

tax planning strategies

In addition to saving income taxes for the current and future years, tax planning can reduce eventual estate taxes, maximize the amount of funds you will have available for retirement, reduce the cost of educating your children, and assist you in managing your cash flow to help you meet your financial objectives.



Now, more than ever, individuals and families should take steps to maximize income and gift tax savings, taking into consideration their own specific economic, financial and tax situation.

In addition, tax planning can reduce eventual estate taxes, maximize the amount of funds you will have available for retirement, reduce the cost of educating your children, and assist you in managing your cash flow to help you meet your financial objectives.

Specifically, tax planning strategies can defer some of your current year's tax to a future year, thereby freeing up cash for investment, business or personal use. This can be accomplished by timing when you pay certain expenses, or controlling when your income is recognized. Tax planning can also help you take advantage of tax rate differentials between years. However, if tax rates rise in a subsequent year, extra caution may be necessary. Tax planning can also help you prevent, or minimize, the impact of the alternative minimum tax ("AMT") by preserving the tax benefit of many of your deductions.

The key things you need to understand as you look for ways to minimize your taxes are:

- Residents of states with high income and property taxes, such as New York, California, Connecticut, Pennsylvania and New Jersey, are most likely to be subject to the AMT.
 - For 2012, long-term capital gains generally were subject to a maximum tax rate of 15% (with rates as low as 0% for lower income taxpayers). However, short-term capital gains were taxed as high as 35%. For 2013 and beyond, the top long-term capital gains tax rate is 20%, in addition to the 3.8% Medicare Contribution Tax on unearned income. The top short-term capital gains tax rate is 43.4%, inclusive of the Medicare Contribution Tax.
1. What happens if you currently have a capital loss carry forward? In that case, you may wish to consider utilizing the capital loss carryforward against any 2013 capital gains.
 2. Under current law, the complex netting rules have the potential effect of making your long-term gains subject to short-term rates, so you must carefully time your security trades to ensure that you receive the full benefit of the lowest capital gains tax rate.

YEAR-END TAX PLANNING TIPS

Tax Tip 1 gives you a snapshot of key strategies that will help you achieve your goals. It includes planning ideas to help you reduce your current year's tax as well as ideas to reduce your future taxes. While this chart is not all inclusive, it is a good starting point to

help you identify planning ideas that might apply to your situation. Keep in mind that many of the strategies involve knowing what your approximate income and tax rates will be for the current and subsequent years, and then applying the applicable tax law for each year to determine the best path to follow. Implementation of many of these ideas requires a thorough knowledge of tax laws, thoughtful planning and timely action.

TAX PLANNING GOALS

Proper tax planning can achieve the following goals:

- Lower this year's tax.
- Defer this year's tax to future years.
- Reduce your tax in future years.
- Maximize the tax savings from allowable deductions.
- Minimize the effect of the AMT on this year's tax liability.
- Take advantage of available tax credits.
- Maximize the amount of wealth that stays in your family.
- Minimize capital gains tax.
- Avoid penalties for underpayment of estimated taxes.
- Free up cash for investment, business or personal needs by deferring your tax liability.
- Manage your cash flow by projecting when tax payments will be required.
- Minimize potential future estate taxes so you can leave the maximum amount to your beneficiaries (and/or charities) rather than the government.
- Maximize the amount of money you will have for your retirement and education funding for your children.

Timing when you pay deductible expenses and when you receive income (to the extent you have control) can permanently reduce your taxes — especially if you are subject to the AMT in one year but not another. Timing expenses and income can also defer some of your tax to next year (or even later years) giving you, rather than the government, use of your money.

To gain the maximum benefit, you need to project, as best you can, your tax situation for the current and subsequent years so you can identify your tax bracket for each year and determine whether the AMT will likely affect you in either or both years. Included in your projections should be your year-to-date realized capital gains and losses. Be sure to consider prior year loss carry forwards (if any). Based on these results, you can decide what steps to take before year-end. Should you prepay deductions and defer income, or defer expenses and accelerate income, realize capital losses, or lock in capital gains?

Tax Tip 2 offers basic guidance for deciding when to prepay or defer deductible expenses and when to defer or collect income. Tax Tip 3 offers steps to follow when deciding whether to take capital gains and losses, and the type of gains and losses you should trigger.

STEPS TO TAKE IF THE AMT APPLIES EITHER THIS YEAR OR NEXT

As a general rule, if your year-end projection indicates that you will be in the AMT, or are highly likely to be in the AMT, it is very important that you do not pay any of the following expenses before the end of the year, since they are not deductible in computing your AMT and you will receive no tax benefit from the deduction:

- State and local income taxes
- Real estate taxes
- Miscellaneous itemized deductions such as investment expenses and employee business expenses

Conversely, if it looks like you will not be in the AMT in the current year, you should try to prepay as many of the above expenses as possible to receive the maximum tax benefit. Keep in mind, though, that the more you prepay, the more likely that you will end up in the AMT.

EXPENSES YOU CAN PREPAY

Here are the most common deductible expenses you can easily prepay by December 31, 2013, if appropriate:

Charitable Contributions

You can deduct cash charitable gifts totaling up to 50% of your adjusted gross income (“AGI”) and charitable gifts of appreciated capital gain property up to 30% of your AGI (30% and 20%, respectively, if given to a private non-operating foundation).

State and Local Income Taxes

If you are not in the AMT this year, you can prepay before December 31, 2013 your fourth quarter 2013 state estimated tax payment due on January 15, 2014, and even any state income tax you project will be due on April 15, 2014. You will gain the benefit of deferring part of your federal income tax liability and protect those deductions that could be lost if you fall into the AMT in 2014. Prepaying these taxes will probably outweigh any lost earnings on the use of the funds. However, be careful that the prepayment itself doesn’t put you into the AMT.

Real Estate Taxes

Like state and local income taxes, prepaying 2014 taxes early can be an especially beneficial strategy should you end up subject to the AMT next year, but would not be if you are in the AMT in 2013.

Miscellaneous Itemized Deductions

Miscellaneous itemized deductions are deductible for regular income tax purposes only if they exceed, in the aggregate, 2% of your AGI and you are not subject to the AMT. Bunching these deductions to gain the most favorable tax result may be a viable strategy.

Mortgage Interest

Consider prepaying your January 2014 mortgage payment in 2013 in order to accelerate the deduction into the current year.

Margin Interest

Be sure to pay any margin interest before December 31, 2013 since interest accrued at year-end is only deductible if actually paid.

Business Equipment

You can accelerate purchases of business equipment before the end of the year to take advantage of expanded expensing allowances, subject to certain limitations. To qualify, the property must be placed in service in 2013.

INCOME YOU CAN ACCELERATE OR DEFER

Timing income can be more difficult than timing deductions, but here are some types of income that you may be able to control the timing of receipt so that you can gain the advantage of having the income taxed in a year that you are in a lower tax bracket.

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KEY TAX PLANNING STRATEGIES

Situation	Planning idea	Detailed discussion
Your regular tax rate will be the same or lower next year and the AMT will not apply in either year.	<ul style="list-style-type: none"> ■ Prepay deductions. ■ Defer income. 	Pg 6
Your regular tax rate will increase next year and the AMT will not apply in either year.	<ul style="list-style-type: none"> ■ Defer deductions. ■ Accelerate income, but only if the tax rate increase warrants accelerating tax payments. 	Pg 6
The regular tax rate applies this year and is higher than the AMT rate that you expect will apply next year.	<ul style="list-style-type: none"> ■ Prepay deductions, especially if they are not deductible against the AMT and would therefore be lost next year. These deductions include state and local income taxes, real estate taxes, and miscellaneous itemized deductions such as investment fees. ■ Defer income. 	Pg 22
This year you are in the AMT and next year you will be subject to a higher regular tax rate.	<ul style="list-style-type: none"> ■ Defer deductions, especially those not allowed against the AMT that would be lost this year. ■ Accelerate income. 	Pg 22
You have net realized capital losses this year or loss carryforwards from last year.	<ul style="list-style-type: none"> ■ Consider recognizing capital gains by selling appreciated securities to offset realized losses and loss carryforwards. 	Pg 9
You have net realized capital gains this year.	<ul style="list-style-type: none"> ■ Sell securities with unrealized losses to offset the gains — if market conditions justify it. ■ Use a bond swap to realize losses. ■ Consider tax implications of netting rules. ■ Avoid wash sale rules. 	Pg 9 Pg 36 Pg 33 Pg 35
You are contemplating purchasing new business equipment.	<ul style="list-style-type: none"> ■ Accelerate the purchases into 2013 to take advantage of bonus depreciation and section 179 deductions available this year. (Purchases must be placed in service in 2013.) 	Pg 27
Your miscellaneous deductions will be reduced due to the limitation based on 2% of your AGI.	<ul style="list-style-type: none"> ■ Bunch these deductions into a single year, thereby increasing the deductible amount. Make sure you avoid the AMT. 	Pg 10
A penalty for underpayment of estimated taxes will apply.	<ul style="list-style-type: none"> ■ Withhold additional amounts of tax from your wages before December 31. ■ Prepay fourth quarter estimates due January 15 and increase the payment amount, if necessary. 	Pg 20
You want to diversify a concentrated low-basis stock position and avoid paying taxes currently.	<ul style="list-style-type: none"> ■ Consider using a charitable remainder trust that will allow you to sell the stock in exchange for an annuity. This will allow you to defer the tax while benefiting a charity of your choice. 	Pg 62

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KEY TAX PLANNING STRATEGIES

Situation	Planning idea	Detailed discussion
You have incentive stock options that you can exercise.	<ul style="list-style-type: none"> ■ Consider exercising your options to start the long-term holding period, but only if the spread between the market price of the stock and the exercise price will not put you into the AMT. 	Pg 40
Your passive activity losses exceed your passive income.	<ul style="list-style-type: none"> ■ Dispose of an activity that is generating passive losses in order to deduct the suspended loss on that activity. 	Pg 51
You would like to make significant charitable contributions.	<ul style="list-style-type: none"> ■ Donate appreciated securities you have held for more than one year. ■ Consider establishing a charitable trust or a private foundation, or take advantage of a donor-advised fund. 	Pg 60 Pg 62
You need funds for personal use, such as improvements to your home in excess of the mortgage limitations or to pay tax liabilities.	<ul style="list-style-type: none"> ■ Sell marketable securities with little or no appreciation to fund your needs, and then use margin debt to purchase replacement securities. The interest on the debt will be deductible, subject to investment interest limitations. ■ Take distributions, if available, from partnerships, limited liability companies, or S corporations on income that you have already paid taxes on. Just make sure you have sufficient tax basis and are “at risk” in the entity. 	Pg 68 Pg 28
You want to take advantage of the tax-deferred nature of retirement accounts.	<ul style="list-style-type: none"> ■ Maximize your contributions to your retirement accounts and take advantage of the best plans available to you prior to December 31, 2013. 	Pg 72
You expect the value of your IRA to appreciate over time, and you want to position your IRA now so that there will be little or no tax impact when you or your beneficiaries take distributions later.	<ul style="list-style-type: none"> ■ Consider converting your traditional IRA into a Roth IRA in the current year. However, this will cause a current tax liability. 	Pg 75
<p>You have a sizeable estate and want to protect your assets from estate tax.</p> <p>You want to transfer assets to your designated beneficiaries during your lifetime.</p>	<ul style="list-style-type: none"> ■ Make gifts of \$14,000 to each individual in 2013. ■ Pay beneficiaries’ tuition and medical expenses directly to the providers. ■ Use your lifetime gift tax exclusion of \$5.25 million (effective for 2013 only; for 2014 and beyond, the exclusion will be indexed for inflation). ■ Create a grantor retained annuity trust (“GRAT”). ■ Set up a family limited partnership (“FLP”) or family limited liability company (“FLLC”). ■ Make loans to your beneficiaries at minimum required interest rates. 	Pg 79
You want to provide for your children’s and/or grandchildren’s college costs.	<ul style="list-style-type: none"> ■ Establish and fund a 529 plan that can grow tax-free as long as you use the funds to pay qualified education expenses. 	Pg 90

Cash Salaries or Bonuses

If you anticipate that your 2013 income tax rate will be lower than the 2014 rate, you can accelerate salary or bonuses into 2013. You would need to determine if there are strict limitations on amounts that can be accelerated. However, if the 2014 rate is lower than your 2013 rate, it may make sense to defer such income until 2014.

Consulting or Other Self-Employment Income

If you are a cash-basis business, you can accelerate income into 2013, if your 2013 tax rate is anticipated to be lower than the 2014 rate. Otherwise, you would want to defer such income.

Retirement Plan Distributions

If you are over age 59 1/2 and your tax rate is unusually low this year, you can consider taking taxable distributions from your retirement plan even if they are not required, or consider a Roth IRA conversion.

IRA Distributions to Charity

Tax-free distributions from individual retirement accounts (IRAs) to public charities can be made by individuals age 70 1/2 and older, up to a maximum of \$100,000 per taxpayer per year through

December 31, 2013. Special transition rules allow taxpayers to re-characterize distributions made in January 2013, as though made in 2012. Also, taxpayers may treat a distribution made from the IRA in December 2012 as a charitable distribution if transferred to the charity before February 1, 2013.

Capital Gains

The following ideas can lower your taxes this year:

- If you have unrealized net short-term capital gains, you can sell the positions and realize the gains in 2013 if you expect your 2014 tax rate to be higher. For example, this may be a good strategy if the gain will be taxed at the AMT rate of 28% this year but at 39.6% next year (exclusive of the additional Medicare Contribution Tax). But you would only consider this strategy if you do not otherwise intend to hold the position for more than 12 months, making it eligible for the long-term capital gain rate of 20% in 2013 and beyond, exclusive of the additional Medicare Contribution Tax. However, you may be able to apply the netting rule which may result in the offsetting of long-term losses to short-term gains, resulting in a tax savings of 39.6% rather than 20%.

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2 YEAR-END TAX TIPS

Nature of deduction or income	You will not be in the AMT this year or next year and your 2014 tax rate		You are in the AMT*		
	will be the same as 2013 or will decrease	will increase	only this year	this year and next year	only next year
Charitable contributions, mortgage interest, investment interest and self-employed expenses	Prepay	Defer	Defer	Prepay	Prepay
State and local income taxes, real estate taxes, and miscellaneous deductions that are not deductible if you are in the AMT	Prepay	Defer	Defer	Defer	Prepay
Income such as bonuses, self-employed consulting fees, retirement plan distributions, and net short-term capital gains (unless you have long-term losses offsetting the gains)	Defer	Collect	Collect	Defer	Defer
Miscellaneous itemized deductions bunched (not deductible for the AMT) into a single year to exceed the 2% AGI income floor	Prepay	Defer	Defer	Defer	Prepay

(Legend = Prepay before Dec. 31, 2013/Defer into 2014 or later/Collect before Dec. 31, 2013)

*The chart assumes your regular tax rate on ordinary income is higher than the maximum AMT tax rate of 28%.

- Review your portfolio to determine if you have any securities that you may be able to claim as worthless, thereby giving you a capital loss before the end of the year. A similar rule applies to bad debts.
- Consider a bond swap to realize losses in your bond portfolio. This swap allows you to purchase similar bonds and avoid the wash sale rule while maintaining your overall bond positions.
- Similarly, you may consider selling securities this year to realize long-term capital gains that may be taxed at the more favorable rate this year, and then buying them back to effectively gain a step-up in basis. Because the sales are at a gain, the wash sale rules do not apply.

Real Estate and Other Non-Publicly Traded Property Sales

If you are selling real estate or other non-publicly traded property at a gain, you would normally structure the terms of the arrangement so that most of the payments would be due next year and you can use the installment sale method to report the income. This would allow you to recognize only a portion of the taxable gain in the current year to the extent of the payments you received, thereby allowing you to defer much of that tax to future years. However, for 2012 transactions, you may instead accelerate the recognition of the entire long-term capital gain into 2012, by electing out of the installment sale treatment. This may be beneficial since the

long-term capital gains rate inclusive of the Medicare Contribution Tax of 23.8% in 2013 and beyond is higher than the 2012 tax rate of 15%, and thus you may save substantial taxes by accelerating the gain into 2012. Since the election does not have to be made until your 2012 tax return is filed in 2013, you do have time to make this decision.

U.S. Treasury Bill Income

If you have U.S. Treasury Bills maturing early in 2014, you may want to sell these bills to recognize income in 2013 if you expect to be in a lower tax bracket this year than next year.

BUNCHING DEDUCTIONS

Bunching miscellaneous itemized deductions from two different years into a single year may allow you to exceed the 2% of AGI limitation that applies to these deductions. If you have already exceeded the 2% floor, or will do so by prepaying some of next year's expenses now, prepay the following expenses by December 31, 2013 (assuming you will not be in the AMT this year):

Investment Expenses

These include investment advisory fees, custody fees, and investment publications.

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YEAR-END CAPITAL GAINS AND LOSSES

If you have

Both short-term and long-term losses

Long-term gains in excess of short-term losses

Both short-term and long-term gains, or short-term gains in excess of long-term losses

Worthless securities and bad debts

Consider taking these steps

Sell securities to recognize unrealized gains, preferably if held short-term, up to the amount of your losses less \$3,000.

Take losses equal to the net gain, plus \$3,000. Use long-term loss positions first, then short-term loss positions.

Take losses equal to the net gain, plus \$3,000. Use long-term loss positions first to gain the benefit of offsetting short-term gains (taxed at a rate as high as 39.6% plus 3.8% Medicare Contribution Tax).

Identify these securities and debts and take the necessary steps to ensure that the losses are deductible in the current year, by having the proper substantiation.

Note: If you are married filing separately substitute \$1,500 for \$3,000 in the above tip.

Professional Fees

The most common of these fees are income and gift/estate tax planning and tax return preparation, accounting, and legal fees (to the extent deductible).

Unreimbursed Employee Business Expenses

These include business travel, meals, entertainment, vehicle expenses and publications, all exclusive of personal use. You must reduce expenses for business entertainment and meals (including those while away from home overnight on business) by 50% before the 2% floor applies.

Medical Expenses

These expenses are only deductible if they exceed 7.5% of your AGI in 2012. For 2013 and beyond, the threshold is 10%. For AMT purposes, the threshold is 10%. Therefore, bunching unreimbursed medical expenses into a single year could result in a tax benefit. Medical expenses include health insurance and dental care. If you are paying a private nurse or a nursing home for a parent or other relative, you can take these expenses on your tax return even if you do not claim the parent or relative as your dependent, assuming you meet certain eligibility requirements.

ADJUST YEAR-END WITHHOLDING OR MAKE ESTIMATED TAX PAYMENTS

If you expect to be subject to an underpayment penalty for failure to pay your 2013 tax liability on a timely basis, consider increasing your withholding and/or make an estimated tax payment between now and the end of the year in order to eliminate or minimize the amount of the penalty.

UTILIZE BUSINESS LOSSES OR TAKE TAX-FREE DISTRIBUTIONS

It may be possible to deduct losses that would otherwise be limited by your tax basis or the "at risk" rules. Or, you may be able to take tax-free distributions from a partnership, limited liability company or S corporation if you have tax basis in the entity and have already been taxed on the income. If there is a basis limitation, consider contributing capital to the entity or making a loan under certain conditions.

PASSIVE LOSSES

If you have passive losses from a business that you do not materially participate in that are in excess of your income from these types of activities, consider disposing of the activity. The tax savings can be significant since all losses become deductible when you

dispose of the activity. Even if there is a gain on the disposition, you can get the benefit of having the long-term capital gain taxed at 23.8% inclusive of the Medicare Contribution Tax with all the previously suspended losses offsetting ordinary income at a potential tax benefit of 43.4% inclusive of the Medicare Contribution Tax.

INCENTIVE STOCK OPTIONS

Review your incentive stock option plans ("ISOs") prior to year-end. A poorly timed exercise of ISOs can be very costly since the spread between the fair market value of the stock and your exercise price is a tax preference item for AMT purposes. Other issues include avoiding a cash flow problem on the exercise of options and funding taxes as a result of an exercise. You may wish to consider accelerating the recognition of such income into 2013 if such rates are lower than the 2014 rates. This strategy can also apply to nonqualified options.

ESTATE PLANNING

If you have not already done so, make your annual exclusion gifts to your beneficiaries before the end of the year. For 2012, you were allowed to make tax-free gifts up to \$13,000 per year, per individual (\$26,000 if you are married and use a gift-splitting election, or each spouse gives \$13,000 from his or her separate funds). For 2013, the annual exclusion is increased to \$14,000 per individual (\$28,000 if you are married and elect gift-splitting). By making these gifts, you can transfer substantial amounts out of your estate without using any of your lifetime exclusion. Also, try to make these gifts early in the year to transfer that year's appreciation out of your estate. Further, because of the increased lifetime gift exclusion, you may wish to make additional gifts to fully utilize such exclusion of \$5.25 million (\$10.5 million for married couples) in 2013. Future exclusions are indexed for inflation. When combined with other estate and gift planning techniques, such as a GRAT, you could have the opportunity to avoid estate and gift taxes and transfer a great deal of wealth to other family members who may need financial assistance.

TAX STRATEGIES FOR BUSINESS OWNERS

Timing of Income and Deductions

If you are a cash-basis business and expect that your 2013 tax rate will be higher than your 2014 rate, you can delay billing until January 2014 for services already performed, thereby deferring your tax until next year. Alternatively, if you expect to be in a higher tax bracket next year, or the AMT applies this year, you can accelerate billing and collections into the current year to take advantage of the lower tax rates.

Similarly, you can either prepay or defer paying business expenses so that the deduction comes in the year that you expect to be subject to the higher tax rate. This can be particularly significant if you are considering purchasing (and placing in service) business equipment. If you are concerned about your cash flow and want to accelerate your deductions, you can charge them on your credit card. This will allow you to take the deduction in the current year, when the charge is made, even though you may actually pay the outstanding credit card bill after December 31, 2013.

Business Equipment

Significant tax benefits are available for immediate expensing of business equipment purchases in 2013. The 50% bonus depreciation is effective for qualified property placed in service in 2013.

Section 179 expensing rules allow you to fully deduct up to \$500,000 of qualifying property placed in service in 2013. However, this rule only applies if the total amount of qualifying property placed in service in 2013 does not exceed \$2 million.

Business Interest

If you have debt traced to your business expenditures — including debt used to finance the capital requirements of a partnership, S corporation or LLC involved in a trade or business in which you materially participate — you can deduct the interest “above-the-line” as business interest rather than as an itemized deduction. The interest is a direct reduction of the income from the business. This lets you deduct all of your business interest, even if you are a resident of a state that limits or disallows all of your itemized deductions.

Business interest also includes finance charges on items that you purchase for your business (as an owner) using your credit card. These purchases are treated as additional loans to the business, subject to tracing rules that allow you to deduct the portion of the finance charges that relate to the business items purchased. Credit card purchases made before year-end and paid for in 2014 are allowable deductions in 2013 for cash basis businesses.

Conclusion

Now more than ever, effective tax planning is crucial if one is to achieve certain financial goals.

2013 personal tax guide

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