

Proactive Year-End Financial and Tax Planning Series:

Year-End Financial and Tax Planning Strategies to Address ATRA and the Net Investment Income Tax

Presented by:

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Introduction

▶ About the PFP Section & PFS Credential

- The AICPA PFP Section provides information, resources, advocacy and guidance for CPAs who specialize in providing estate, tax, retirement, risk management and investment planning advice to individuals and their closely held entities
- The CPA/Personal Financial Specialist (PFS) credential distinguishes CPAs as subject-matter experts who have demonstrated their financial planning knowledge through experience, education and testing

Today's Speakers



Beth Gamel, CPA/PFS, AEP®

Pillar Financial Advisors, Inc.



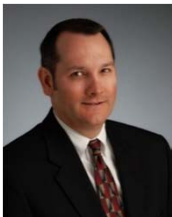
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Agenda

- ▶ **Year-end planning strategies for addressing:**
 - American Tax Relief Act (ATRA)
 - Net investment income tax

- ▶ **Throughout the event, panelists will discuss planning strategies to consider with clients before Dec. 31 related to:**
 - Tax
 - Estate
 - Investment
 - Retirement
 - Insurance
 - Healthcare reform

Overview of New Tax Considerations Under ATRA

Determining The Marginal Tax Rate For Various Types Of Income In 2013

Individual income above...	Couple's income above...	Income "type"	Ordinary Income	AMT rate	L/T gains & qual. dividends	Wage earned income	Self-employed earned income	Net inv. income	Itemized deduction phaseout (Pease)	Personal exemption phaseout (PEP)*	AMT exemption phaseout
\$0	\$0	Taxable	10%	26%	0%	7.65%	15.30%	0%	0%	0%	0%
\$8,950	\$17,900	Taxable	15%								
\$36,250	\$72,500	Taxable	25%								
N/A	\$113,700	Earned	28%	15%	0% / 1.45%	0% / 2.9%	0%	0%	0%	6.5% / 0%	
\$87,850	\$146,400	Taxable									
\$112,500	N/A	AMTI									
\$113,700	N/A	Earned	33%	28%	1.45%	2.90%	3.80%	1%	1%	6.5%	
N/A	\$150,000	AMTI									
\$175,000	\$175,000	AMTI									
\$183,250	\$223,050	Taxable	35%	20%	2.35%	3.80%	3.80%	1.05%	0% / 1.1%	7%	
\$200,000	\$250,000	Earned									
\$200,000	\$250,000	AGI									
\$250,000	\$300,000	AGI	39.6%	0%	1.2%	0%	0%	0%	0%	0%	
\$323,000	N/A	AMTI									
\$372,500	N/A	AGI									
\$398,350	\$398,350	Taxable									
N/A	\$422,500	AGI									
\$400,000	\$450,000	Taxable									
N/A	\$473,000	AMTI									

Income thresholds based on estimated 2013 inflation adjustments (where applicable).

Where two rates are shown, the first applies to individuals, the second to married couples

* Phaseout per exemption

© 2013 This chart was created by Michael Kitces for the November/December 2012 issue of The Kitces Report.

www.kitces.com

Comparison of 2012 and 2013 Rates

	<u>2012</u>	<u>2013</u>	<u>2013</u>	<u>Adj</u>
Top Ordinary Income Rate - Salary	35%	39.6%	41.292%	*
Top Ordinary Income Rate - Investment Income	35%	39.6%	44.192%	**
Top Capital Gain Rate	15%	20%	24.592%	***
Top Tax Rate on Dividends	15%	23.8%	24.592%	***
Payroll Tax	10.40%	12.4%	12.4%	
Medicare Surtax on Investment Income	0%	3.8%	3.8%	****
Payroll Surtax on Earned Income	0%	0.9%	0.9%	
Estate Tax Rate	35%	40%	40%	
*Includes phase-out of deductions and 0.9% healthcare wage tax				
**Includes 3.8% Surtax and phase-out of deductions				
***20% base rate plus 3.8% Surtax plus 0.792% adjustment for itemized deductions				
****Threshold amounts are \$200,000 for single filers, \$250,000 for joint returns, and \$11,950 for Estates/Trusts				

The government is reopen...for now

Continuing Appropriations Act

- ▶ Debt ceiling suspended until Feb. 7
- ▶ Provides sufficient funding to reopen government through Jan. 15
- ▶ Establishes congressional budget conference that would issue a report no later than Dec. 13
- ▶ Help protect the U.S. credit rating from a threatened downgrade that would have affected borrowing costs
- ▶ S&P 500 increased in response to the news
- ▶ Standard & Poor's estimated that as of the day before the agreement, the shutdown had cost the U.S. economy \$24 billion, cutting roughly 0.6% from inflation-adjusted Q4 gross domestic product.** (S&P also estimated that had there been a default, the result would have put the economy into recession.)

*Source: U.S. Treasury Resource Center (www.treasury.gov) Daily Treasury Yield Curve Rates as of 10/17/2013.

**Source: Standard & Poor's press release, October 16, 2013.

Healthcare Reform

- ▶ **2014 rules for those who do and don't have insurance**
- ▶ **Insurance exchanges**
- ▶ **Small business considerations**
 - Pay the penalty or provide insurance?
 - Educating employees if insurance isn't provided
- ▶ **Important to educate clients now so that they can adequately prepare**
- ▶ **Visit aicpa.org/pfp for more information**
 - Podcast and webcast archive (under CPE & Events)

Key Planning Concerns Following DOMA

- ▶ Estate Tax Returns
- ▶ Portability for 2011 and 2012 returns
- ▶ IRA Rollovers
- ▶ Gift Tax Returns
- ▶ Gift Splitting
- ▶ **Recall:** Same-sex spouses are married for ALL federal tax purposes
- ▶ Visit aicpa.org/pfp for more information
 - Podcast and webcast archive (under CPE & Events)

Considerations Following DOMA

▶ Revenue Ruling 2013-17:

- In short, regardless of what state the same-sex couple currently lives in, if they were legally married in a jurisdiction that recognizes same-sex marriages as legal and valid, then same-sex spouses are married for ALL federal tax purposes.

▶ Filing status:

- Same-sex married couples:
- Living in a same-sex marriage state
 - Married for federal tax purposes
- Living in a traditional marriage state
 - Married for federal tax purposes
- Effective date:
 - Filed after 9/16/2013 – same-sex spouses must use MFS or MFJ
 - Filed before 9/16/2013 – may choose, but are not required to amend return

Income Tax & Retirement Planning

2013 Ordinary Income Tax Rates

- ▶ **10%, 15%, 25% and 28% rates from Bush Administration tax cuts made permanent**
- ▶ **33% and 35% rates made permanent up to certain threshold levels—**

Single taxpayers	\$400,000
Head of households	\$425,000
Married filing jointly or surviving spouse	\$450,000
Married filing separately	\$225,000

- ▶ **Amounts of income above these threshold levels taxed at 39.6%**
- ▶ **Threshold amounts adjusted for inflation**

2013—Long-Term Capital Gains & Dividends

- ▶ **Tax rate increases to 20% for taxpayers with income above the threshold amounts**
 - As these taxpayers will be above the threshold amounts for the 3.8% surtax, their capital gain rate will actually be 23.8%
- ▶ **Maximum rate stays at 15% for taxpayers with lower incomes**
- ▶ **Qualified dividend treatment is made permanent**
- ▶ **Under the original Obama Administration proposal, the rate on dividends would have been the ordinary income rate**

Phase-out of Personal Exemptions and Itemized Deductions

- ▶ **Phase-out of personal exemptions (PEP) and limitations on itemized deductions (Pease) as income rises above the following threshold amounts--**

Single taxpayers	\$250,000
Head of households	\$275,000
Married filing jointly or surviving spouse	\$300,000
Married filing separately	\$150,000

- ▶ **Amounts will be indexed for inflation**

Marriage Penalty Relief

- ▶ **Prior to EGTRRA, married taxpayers sometimes paid more tax than two unmarried individuals**

- ▶ **EGTRRA helped married couples in two ways—**
 - Set the standard deduction for married couples at twice the deduction for single individuals

 - Increased the 15 percent marginal tax bracket to twice the amount of the 15 percent bracket for an unmarried individual

- ▶ **ATRA extends both provisions**

Alternative Minimum Tax (AMT)

- ▶ Over the past decade, several AMT exemption patches have been made. The new law makes these permanent and fixed retroactively. (The last patch expired in 2011)
- ▶ New AMT exemption amount will be \$78,750 for married couples, and \$50,600 for singles in 2012
- ▶ AMT amounts will be indexed for inflation in the future

0.9% Healthcare Tax on Earnings

An additional
0.9% surtax
on higher income
households

The tax applies to wages and
self-employment income in
excess of threshold

There is no employer match on the
0.9 percent tax.

THRESHOLDS

Single
taxpayers \$200,000

Married
taxpayers
filing jointly \$250,000

Net Investment Income Tax Overview

Investment Income

- ▶ **Beginning with the 2013 tax year, a new 3.8% net investment income tax will apply to all taxpayers whose income exceeds a certain “threshold amount”. This new “surtax” will, in essence, raise the marginal income tax rate for affected taxpayers.**
- ▶ **Thus, a taxpayer in the 39.6% tax bracket (i.e. the highest marginal income tax rate in 2013) would have a marginal rate of 43.4%!**

Net Investment Income Tax Overview

APPLICATION TO INDIVIDUALS

NIIT is equal to:

3.8% X
the lesser of



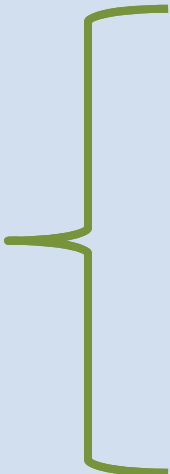
1. Net Investment Income
- OR
2. The excess (if any) of –
 - “Modified Adjusted Gross Income (MAGI)
 - “Threshold Amount”

Net Investment Income Tax Overview

APPLICATION TO ESTATES AND TRUSTS

NIIT is equal to:

3.8% X
the lesser of

- 
1. Undistributed “net investment income” for such taxable year
OR
 2. The excess (if any) of –
 - “Adjusted Gross Income” (as defined in section 67)) for such taxable year, over the dollar amount at which the highest tax bracket in section 1(e) begins for such a taxable year

Net Investment Income

▶ Includes

- Interest
- Dividends
- Annuity distributions
- Rents
- Passive royalties
- Income derived from passive activity
- Net capital gain derived from disposition of property

▶ Excludes

- Salary, wages, bonuses
- Distributions from IRAs or qualified plans and Social Security
- Self-employment income
- Active royalties
- Gain on the sale of active interest in partnership or S corp.
- Items otherwise excluded or exempt from income under the tax law (i.e., tax-exempt bond interest)

General Income Tax Planning Strategies

- ▶ Rules of thumb like tax deferral no longer apply; planning is very individualized now based on client circumstances
- ▶ Multi-year/multi-scenario projections; spreading income over multiple years will now be important to mitigate the impact of the new laws
- ▶ If accelerating income into a time period makes sense, make use of capital gain harvesting, etc.
- ▶ Clients above the threshold - focus on tax exempt income, retirement account distributions from non-deductible IRAs
- ▶ Clients near the threshold - focus on year-to-year planning to accelerate income and stay below the threshold and monitor investment income

Roth IRA Conversion Strategies

▶ Roth IRA benefits

- Lowers overall taxable income long-term
- Tax-free compounding
- No RMDs at age 70½
- Tax-free withdrawals for beneficiaries
- More effective funding of the “bypass trust”

▶ Critical decision factors

- Tax rate differential (year of conversion vs. withdrawal years)
- Use of “outside funds” to pay the income tax liability
- Need for IRA funds to meet annual living expenses
- Time horizon

▶ The key to successful Roth IRA conversions is to keep as much of the conversion income as possible in the current marginal tax bracket

- However, there are times when it may make sense to convert more and go into higher tax brackets

Investment & Retirement Planning Strategies

▶ **Asset placement**

- Determine what to keep in tax deferred vs. taxable accounts

▶ **Roth conversions**

- Use “free look” until tax return extension date to move income and assess impact

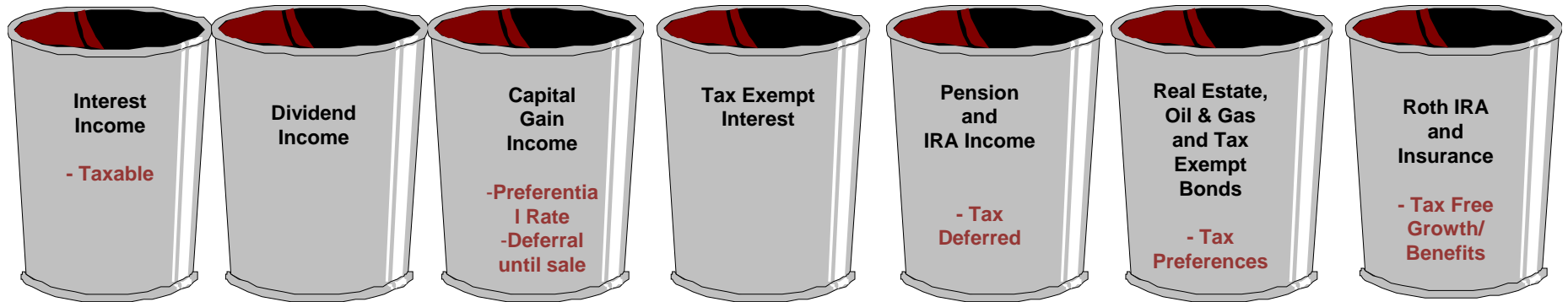
▶ **Annuities may once again become popular as a tax deferral vehicle**

▶ **Use of CRTs to manage gains and smooth income**

▶ **Life insurance and products in general are back in vogue with higher tax rates**

▶ **Defined benefit plans**

TAX ASSET CLASSES



- ✓ Money market
- ✓ Corporate bonds
- ✓ US Treasury bonds

Attributes
 ✓ Annual income tax on interest
 ✓ Taxed at highest marginal rates

- ✓ Equity securities
- Attributes
 ✓ Qualified dividends at LTCG rate
 ✓ Return of capital dividend
 ✓ Capital gain dividends

- ✓ Equity Securities
- Attributes
 ✓ Deferral until sale
 ✓ Reduced capital gains rate
 ✓ Step-up basis at death

- ✓ Bonds issued by State and local Governmental entities
- Attributes
 ✓ Federal tax exempt
 ✓ State tax exempt

- ✓ Pension plans
 - ✓ Profit sharing plans
 - ✓ Annuities
- Attributes
 ✓ Growth during lifetime
 ✓ RMD for IRA and qualified plans
 ✓ No step-up

- Real Estate
 ✓ Depreciation tax shield
 ✓ 1031 exchanges
 ✓ Deferral on growth until sale
- Oil & Gas
 ✓ Large up front IDC deductions
 ✓ Depletion allowances

- Roth IRA
 ✓ Tax-free growth during lifetime
 ✓ No 70½ RMD
 ✓ Tax-free distributions out to beneficiaries life expectancy
- Life Insurance
 ✓ Tax-deferred growth
 ✓ Tax-exempt payout at death

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Estate, Trust, and Gift Planning

Key “Permanent” Estate, Gift, and GST Changes under ATRA

- ▶ **Estate, Gift and GST exemptions set at \$5,250,000 for 2013**
- ▶ **Applicable exclusion amount will be adjusted for inflation**
- ▶ **Top transfer tax rate is 40% (up from 35% in 2012; down from 45% maximum rate in 2009)**
- ▶ **Spousal portability made permanent**
- ▶ **GST Provisions extended**

Estate & Gift Planning Strategies

- ▶ **Shift away from estate tax planning to true estate planning – ensuring that the plan distributes assets in accordance with client wishes.**
- ▶ **Put the focus on such topics as: naming guardians; determining beneficiaries, ages for distributions, need for trusts; titling of assets; Powers of Attorney; beneficiary designations for retirement plans, etc.**
- ▶ **Portability, which allows a surviving spouse to use the unused estate tax exemption of a deceased spouse, offers a “band aid” but does not solve all issues**
 - Even a non-taxable estate will have to file an estate tax return, which could keep the return open for many years.
 - If surviving spouse remarries, portability is lost
 - Portability does not apply for GST purposes
 - Assets at the surviving spouse’s death may have increased in value, but the unused exemption has not.

Estate & Gift Planning Strategies

- ▶ **Be sure to read your clients' existing documents! Before 2013 the estate plan of many married couples included a credit shelter trust and a QTIP trust. Do these formula clauses make sense for clients whose combined assets are below \$10.5 million?**
- ▶ **In general, do bypass and QTIP trusts continue to make sense with portability? What about second marriages and creditor protection concerns?**
- ▶ **What kind of planning should be considered when state and federal estate tax laws differ? Does it make sense to use a credit shelter trust to hold the state exemption amount and then use portability for the excess?**
- ▶ **For long-term marriages, should the options be leaving assets outright or funding a trust if the surviving spouse disclaims? Does this provide enough flexibility should tax laws change?**
- ▶ **Need to consider impact of ATRA and healthcare surtax on trusts. Should income be distributed to beneficiaries in lower brackets rather than retained in trust?**

Rethinking Life Insurance after ATRA

- ▶ **What were the reasons for buying the existing amounts and types of life insurance? Are they still valid?**
- ▶ **If to create estate liquidity, how much life insurance should you have now?**
- ▶ **If in a trust, how best to deal with policies that exceed current needs?**
- ▶ **What's the role of term, whole life and no lapse insurance in the post-ATRA world?**
- ▶ **What's the role of charitable giving?**

Rethinking Life Insurance after ATRA

- ▶ **Should ultra high net worth clients use some or all of their transfer tax exemption to purchase a single pay policy?**
- ▶ **Does the new estate tax regime provide more opportunities for 1035 exchanges?**
- ▶ **Consider the income tax advantages of life insurance for those in the 39.6% bracket and subject to the 3.8% Medicare surtax.**
- ▶ **If held individually, should whole life policies be retained to provide tax-free borrowing or to supplement retirement funding?**

Practical Ideas for Proactive Planning

- ▶ **This is the first time since 1986 that it is critical to look at tax ramifications when providing investment advice**
- ▶ **Face-to-face meetings with clients is crucial this year**
 - Tax projections to compare 2013 to 2012
- ▶ **Use these legislative changes as an opportunity to demonstrate your value and to grow your practice**

Questions?

PFP Section Resources (aicpa.org/PFP)

- ▶ **The CPA's Guide to Financial & Estate Planning– Volumes 1-4**
- ▶ **Planning After ATRA and the NIIT Toolkit**
- ▶ **Forefield Advisor (aicpa.org/pfp/forefield)**
 - Client education and communication tool
 - Written by CPAs, attorneys and other subject matter experts.
 - More than 3,000 resources covering personal financial planning, including estate, tax, retirement, investment and risk management planning.
- ▶ **More resources on estate, tax, retirement, insurance, and investments (aicpa.org/pfp)**
- ▶ **AICPA Advanced Personal Financial Planning Conference (cpa2biz.com/PFP) – January 20-22, 2014 in Las Vegas**
 - 2-day session (Jan 18-19) for those in earlier stages of PFP
 - Implementing PFP Services: Step by Step Plans for Success
- ▶ **For the full calendar of upcoming PFP Section events, visit www.aicpa.org/PFP and click on CPE & Events.**

Upcoming PFP Section Webcasts

- ▶ **Register now for these events on post-ATRA planning:**
 - *Top Estate and Income Tax Planning Strategies* (November 11, 1:00-2:45p.m. ET)
 - *Investment Tax Planning – Creating Tax Alpha* (November 12, 1:00-2:45p.m. ET)
 - Series: The CPA's Guide to Financial and Estate Planning
 - *Business Succession Planning After the American Tax Relief Act of 2012* (October 31, 1:00-2:45p.m. ET)
 - *Taxation of Divorce* (November 21, 1:00-2:45p.m. ET)
- ▶ **Other upcoming events:**
 - *PFP Power Hour: How to Use Forefield Advisor in Your PFP Practice* (November 14, 3:00-4:00p.m. ET)
 - *Trust Situs for Dynasty Trusts & DAPTs* (November 15, 1:00-2:45p.m. ET)
- ▶ **For the full calendar of upcoming PFP Section events, visit aicpa.org/PFP and click on CPE & Events.**
- ▶ **To access the archives, visit aicpa.org/pfp/webseminars.**

CPA/PFS News and Events

▶ PFS Referral Program

- Receive 100% credit to apply toward future CPA/PFS dues by referring a CPA to become a PFS or sit for the PFS exam

▶ PFS Exam

- Register now for Winter window
- Discounts, sponsorships and volume pricing available

▶ Education Opportunities

- Live 2 ½ day review class
- In-depth courses in estate, retirement, tax, investments, insurance, and PFP process
- Self-study PFS exam review course

▶ Learn more at aicpa.org/pfp/pfs

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