will impact tens of millions of taxpayers.
- Potential across-the-board budget cuts in both defense and non-defense spending.

Many of these changes will have an impact on businesses and call for tax planning and quick action to soften the potential burden, particularly if you operate as a pass-through entity, as many tax increases will also affect individuals.

We are recommending that clients take a two-pronged approach that involves 1) addressing many of the possible changes directly while 2) also making use of all options for deductions and credits, or other tax-advantaged opportunities to lower taxable income. Planning for these changes should begin now, since it may involve significant modifications in your tax strategy.

START WITH SOUND TAX PLANNING STEPS

It is always wise to check the following items off of your year-end tax planning list:

- Make the greatest possible contribution to your 401(k) or other employer-based retirement plan. A contribution of pretax income to a plan not only lowers your taxable income, but it may also be eligible for a matching contribution from your employer to your retirement account. You can enhance your retirement income by contributing enough to receive the maximum match offered.
- Do not leave your 401(k) investments on auto pilot. Review the investment mix to determine if you are maximizing value.

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- Set up or contribute to a 529 college savings plan. Your earnings on these accounts grow tax-free as long as they are ultimately used for qualified education expenses.
- In many states, taxpayers are required to pay a use tax on Internet purchases when the seller did not collect sales tax on that purchase. This is a good time to determine whether you might be subject to a use tax so that it's not a surprise later.
- Determine if you must begin taking a required minimum distribution from a retirement account. Taxpayers generally must begin taking them during the year in which they reach 70½ (although the first year's payment may be delayed until April 1 of the following year).
- Wherever possible, use valuable credits, such as the American Opportunity Credit, which can be used for the first four years of college. For eligible taxpayers, it is a dollar-for-dollar reduction of taxes owed. If your tax bill is going to rise, such credits will become even more valuable.

FOR SMALL BUSINESSES, REVIEW THESE CONSIDERATIONS FOR DEDUCTIBLE EXPENSES

- Under Section 179 of the tax code, small businesses can deduct the total cost of some qualifying property in the year it is placed in service, rather than depreciating it over time. The limit on the cost of property (including real property) that can be expensed is now $139,000. The total value of the equipment purchased cannot be higher than $560,000.
- As of Jan. 1, 2013, the expensing limit is set to drop and real property, some of which is allowed now, will no longer be included. As a result, businesses may want to consider making equipment or property purchases before year-end to take advantage of the higher expense amount.
- With the expiration of the current 50% first-year bonus depreciation allowance, businesses will have to revert to the modified accelerated cost recovery system to calculate depreciation. This means more costs will have to be deducted over time rather than immediately.

PREPARE FOR THE WORST CASE SCENARIO – REVIEW TAX-ADVANTAGED OPPORTUNITIES

Review your mix of investments and consider the following options:

- Move into tax deferred or federally non-taxable investments like municipal bonds.
- Lower your net investment income or modified adjusted gross income if you may be subject to the 3.8% surtax on certain passive income of individuals, trusts and estates.
- Gift to family members now to avoid the confusion from the estate tax issues. If you'd like the beneficiaries of your will to avoid a possible spike in estate tax, you can give them up to $13,000 a year tax free right now. Sharing the wealth now may also make it possible to reduce the value of your overall estate so that little or none of it is subject to estate taxes when your beneficiaries inherit it. The annual exclusion for gifts will rise to $14,000 in 2013, up from $13,000 in 2012.
- Review your estate planning as the $5 million lifetime exemption is set to expire and be replaced with a $1 million exemption and higher estate tax rates.
- Accelerate ordinary income into 2012. If you have flexibility on when you can receive payments of income before year end, consider that they may be subject to lower taxes than in 2013. Another option may be to convert a traditional IRA to a Roth IRA this year, if a conversion otherwise makes sense. Or reverse a conversion if it has not benefited your IRA accounts to have made the conversion.
- Defer expenses into 2013 but take care not to violate accounting method rules.
- Delay some contributions. If you always make year-end donations to favorite charities, consider putting them off until January 2013 so they can offset the higher tax rates that may come into play then. If you have securities that have appreciated in value, consider donating them to charities to avoid potential new taxes on dividends.

NOTE THESE ADDITIONAL TAX FACTS FOR 2013

- The Standard Business mileage rate will be 56.5 cents per mile.
- The 401(k) elective deferral limit will increase to $17,500 while the catch-up limit remains the same at $5,500.
- The Social Security taxable wage base will increase to $113,700 from $110,100.

We can help you understand the effect these possible increases could have on your unique tax situation and create strategies to minimize the impact. Contact RotenbergMeril today at cpas@rmsbg.com.