TAXES & DAVID HATT

Two things you can count on in life...

800 Menlo Ave., Suite 128
Menlo Park, CA 94025-4732
Phone: 650-326-1099
Fax: 650-326-4421
David@DavidHattEA.com
DLHEA@aol.com
WWW.DAVIDHATTEA.COM

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HELLO EVERYONE,

I am always thinking what I will say in my newsletter because I am always thinking of you. I know what I want to say, it is simply a matter of putting electronic quill to electronic paper.

There are many tax changes – some retroactive to January 1, 2012 and some starting January 1, 2013.

Before I start with the changes, I would like to call attention to the obvious: Politicians love to toss out words like "entitlements" and "loopholes." I think many of us assume that "those people over there" are taking entitlements and loopholes. In reality, some of the "entitlements" and "loopholes" are income and deductions that we have earned. Some politicians believe that mortgage interest is a "loophole." Well, try living in California and buying a home. Another example is people who are perpetually caught in the Alternative Minimum Tax (AMT) because the AMT is a way to plug those loopholes. Under regular income tax, people are allowed to deduct property taxes, state income taxes and unreimbursed employee expenses. Taxpayers are shelling out money to pay these expenses because they required to. Under AMT, those expenses are not allowed. So many California taxpayers are paying an additional tax for taxes they must pay. Pretty unfair, if (since) you asked me. But AMT will not go away. It brings soooo much money to the U.S. Treasury. My point is that when a politician spews getting rid of "entitlements" and "loopholes," you should ask "what specific 'entitlements' and 'loopholes' are you talking about?" You need to know. It could affect you.

Another political statement that should be viewed with a cocked eyebrow is "broaden the tax base." Translated, that means: tax everyone. "Entitlements" often mean the Social Security, Medicare, unemployment, Earned Income Tax Credit and the Childcare Tax Credit. Some people think it's an entitlement and other people think it's a credit that helps them to financially survive. Caveat emptor – buyer beware.

And now for the changes.

RETROACTIVE TO JANUARY 1, 2012:

CALIFORNIA: The voters of California passed Proposition 30. The maximum marginal tax rate is now 12.3 percent.

There are several changes to the tax system, but the one that affects 2012 is the increased tax on incomes over $250,000 ($500,000 for married filing jointly) of taxable income. If your income is below those amounts, then there is no change. This increase is in effect for the next seven years.

If your California taxable income is $1 million or more, then there's that pesky additional 1 percent mental health tax.

EFFECTIVE JANUARY 1, 2013:

CALIFORNIA:

Proposition 30 increased the sales tax by 0.25 percent for four years – from January 1, 2013 through December 31, 2016. Now the state sales tax rate is 7.5 percent. Plus counties and cities will have their additional rates.

FEDERAL:

There are two parts to the changes. The first group result from the Patient Protection and Affordable Care Act, and the Health Care and Eduction Reconciliation Act of 2010 ("ACA") – also known as ObamaCare. There are provisions that start in 2013. The other source of change is the American Taxpayer Relief Act of 2012 (that passed on January 1, 2013 – so much for tax planning!) ("ATRA").

Without ATRA, the income tax rates that were in effect in 2012 would sunset and pre-2001 tax rates, would be in effect, i.e., income tax rates at 39.6 percent for taxable incomes over $250,000. Basically, if your income is less than $400,000 (singles) or $450,000 (married), you have Bush tax rates. If your income is over that, you're under Clinton tax rates. Please notice that I said income tax rates. More to come!

A little bit of history about the 39.6 percent tax rate. It really was not a tax rate. In the late 1990s, the highest tax rate was 36 percent. The Congress passed a 10 percent surtax (meaning it was not an income tax but a surcharge) on incomes over $250,000. Ten percent of 36 (the highest marginal rate at the time) percent is 3.6 plus the already-in-place 36 percent = 39.6 percent. Usually income tax rates vary with a taxpayer's filing status. But this surcharge affected all filing statuses with income $250,000 or more.

Here is tax history: Previous to the late 1990s surtax, in what year did the U.S. assess a surtax? Give up? The last time was in 1970. There was an up to 2.5 percent surcharge on the tax. In 1969, the surcharge was up to 10 percent of your tax. And this surcharge was on top of the highest marginal rate of 70 percent! The surtax was earmarked to pay for the Vietnam War. The war was still going strong in 1969, but winding down in 1970. Interesting how the U.S. Government paid for that war.

BACK TO THE FUTURE...2013.....

The two percent reduction in Social Security tax for workers is gone. Now taxpayers with earned income may pay up to an additional $2,425 in Social Security tax. I think everyone knew that this tax "holiday" would be the first to go. With the talk of Social Security projected to run out of money in something like 2031, you should not be surprised that workers are paying more now.

Under ATRA, the maximum estate tax rate will be 40 percent with an exclusion of $5 million. Indexed for inflation, the exclusion is $5,250,000 in 2013. Also, we are back to the Unified Estate and Gift tax exemption. Under Clinton, the exemption was "unified" so that everyone had one exemption amount meaning that you could use your exemption amount by making taxable gifts during your lifetime or at death. Under Bush, it was separated so there was one exemption for estates and a different exemption for gifts. Under ATRA, we are back to a unified figure. And starting in 2013, the gifting limit without having to file a gift tax return is $14,000.

Before I start, some of these tax rates comes into play for taxable income and, in other cases, adjusted gross income. Taxable income is after itemized deductions and after personal exemptions. Adjusted gross income – AGI – is before itemized deductions and before personal exemptions.

In either case, tax planning will help reduce your income tax.

Under ATRA, for taxpayers who file as single, if your income is $400,000 or more, then your tax rates will increase from 35 percent to 39.6 percent on the amount of taxable income over $400,000. For couples the income level is $450,000 or more. I would like to put this increase in perspective: for every $10,000 of income, your income tax increases by an additional $460. So the bite is not as big as you would think.

Now that's part of it....for those who are waiting for the other shoe to drop: This change affects taxpayers with adjusted gross income of $250,000/$300,000 (single/married) or more. If your AGI is over that amount, then your itemized deductions and exemption amounts will be reduced.

Personal exemptions are reduced by 2 percent for each $2,500 of amounts when your AGI is over $250,000/$300,000 and completely phases-out when your AGI is over $372,500/$422,500. The good news, I guess, if you are in the AMT bracket, you would not get the personal exemptions anyway! So no change there.

The itemized deduction phase-out has the same income thresholds. Itemized deductions are phased-out at 3 percent when the AGI exceeds $250,000/$300,000. Even if your income is a gazillion dollars (think Romney and Oprah) the good news is that you will get at least 20 percent of your itemized deductions.

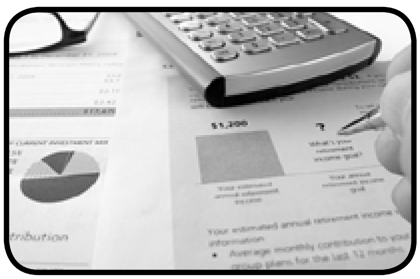
Under the Affordable Care Act, the top rate on long-term capital gains and qualified dividends is 20 precent on taxable incomes of $400,000 (single) and $450,000 (joint).

And a "surtax" – there's that word again – of 3.8 percent of net investment income on AGI for $200,000 (single) and $250,000 (joint).

Under ATRA, the AMT exemption is retroactive to January 1, 2012 and is now made permanent. For about eight years, Congress kept passing band-aid laws for each year and the exemption amount had to be approved. It created havoc at the IRS because they had to create tax forms and it drove tax software programmers crazy because they had to write the code and then it have tested in-house and then get approved by the IRS. The exemption amount is $50,600/$78,750. Without this increase, many taxpayers would have paid even more in income tax!

Under ATRA, the energy-saving home improvements credit has been extended through 2012 and 2013. If you made these changes to your home – windows, doors, furnaces – then please let me know. The credit is not much, but it is something.

IRA Charitable Contributions:



Under ATRA, Congress has allowed taxpayers 70-1/2 and older to transfer up to $100,000 of IRA distributions to a non-profit organization. People may scoff and wonder why anyone would want to do this. But if you are taking your required distributions, depending on what your income is, it could increase the amount of your Medicare B and D insurance premiums. It will not help immediately, but it will in 2014. There is a two year lag. So, if you contribute money to your favorite charity, you might consider making a direct transfer from your IRA to your charity. It will be a win-win situation. For more information on premiums and income levels, see www.socialsecurity.gov.

Tax Planning:

Directly transferring your IRA to a charity will reduce your AGI and your taxable income, and with these new income tax rates and it could be advantageous for you. AGI affects the calculation for itemized deduction phase-out, the personal exemption phase-out; your Medicare B and D premiums; and 3.8 percent investment tax. Also, you do not have to transfer your whole IRA distribution – you can transfer what you normally contribute to your favorite charities and keep the rest. But you have to be 70-1/2 and older. Sorry, you youngsters!

ATRA and Capital Gains Rate:

For incomes $400,000/$450,000, the capital gains rate remains at 15 percent. Over those amounts, the capital gains increases to 20 percent, but only for the portion which is over the the $400,000/$450,000.

Affordable Care Act

Net investment income applies to rents, royalties, net capital gains, interest and dividends. It does not apply to tax-free municipal bond interest. The tax is levied only the investment over $200,000 for singles and $250,000 for couples.

Who Ya Calling Rich?

According to the Wall Street Journal (Sat/Sun Dec 29-30, 2012) who got the information from 2012 data from the Tax Policy Center.

If your household income is $521,411, then you are in the top 1 percent, $208,810 top 5 percent, $148,688 top 10 percent and $107,628 top 20 percent.

Refunds, Refunds, Refunds

Starting this year, the IRS has stopped publishing its “Refund Cycle Chart.” I used to let you know when to expect your refund. The IRS has changed its policy. Now refunds will be directly deposited within 21 days. The change is due to the impact of fraud and fraudulent refunds. The IRS has safety checks. For refund information, please go to www.irs.gov and www.ftb.ca.gov and click on “Where’s My Refund?” Make sure you have your tax return handy because it will ask you for information on your tax return.

For Same Sex Couples....

Please come in before March 15 to have your tax return completed by April 15. I should – will? – be able to efile your federal tax return this year. The IRS has created a new form that eases – complicates? – the filing of your tax return. If you come in after March 15, I cannot guarantee that I will complete your tax return by April 15. I hope you understand. Speaking of same-sex couple tax returns. For same-sex married couples (SSMC)– not Registered Domestic Partners – you might want to consider filing an extension and waiting until some time this summer to file. That is because the U.S. Supreme Court is scheduled to take up the case on SSMCs filing a joint tax return. The hope is that the Court will allow SSMCs to file a joint federal tax return. For some SSMCs it's a blessing, for others it won't be.

Increase In Medicare Tax Rates

Starting January 1, 2013, for earned income (meaning W-2, sole proprietors, and certain partnerships), the Medicare tax rate will increase by 0.9 percent for individuals earning more than $200,000 and couples earning more than $250,000. Normally, the payroll department would take care of it. BUT... think about this situation. Married couple, each earning $175,000. Well, you're under the $200,000 before any automatic adjustments, BUT combined your earned income is $350,000. Now you are over the $250,000 threshold and maybe that 0.9 percent Medicare surcharge was not withheld because how would your payroll department know a) your spouse is working and b) how much your spouse earns. Now your combined income is $100,000 over the married threshold, so your income tax could be an additional $900.

Conversely, married couple. She earns $240,000 a year. He's a stay-at-home Dad. Because she's over the $200,000 threshold, the 0.9 percent Medicare surcharge kicks in. But combined, they are below the $250,000 threshold. In this case, they would get a credit for extra Medicare tax withheld. The amount is $360 if you like arithmetic. (And it's still $360 even if you don't like arithmetic.)

The surcharge kicks in when your income reaches $200,000. If your income is $400,000 per year, then the surcharge will not kick in until July 1. The employer does not match this payment. I have an abbreviated five page treatise on this Medicare surcharge in case you are interested.

Mundane Changes:

MILEAGE RATES: (2012/2013)

Business 55.5 cents / 56.5

Medical and moving 23.0 / 24.0

Charitable 14.0 / 14.0

MORE INFORMATION:

401(k) limits $17,000 / $17,500

IRA limits $5,000 / $5,500

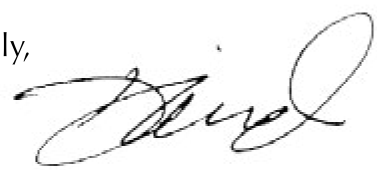
Social Security Wage Base $110,100 at 4.2 percent ($4,624.20) / $113,700 at 6.2 percent ($7,049.40)

There are more changes to 2013 that I will address later this year. This newsletter is long enough!

I look forward to seeing you this year.

If you have any questions, please feel free to contact me. I welcome all your questions.

Sincerely,



DAVID HATT, EA
800 Menlo Ave., Suite 128
Menlo Park, CA 94025-4732
Phone: 650-326-1099
Fax: 650-326-4421
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WWW.DAVIDHATTEA.COM

This newsletter is intended to be an overview. Please contact me if you have any questions.