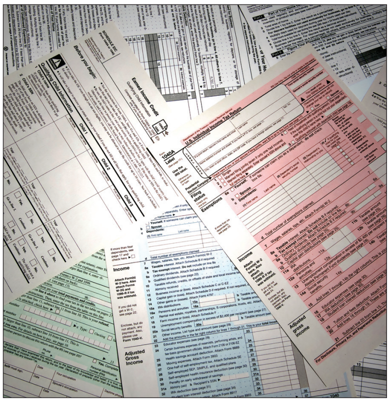
The Individual Investor's Guide to Personal Tax Planning 2013

By AAII Staff

Article Highlights

- Covers information on 2013 and 2014 taxes, including rates, exemptions and deductions.
- The new 0.9% additional Medicare tax and the 3.8% net investment income (NII) surtax are now in effect.
- Options to deduct state and local sales tax and make charitable distributions from IRAs in lieu of RMDs expire at end of 2013.
- All projected 2014 rates have been confirmed as of January 6, 2014.



The American Taxpayer Relief Act of 2012 (ATRA), signed into law at the start of 2013, simplified planning for the current tax year.

Following the uncertainty that existed at the end of 2012, this clarity was a welcome change. The revisions covered most of the tax code as it applies to individuals. Since the comprehensive legislation was passed in early January 2013, there has been little additional change beyond extending to married same-sex couples the same treatment as common-law married couples under the tax code.

We cover the changes included in the ATRA as they apply to 2013 and 2014 in this guide. We also cover the tax changes included in the Affordable Care Act. A higher floor for deducting medical expenses went into effect this year for those under the age 65. High income earners face two new Medicare taxes.

Those who like to file early may have to wait an extra one to two weeks. The Internal Revenue Service (IRS) expects to delay the starting date for when returns will be processed because of the partial government shutdown. The deadline for filing a return or claiming an extension will remain April 15, however.

The outlook for 2014 is not completely certain. A 29-person House-Senate budget committee is attempting to find common ground on fiscal issues and propose a plan going forward. Whether their discussions will encompass changes to the tax code or if any agreement on fiscal matters will be found are unknown. We do know that several tax breaks, including the exclusion from gross income of qualified charitable contributions made from a traditional individual retirement account (IRA), will expire on December 31, 2013, unless legislation to maintain them is passed.

Several line item numbers, including the standard deduction and mileage deductions, had yet to be updated for 2014 by the Internal Revenue Service at press time. This delay is due to the partial federal government shutdown. We have used estimates for these tax figures from what we consider to be reliable sources. Our intention is to update the online version of this guide as new information is released.

Regardless of what changes Congress makes (or does not make) to the tax laws, one thing will be constant—you will still have to pay taxes. Furthermore, even a simplified tax code is still likely to be too complex; hence the need for tax guides. As has been the case in years past, our tax guide provides an overview of the tax rates and deductions likely to impact the majority of AAII members. Since there are many details, loopholes and pitfalls within the tax code, it is impossible for this guide to provide enough details to cover specific tax situations. If you have questions, consult a tax professional. It is your tax return, and the IRS will hold you responsible for any errors made on it.

A special note of thanks goes out to Mark Luscombe, a principal federal tax analyst at tax authority CCH (www.CCHGroup.com), a Wolters Kluwer business, for answering detailed questions about the current and prospective rules. Sources of information used for this year's guide include CCH, the Federal Register, "J.K. Lasser's Your Income Tax 2014" (John Wiley & Sons, 2013), the Internal Revenue Service, the Social Security Administration and The Wall Street Journal.

Table 1. An Overview of Tax Changes in the Coming Years

	2013	2014	2015
Long-Term Capital Gains Rate			
Tax Bracket Equals 39.6%*	20%	20%	20%
Tax Brackets 25%–35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Qualified Dividends Rate			
Tax Bracket Equals 39.6%*	20%	20%	20%
Tax Brackets 25%–35%*	15%	15%	15%
Tax Bracket 15% or Below	0%	0%	0%
Marginal Income Tax Rates			
Top Bracket	39.6%	39.6%	39.6%
Sixth Bracket	35%	35%	35%
Fifth Bracket	33%	33%	33%
Fourth Bracket	28%	28%	28%
Third Bracket	25%	25%	25%
Second Bracket	15%	15%	15%
First Bracket	10%	10%	10%
Child Tax Credit	$1,000	$1,000	$1,000
Marriage Penalty Relief			
Standard Deduction (% of S.D. for singles)	200%	200%	200%
15% Tax Bracket (% of bracket for singles)	200%	200%	200%
Personal Exemption Phase-outs	$300,000	$305,050	$305,050**
Limitation on Itemized Deductions	$300,000	$305,050	$305,050**
AMT Exemption			
Single	$51,900	$52,800	$52,800**
Married Filing Joint	$80,800	$82,100	$82,100**
Head of Household	$51,900	$52,800	$52,800**
Estate Tax			
Exemption	$5.25 million	$5.34 million	$5.34 million**
Maximum Rate	40%	40%	40%

*3.8% net investment income tax (NII) surtax applies when AGI is above $250,000/$200,000.
**Projected and to be indexed for inflation.
Revised with confirmed IRS rates January 6, 2014.

Estimate Your Taxes on AAII.com

We continue to give you the ability to estimate your 2013 and 2014 tax liabilities on AAII.com. Our Tax Forecasting Worksheet allows you to enter your data on our website. The fillable PDF document will calculate the results.

Once you are finished, you can print a copy for your records. (Be sure to print the document if you want to preserve your work, since the document cannot be saved to AAII.com. See the inside front cover of this issue, opposite the Table of Contents, for more details.)

What's New?

Most individuals will continue to fall into the long-standing tax brackets of 10%, 15%, 25%, 28%, 33% and 35%. Starting this year, the ATRA added a new upper bracket for higher income earners of 39.6%. This bracket applies to taxable income above $450,000 for married couples filing joint returns $400,000 for single filers in 2013.

Social Security is now taxed back at the full 6.2% for employees and the full 12.4% for those working in self-employed positions. Payroll taxes had temporarily been reduced by two percentage points to 4.2%, but this break expired at the end of 2012. The tax is applicable to the first $113,700 of taxable earnings. In 2014, this limit will rise to $117,000.

A permanent patch to the alternative minimum tax (AMT) has been written into law. The exemptions were raised to $80,800 for married couples filing jointly and $51,900 for single filers in 2013. In 2014, the exemptions will rise to $82,100 and $52,800, respectively. The exemptions are indexed to the rate of inflation and will be raised accordingly in the future. This automatic increase is important because previously the AMT exemption was not indexed to inflation. New legislation had to be passed to prevent the AMT from ensnaring an ever-larger number of taxpayers.

The repeal of the phase-out for the personal exemption ended on December 31, 2012. The phase-out has returned in 2013, but at higher levels than in the past. The personal exemption phases out at income levels of $300,000 for married couples filing jointly and $250,000 for single filers for 2013. The phase-outs are projected to increase to $305,050 and $254,200, respectively, in 2014. According to tax authority CCH, the total amount of exemptions that can be

Cost Basis Reporting for Stocks, Bonds, Funds and Options

The cost basis and the proceeds from options and bonds purchased after January 1, 2014, will be reported by your broker. This date reflects a one-year postponement from the previous implementation date of January 1, 2013. The cost basis for complex debt instruments, including inflation-indexed debt instruments, convertible bonds and stripped bonds, is not required to be reported by brokers until January 1, 2016. The delay reflects requests by brokers for more time to implement the systems needed for handling the complexities of these types of securities.

Investors have the option of notifying their broker as to how market discounts or interest is treated. Brokers will follow a default method of amortizing bond premiums if not otherwise notified. The rules are complex and we suggest speaking with your brokerage firm about the application of the rules, and a tax professional about the best tax treatment to use.

The type of option owned alters how cost basis is reported. Index options may be subject to different cost basis reporting rules. Again, we suggest speaking with your broker if you have questions about how the cost basis is reported.

Brokers have previously been required to report cost basis for stocks purchased after January 1, 2011, and for mutual fund, exchange-traded fund (ETF) and dividend reinvestment plan (DRP) shares purchased after January 1, 2012. The rules do not apply to securities and funds purchased before those dates.

This is a change from what brokers had historically reported. Previously, only proceeds were listed on Form 1099-B. On January 1, 2011, a rolling period began for brokers to also list the cost basis and state whether the gain or loss is short term or long term. The rule applies to all brokers, including online and full-service brokers.

The change was the response to a 2008 law passed by Congress. The law is intended to limit the loss in revenues caused by investors who underestimate their capital gains on tax returns.

A default accounting methodology known as first-in, first-out (FIFO) is used when the purchase of securities (other than a mutual fund or DRP shares) involves more than one transaction. The FIFO method treats the first shares purchased ("first in") as also being the first shares sold ("first out"). Depending on how the stock has performed, this treatment can result in a larger tax bill (the shares appreciated in value) or a bigger capital loss (the shares fell in value).

For mutual funds and DRP stocks, the adjusted basis must be reported in accordance with the broker's default method, average cost basis, unless you specify otherwise. As the name implies, the average purchase price for your shares, regardless of when they are acquired, is used to determine the cost basis. You can specify FIFO instead of average cost basis. Another option is specific identification. The specific identification method allows you to choose the specific shares that are sold. This treatment can also result in a larger or a smaller tax bill, depending on how the fund has performed relative to the purchase price of the selected shares. You may be able to use other methods such as highest-in, first-out (HIFO) or last-in, first-out (LIFO). Contact your broker, fund family or DRP program to determine what their default methodology is and what choices you have for selecting methodologies.

If you want your broker or fund family to use a specific methodology other than their default methodology (e.g., FIFO for stocks or average cost for mutual funds), you must notify them. In order to do this, you must provide written instructions to your broker detailing your intentions before the order is executed, not afterward. Dustin Stamper at Grant Thorton's National Tax Office emphasized the importance of providing these instructions in writing. If you give your broker or fund family specific instructions and they report a different methodology to the IRS, the only way you can dispute what is on Form 1099-B is to provide a dated copy of your instructions. Stamper said that investors will not be able to retroactively determine which shares were sold; they must provide written instructions at or before the time the shares are sold.

claimed by a taxpayer is reduced by 2% for each $2,500 or portion thereof by which adjusted gross income exceeds the threshold level. Married couples filing separate returns will see their exemptions reduced by 2% for each $1,250 of adjusted gross income.

An adjustment for the so-called "marriage penalty" puts the standard deduction for married couples filing jointly at double the standard deduction for those filing single. Married couples filing jointly can claim a standard deduction of $12,200 and single filers can claim a standard deduction of $6,100 on their 2013 tax returns. In 2014, those amounts are projected to increase to $12,400 and $6,200, respectively.

The $1,000 maximum child tax credit has been made permanent. The credit was phased out for married couples filing jointly with modified adjusted gross income (MAGI) above $110,000 in 2013. If the child tax credit exceeds

Health Care Reform's Impact on Taxes

Tax code changes included in the 2010 Patient Protection and Affordable Care Act went into effect on January 1, 2013. These changes include two new taxes, the amount of medical expenses that can be deducted and how much can be contributed to a flexible savings account.

The first of the new taxes is the 0.9% additional Medicare tax. This levy will apply to wages, compensation and self-employment income above $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and head of households and $125,000 for those who are married but filing separately. The tax applies to wages that are subject to the Medicare tax and does not depend on adjusted gross income. Should the additional tax not be withheld from wages (a situation that could occur for dual-income couples or individuals working more than one job), the tax could be subject to a penalty if not paid with estimated taxes or through additional withholdings (you can request that your employer increase the income tax withholding on your W-4). More information about the additional Medicare tax can be found on the IRS website at www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax.

The second new tax is the 3.8% surtax on net investment income (NII surtax). This applies to the lesser of net investment income or modified adjusted gross income exceeding $250,000 for married persons filing jointly and qualifying widows(ers), $200,000 for single persons and head of households and $125,000 for those who are married but filing separately. (These thresholds are not indexed for inflation.) Investment income subject to the tax includes, but is not limited to, taxable interest, dividends, non-qualified annuities, rents and royalties, capital gains and passive income from partnerships. Capital gains from the sale of one's primary residence are subject to the tax to the extent the income exceeds the applicable home sale exclusion ($500,000 for joint filers and $250,000 for single filers). Excluded from the new tax are tax-exempt interest (e.g., municipal bond interest payments), distributions from individual retirement accounts (IRAs) and distributions from qualified retirement plans (e.g., 401(k) plans). The IRS has answers to common NII surtax questions at www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs.

Uninsured medical expenses must exceed 10% of adjusted gross income before they can be claimed as a deduction in 2013. This is an increase from the 7.5% floor that existed in 2012. Individuals age 65 and older continue to qualify for the lower 7.5% floor, however.

Flexible savings arrangement contributions are now limited to $2,500 annually. This limit will be adjusted for inflation starting in 2014. (The projected amount was not available at press time.) Previously, the maximum contribution was set by employers. At the election of their plan sponsors, employees can either carry over unused balances of $500 into the next plan year or take a grace period of up to two-and-half months.

the tax liability, the difference will be paid to the taxpayer subject to certain requirements. See IRS Publication 972 for more information.

Most taxpayers will not see a change in capital gains and dividend tax rates. Long-term capital gains and qualified dividends are taxed at 15% if incurred for securities held within a taxable account. (There is no capital gains tax or dividend taxes for securities held within a retirement account, such as an IRA. See Robert Carlson's article, "Do's and Don'ts of IRA Investing," in the March 2010 *AAII Journal* for investments that can cause an unexpected tax problem; the article is available at AAII.com.) Collectibles, which include gold coins and bars, are taxed at a maximum 28% rate. Short-term capital gains are taxed as ordinary income. If you are in the 10% or 15% tax bracket, long-term capital gains and qualified dividends are not taxed.

High-income taxpayers incur higher rates on capital gains realized on or after January 1, 2013. A 20% tax applies to long-term capital gains and dividends realized by married couples filing jointly with incomes above $450,000 and single filers with incomes above $400,000 and in taxable accounts in 2013. Married couples filing joint returns with net investment income or modified adjusted gross incomes above $250,000 and single filers with net investment income or modified adjusted gross incomes above $200,000 also must pay the new, additional 3.8% net investment income (NII) surtax on capital gains and dividends. Collectibles, which include gold coins and bars, are taxed at a 28% rate, but are eligible for the new 3.8% additional tax as well. The $250,000/$200,000 thresholds are not indexed to inflation and will remain the same in 2014.

Start of Tax Season Delayed

As of late October 2013, the IRS anticipated delaying the start of tax season by one to two weeks. The original start date was January 21, 2014, but returns now may not be accepted and processed until between January 28, 2014, and February 4, 2014. A final decision should be made in December, while our deadline for sending this month's issue to the printer was in mid-November.

New Health Care Reform Taxes

Two new taxes stemming from

health care reform went into effect on January 1, 2013. The first is the 0.9% additional Medicare tax on wages, compensation and self-employment income above $250,000 for married persons filing jointly and $200,000 for single persons. The second is the previously mentioned surtax on net investment income that applies to married couples filing jointly and single filers with net investment income or modified adjusted gross income exceeding $250,000 and $200,000, respectively.

More information about these new taxes can be found in the box on page 10.

Small to No Inflation Adjustments

Several deductions, exemptions and limits will be kept unchanged in 2014 or only rise by a modest amount because of the low levels of inflation. For example, Social Security taxes will cover a larger maximum amount of wages ($117,000), but the maximum contribution a worker can make to a 401(k) plan will remained capped at the 2013 level of $17,500. Some 2014 figures had been announced by press time, but we expect more announcements to be made in late November and in December.

Estate Tax

Effective January 1, 2013, the estate tax rate is 40%, versus 35% in 2012. The exemption is indexed to inflation, which means a large dollar amount of a person's estate can be shielded from the tax rate. The exemption is $5.25 million in 2013. It is projected to be $5.34 million in 2014. This is a per-spouse exclusion and it is portable, meaning if one spouse passes away, the surviving spouse can claim the exclusion, resulting in a total effective exclusion of $10.5 million in 2013 and $10.68 million in 2014. The large figures will prevent most families from having to pay estate taxes.

The step-up basis rule now remains part of tax code as long as future legislation does not change it. Under the step-up basis rules, if an inherited asset is sold, the capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of inheritance.

For a complete tax guide to the buying and selling of your personal investments, go to our Personal Investments 2013 Tax Guide in the online version of this article.

Change in Capital Gains Reporting

The requirement for brokers to report the cost basis for options and bonds bought and sold by their clients was delayed to January 1, 2014 (and January 1, 2016, for certain debt instruments). The rule covering bonds and options was originally intended to go in effect on January 1, 2013.

The cost basis reporting requirement is a change from previous years, when brokers only reported the proceeds from a sale. This is the third part of a rule that started going into effect in 2011. Brokers and mutual fund companies must report the cost basis for stocks purchased after January 1, 2011, and mutual fund, exchange-traded fund (ETF) and dividend reinvestment program (DRP) shares purchased after January 1, 2012.

If you sold a capital asset in 2013, you will need to fill out Form 8949. See the special write-up in the "Cost Basis" box on page 9 for details on the new rules.

Medical Expenses

A new, higher threshold for deducting medical expenses went into effect on January 1, 2013. Those who are under the age of 65 at the end of 2013 now can only deduct medical expenses exceeding 10% of adjusted gross income (AGI). Those age 65 or older at the end of 2013 will continue to be able to use the lower 7.5% floor for deducting medical expenses until 2016.

Medical insurance premiums for the self-employed are deductible and can be used to reduce adjusted gross income on Form 1040.

Workers participating in flexible savings accounts (FSA) can now carry over up to $500 of unused amounts into the next plan year if their plan sponsor allows them to. Plan sponsors have the choice of either offering employees the ability to carry over up to $500 or allow employees a grace period of up to two-and-half months. This is a change from the previous rule, which required any balance not used by the end of the plan year to be forfeited.

Same-Sex and Common-Law Marriage

Same-sex marriages now receive similar treatment as common-law marriages do under the tax code. A same-sex couple is considered to be married under the tax code if they were married in a jurisdiction where such marriages are legally recognized.

Earlier this year, in United States v. Windsor, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act, which defined marriage as a union between one man and one woman. In response, the IRS clarified and amplified the revenue ruling that determined the tax status of couples living in a common-law marriage situation for federal income tax purposes. In doing so, the IRS said that for over 50 years, it has recognized marriages based on the laws of the states they were entered into.

The last sentence is important. If a couple enters into a same-sex marriage in a state where it is legal to do so, the couple is considered married for federal tax purposes, regardless of where they currently reside. Common-law marriages are recognized if the two people entered into a common-law marriage in a state where the common law is recognized.

Couples in domestic partnerships, civil unions, or other similar formal relationships recognized but not denominated as marriage under state law are not considered to be married for federal tax purposes. This IRS says this conclusion applies to both opposite-sex and same-sex relationships.

Expiring Tax Extenders

As of press time, several tax breaks

for individuals were set to expire at the end of 2013. These "extenders" can be used to reduce 2013 taxes but not 2014 taxes, unless Congress votes to keep them in the tax code. These extenders include, but are not limited to:

State and Local Sales Taxes: State and local sales taxes can be deducted in lieu of state and local income taxes. In states without income taxes, state and local sales taxes can be deducted. CCH says this is the most politically backed extender and may be renewed.

IRA Distributions to Charity: Individuals age 70½ or older can make a tax-free distribution to public charities of up to $100,000 from their individual retirement account. These donations can be used to satisfy required minimum distribution (RMD) requirements. Charitable distributions made before February 1, 2013, can be treated as a 2012 contribution.

Transit Benefits: Employees can use up to $245 in pretax dollars to pay for public transit and van pooling; the same amount as can be used to pay for qualified parking benefits. If not extended, the transit benefit will decline to a projected $130 for public transportation and van pooling in 2014.

Tax Software, Books and Guides

Although the tax rates, deductions and exemptions for 2013 were covered in last January's legislation, if you use a software program (e.g., TurboTax), book (e.g., "J.K. Lasser's Your Income Tax 2014") or a related aid, check for updates before filing. Doing so will ensure that you are using the most up-to-date forms and information.

Be sure to check for updated information regarding 2014 as well. Due to the partial government shutdown, the first versions of the aids may have incomplete or incorrect information. Check with the provider of any software, book or guide to see if a download or a supplement is available.

Useful Tax Numbers

Here is a list of the tax rates, deductions, exemptions, credits and other related items that may apply to your 2013 and 2014 taxes. These numbers reflect the changes made by the American Taxpayer Relief Act of 2012, and also contain some projections for the 2014 tax year.

Standard Deduction

For 2013, the standard deduction is $12,200 for married individuals filing a joint return, $6,100 for singles and married individuals filing separate returns, and $8,950 for heads of household.

For 2014, the standard deduction is projected to be $12,400 for married couples filing a joint return, $6,200 for those who are single or those who are married filing separate returns and $9,100 for heads of household.

Personal Exemptions

The 2013 personal exemption is $3,900. The exemption can be claimed for yourself, your spouse (if filing a joint return) and any qualifying dependents. The exemption will start to phase out at $300,000 for married couples filing jointly and $250,000 for single filers.

The personal exemption is projected to rise to $3,950 in 2014. The phase-out levels are projected to be raised to $305,050 for married couples filing jointly and $254,200 for single filers.

Individual Retirement Accounts and 401(k) Plans

The maximum allowed IRA contribution for 2013 is $5,500 ($6,500 for any individual who is age 50 or older). The contribution limits will remain unchanged in 2014. The additional catch-up contribution limit of $1,000 is not indexed to inflation and will also be unchanged next year. The contributions can be fully deducted for modified adjusted gross incomes (modified AGIs) below $95,000 and $59,000 for married filing joint and single returns, respectively. In 2014, the phase-outs for deducting IRA contributions will rise to $96,000 and $60,000, respectively.

In 2013, the maximum annual contribution limit for 401(k)s is $17,500 ($23,000 if you are age 50 or over); in 2014, these amounts will be unchanged.

In 2013, the maximum annual contribution for SIMPLE plans is $12,000 (those age 50 or over can make a maximum catch-up contribution of $2,500); in 2014, the maximum contribution will be unchanged.

Qualified Plan Contributions

In 2013, the maximum annual contribution for qualified plans, including SEP and Keogh plans, is $51,000 or 25% of your compensation, whichever is less; in 2014, the maximum contribution will be $52,000 or 25% of your compensation, whichever is less.

Estate and Gift Tax Limits

Tax laws passed in 2010 and 2013 made the estate tax exemption both portable and indexed to inflation. The exemption is $5.25 million in 2013. In 2014, the exemption is projected to rise to $5.34 million. See the previous section about the estate tax for information on calculating taxable gains from the sale of the inherited assets.

The annual gift tax exclusion is $14,000 in 2013 and $28,000 for consenting couples. (You will need to file Form 709.) The exclusions are projected to stay unchanged in 2014.

Required Minimum Distributions (RMDs)

Individuals age 70½ and older are required to take a distribution from their retirement accounts by December 31, 2013. These accounts include 401(k) plans, 403(b) plans, 457(b) plans, traditional IRAs, SEP IRAs, SARSEP IRAs, SIMPLE IRAs and Roth 401(k) plans. Roth IRA plans are exempt while the owner is alive.

If you turned 70½ in 2013, you have until April 1, 2014, to take your first RMD. You will need to take a second RMD during 2014 to satisfy that year's distribution requirement.

According to the IRS, "Generally, an RMD is calculated for each account by dividing the prior December 31st balance of that IRA or retirement plan account by a life expectancy factor that IRS publishes in tables in Publication 590, Individual Retirement Arrangements (IRAs)."

Child Tax Credit

In 2013 and 2014, the maximum child tax credit for dependent children younger than 17 is $1,000. The credit was made permanent by the ATRA.

Kiddie Tax

In 2013, the "kiddie tax" applied to children up to age 18 and could apply to children up to age 23—depending on how much earned income they have and whether or not they are full-time students.

Under the kiddie tax rules, children with investment income above a certain amount may have part or all of their investment income taxed at their parents' income tax rate.

The kiddie tax applies in both 2013 and 2014 if the child is age 17 or younger by the end of the year and the child's total investment income for the year is more than $2,000. In 2013, the kiddie tax will apply if the child's total investment income exceeds $2,000. It is projected to stay at this level in 2014.

In addition, the kiddie tax can apply to older children, depending on how much earned income they have and whether or not they are full-time students

- Starting in the year that your child turns 18, the kiddie tax will apply if your child's earned income (including salaries and wages, commissions, professional fees and tips) is less than half of the child's overall support.
- Starting in the year your child turns 19, the kiddie tax will apply if your child is a full-time student.
- The kiddie tax will stop applying in the year your child turns 24.
- The kiddie tax will also not apply if your child is married filing jointly.

Charitable Donations

Donations of clothing and other personal items must be in "good condition" or better in order to be deducted. Form 8283 must be filled out if your total deduction for all noncash contributions exceeds $500.

In addition, charitable contributions of cash (regardless of the amount) to any qualified charity must be supported by a dated bank record (such as a cancelled check) or a dated receipt from the charity that must include the name of the charity and the date and amount of the contribution.

The ATRA extended a provision that allows those age 70½ or older to distribute up to $100,000 from their traditional individual retirement account (IRA) tax-free to qualified charities through the 2013 tax year. Unless new legislation is passed, this provision will expire on December 31, 2013. Effective January 1, 2014, retirees will no longer be able to make tax-free distributions from their IRAs to qualified charitable organizations.

How Much of Your Social Security Is Taxed?

Combined Income*	Percent of SS Benefits Taxed
Below $25,000 Single & Head of Household Below $32,000 Married Filing Jointly	0%
$25,000 to $34,000 Single & Head of Household $32,000 to $44,000 Married Filing Jointly	up to 50%
Above $34,000 Single & Head of Household Above $44,000 Married Filing Jointly	up to 85% of benefits + other income

**The Social Security Administration defines combined income as: Your adjusted gross income + nontaxable interest + ½ of your Social Security benefits.*

Medicare

Taxpayers who itemize deductions can deduct (as a medical expense) the premiums they pay for Medicare Part B supplemental insurance and Medicare Part D prescription drug insurance. Premiums for voluntary coverage under Medicare Part A are only deductible by those over the age of 65 and not covered by Social Security.

Medical expenses must exceed 10% of adjusted gross income to qualify for deductions for those under the age of 65 in tax years 2013 and beyond. The lower 7.5% floor will remain in effect for those age 65 or older through the year 2016.

Itemized Deduction Phase-Outs

The phase-out of itemized deductions (the "Pease" limitation) for taxpayers with adjusted gross income above a certain amount was reinstated by the ATRA. It applies to married filing jointly and single taxpayers with incomes of $300,000 and $250,000, respectively, or higher in 2013. For 2014, the phase-out levels are projected to rise to $305,050 and $254,200, respectively.

Planning Considerations: Married taxpayers filing jointly will need to calculate whether taking the increased standard deduction or itemizing deductions will generate the most tax savings overall. When doing so, make sure to consider whether state law restricts the ability to itemize to only those who itemize for federal purposes. The higher deductions may also require more couples to pay alternative minimum tax (AMT).

Sales Tax Deduction

The provision allowing taxpayers who itemize deductions the option of choosing between a deduction of sales taxes or income taxes when claiming a state and local tax deduction was extended into 2013, but not 2014. It will expire on December 31, 2013, without the passage of new legislation.

Tax-Exempt Interest Reporting

State and local governments are required to report interest paid on tax-exempt state and local bonds on Form 1099-INT, Interest Income. This amount must be shown on your tax return and is for information only.

Health Savings Accounts

You may be able to take a deduction if you contributed to a Health Savings Account (HSA). To qualify, you must be covered by a "high-deductible health plan."

More information on this can be found at AAII.com in the online version of this article.

Education Savings

The maximum American Opportunity education credit of $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books) was extended through 2017 by the ATRA. This credit can be claimed in both 2013 and 2014.

The Lifetime Learning credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phase-outs.

You can make non-deductible contributions to qualified tuition plans, also known as section 529 plans. (However, the contributions may be deductible from your state income tax, depending on where you live.) These accounts, offered by states or their designees, are maintained solely for the qualified higher education expenses of a beneficiary. Distributions are tax-free, provided that the distributions are used to pay qualified expenses.

The ATRA made the $2,000 per beneficiary contribution limit to a Coverdell Education Savings Account permanent. The contributions are not deductible, but they grow tax-free in the IRA. Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers.

Investment Strategies: 2014 and Beyond

The inability of Republicans and Democrats to find much common ground on fiscal issues leaves the future of the tax code in doubt. Though the ATRA provided a great deal of clarity in terms of current legislation, any long-term agreement on the federal budget and debt reduction could include changes to the tax code.

Though we cannot predict what the politicians in Washington will do, or when they will do it, there are strategies that make sense regardless of the legislative environment. Listed below are traditional tax planning strategies that can help keep your tax bill down. It is important, however, to keep in mind that your goals and risk tolerance, not just the income tax impact of an investment, should drive your investment decisions.

Consider Roth IRA Conversion Opportunities

You have the option of converting all or part of your traditional IRA into a Roth IRA, regardless of your adjusted gross income. Roth IRAs can provide certain advantages: The converted assets can be withdrawn tax-free at any time, future earnings are also tax-free (with some limitations) and Roth IRA owners are not required to take any minimum distributions in retirement. The downside, however, is that the conversion amount is taxable in the year it occurs.

While the benefits of a Roth IRA conversion could be considerable, taxpayers must carefully weigh the up-front tax costs against the long-term tax advantages. For more on this, see "Retirement Plans: Evaluating the New Roth IRA Conversion Opportunity" by Christine Fahlund in the November 2009 *AAII Journal* and "New Rules for Converting to a Roth IRA" by William Reichenstein, Alicia Waltenberger and Douglas Rothermich in the January 2010 *AAII Journal* (both available at AAII.com). Though the articles discuss the one-time 2010 option for delaying the taxes from the conversion, their suggestions regarding whether to convert or not continue to be applicable. You may also want to consult a tax adviser for the best strategy.

You cannot convert required minimum distributions (RMDs) from your traditional IRA for a particular year (including the calendar year in which you reach age 70½) to a Roth IRA. IRS publication 590 explains the rules for RMDs and Roth IRA conversions.

Take Advantage of Lower Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gain tax rates of 0% or 15%. For married couples filing jointly with income above $450,000 and single filers with income above $400,000 in 2013, the long-term capital gains rates are now 20%. Short-term capital gains, in contrast, are taxed at ordinary income tax rates and run as high as 39.6% in 2013. The 3.8% net investment income (NII) surtax, which went into effect on January 1, 2013, applies to taxpayers with income above the $250,000/$200,000 threshold. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, non-qualified annuities, rents and royalties, and passive income from partnerships.

Similar rules apply to qualified dividends. For married couples filing jointly with income above $450,000 and single filers with income above $400,000 in 2013, dividends are taxed at 20%.

Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use the proceeds from selling the stock to diversify your portfolio. This is particularly the case if a large portion of your wealth is concentrated in just a few securities.

Use Losses Carefully

While tax considerations should not drive your investment decision, you can take advantage of losses in holdings that you would prefer to either sell or reduce from an investment standpoint.

Capital losses first reduce capital gains: long-term losses reduce long-term gains first, and short-term losses reduce short-term gains first. Any long-term losses left over reduce short-term gains, and vice versa. If you still have losses remaining after offsetting capital gains, you can reduce your "ordinary" income by up to $3,000. Losses not used this year can be carried forward to future years until they are used up. For more information, see "Capital Pains: Rules for Capital Losses" by Julian Block in the September 2010 *AAII Journal* (available at AAII.com).

When planning, make sure you don't run afoul of the wash-sale rules. If you sell an investment at a loss and then acquire substantially identical securities during the 30-day period before or 30-day period after the sale, the loss will be disallowed. If your loss is disallowed by the wash-sale rule, you can increase the cost basis of the new stock by the amount of the disallowed loss. The holding period for the new stock is also adjusted to include the holding period of the stock sold at the disallowed loss. You cannot adjust the cost basis or holding period if you acquire the investment in an IRA or Roth IRA, however.

Consider the Impact of Taxes on Mutual Fund Investments

Selecting tax-aware managers of mutual funds may be important to maximizing your aftertax rate of return in your taxable investment portfolio.

You may choose when to sell specific shares of the fund and may, therefore, create long-term versus short-term capital gains, as long as you notify the fund family or your broker in writing with specific instructions. But you don't control the investments within the fund. Should an equity manager fail to extend the holding period on a stock, it could cost you as much as 19.6% of your gain (39.6% ordinary rate for short-term capital gains versus the 20% long-term capital gains rate).

Some mutual fund dividends can be treated as qualified dividends and eligible for the reduced tax rate, while others will not qualify. Dividends paid by stocks held by the fund and passed through to the shareholder are eligible for the qualified dividend tax treatment. However, capital distributions and bond interest are not. These payments are reported on Form 1099, which specifies the type of distribution.

More on mutual fund distributions can be found at AAII.com in the online version of this article.

Reconsider Taxable Versus Tax-Free Bonds

Interest from tax-free municipal bonds is generally exempt from federal income taxes, unlike the interest from taxable bonds, which is taxed as income. Like any bond, credit quality matters, as you want to ensure that the issuer will not default. Changing yields can also alter the aftertax yield advantage, making municipal bonds more or less attractive to taxable bonds.

Additionally, private-activity bonds (a type of tax-free bond) could increase your exposure to the alternative minimum tax since their interest income is taxable for purposes of the alternative minimum tax. There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds and Gulf Opportunity Zone bonds. Furthermore, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer to find out the bond's tax status.

You should review your bond and money market accounts to make sure that you are earning the highest aftertax return. But don't forget to consider the state tax implications of switching from tax-free to taxable bonds before making any final portfolio decisions.

Consider Increasing Retirement Savings

Increasing retirement savings makes sense from a financial planning standpoint and, depending on your adjusted income, may reduce your tax bill. You have until April 15, 2014, to make an IRA contribution for the 2013 tax year.

Review the Tax Implications of Taxable Versus Tax-Deferred Accounts

The spread between capital gains and ordinary income rates has important implications with respect to your asset allocation between taxable and tax-deferred (retirement) accounts.

For example, from a tax perspective, holding individual stocks in tax-deferred accounts and bonds in taxable accounts could be expensive because the long-term gains resulting from stocks held in tax-deferred plans such as IRAs or 401(k) plans will be taxed at ordinary rates when taken as a distribution. By reversing that structure, taxable bonds and other tax-inefficient assets will be shielded from taxation in the deferred accounts, while equities will enjoy the reduced rates for capital gains in personal accounts.

Tax-free municipal bonds should, of course, remain outside of retirement accounts. Individuals should also consider the cost of commissions and taxes, current cash flow needs, and the new 0.9% additional Medicare tax and 3.8% NII surtax before making any investment moves between taxable and tax-deferred accounts.

Protect Social Security Benefits

If you are receiving Social Security benefits, you may have to pay taxes on them if your combined income (primarily your adjusted gross income plus any tax-exempt interest income plus half of your Social Security benefits) exceeds certain levels.

To protect your benefits, watch the amount of interest you receive from municipal bonds, since this amount is included in your modified adjusted gross income when determining the Social Security benefit taxability. In addition, you may want to delay taxable distributions from a retirement plan or IRA.

Conclusion

It is important to remember that taxes are not the key to investment planning. However, one thing is certain:

Where's My Money? Tracking Your Refund 24/7

If you are expecting a refund on your 2013 income tax, you can check on its status if it has been at least four weeks since the date you filed your return by mail, or 24 hours if you filed electronically. You will need to supply the following information: your Social Security number or IRS Individual Taxpayer Identification number, your filing status and the exact whole-dollar refund amount as it is shown on your return.

You can check the status of your refund in two ways:

- On the Internet, go to www.irs.gov and click on "Refunds" and then "Where's My Refund."
- By telephone (for automated information), call 800-829-4477.

If you are unable to get information on your refund through either of these two automated services, you can call the IRS for assistance at 800-829-1040.

The IRS website also allows you to start a trace for lost or missing refund checks, or to notify the IRS of an address change when refund checks go undelivered. Taxpayers can avoid undelivered refund checks by having refunds deposited directly into a personal checking or savings account. This option is available for both paper and electronically filed returns.

There will be more tax changes coming, and everyone should consider how the changes directly affect their overall tax and investment strategies.

Tax Planning Strategies

All Taxpayers: Determine Where You Are at the End of the Year

At the end of each year, you should take the time to assess your tax situation. Doing so will give you the opportunity to shift certain items around, should that be beneficial in terms of your tax liability. Taking a few initial steps now and using year-end planning strategies can result in significant tax savings.

How can you effectively plan?

Here are the basic steps you should take to help start your personal tax planning:

- Estimate your income, deductions, credits and exemptions for 2013 and 2014 using the Tax Forecasting Worksheet (page 20 and on AAII.com in a fillable PDF; the worksheets have been updated to reflect the new tax law);
- Identify items that you can shift from 2013 into 2014 and beyond (or vice versa);
- Determine your marginal tax rate—the rate at which your next dollar of income will be taxed—for 2013 and 2014;
- Determine how much tax you owe and when you must pay it to avoid underpayment penalties;
- Determine whether you are subject to the alternative minimum tax (AMT);
- Consult with your tax professional, and then take the actions needed to make the best of your tax situation.

To minimize your taxes, consider both short-term and long-term tax planning issues and strategies. Starting early will give you extra time to obtain additional information about items that concern you and to investigate additional ideas for tax savings or deferral. The Tax Forecasting Worksheet on page 20 (and fillable PDF on AAII.com) will provide a starting point for evaluating the tax effects of various strategies.

Avoiding Tax Underpayment Penalties

Make sure you determine your 2014 tax liability as early as possible, as well as the due dates for paying those taxes (including the self-employment tax and the alternative minimum tax), so that you avoid underpayment penalties.

Federal tax law requires the payment of income taxes throughout the year as you earn your income. This obligation may be met through withholding, quarterly estimated tax payments or both. If you do not meet this obligation, you may be assessed an underpayment penalty.

If your total tax due minus the amount you had withheld is less than 10% of your total tax due, you will not be assessed an underpayment penalty. The disadvantage of overpaying throughout the year, though, is that you are in effect making an interest-free loan to the government. However, the underpayment penalty can be high, and it is calculated as interest on the underpaid balance until it is paid, or until the regular filing date for the final tax return, whichever is earlier.

You can avoid underpayment tax penalties by adopting one of the safe harbor rules. The basic rule is to pay the required amount by the end of the year through withholding and quarterly estimated payments. The required amount will be one of the following, depending on your individual situation:

- 90% of the current year's tax liability;
- 100% of the prior year's tax liability (increases to 110% for taxpayers who had adjusted gross income in excess of $150,000 or $75,000 for those married filing separately for 2013 and 2014); or
- 90% of the tax liability based on a quarterly annualization of current year-to-date income (See IRS Form 505 and IRS Publication 505 for worksheets).

Penalties are based on any underpayment, which is the difference between the lowest amount required to be paid by each quarterly payment date and the amount actually paid by that date.

(continued on page 25)

2013 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,925	$0 + 10%	$0
8,925	36,250	$892.50 + 15%	$8,925
36,250	87,850	$4,991.25 + 25%	$36,250
87,850	183,250	$17,891.25 + 28%	$87,850
183,250	398,350	$44,603.25 + 33%	$183,250
398,350	400,000	$115,586.25 + 35%	$398,350
400,000	—	$116,163.75 + 39.6%	$400,000

For Married Taxpayers Filing Joint Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	17,850	0 + 10%	$0
17,850	72,500	$1,785 + 15%	$17,850
72,500	146,400	$9,982.50 + 25%	$72,500
146,400	223,050	$28,457.50 + 28%	$146,400
223,050	398,350	$49,919.50 + 33%	$223,050
398,350	450,000	$107,768.50 + 35%	$398,350
450,000	—	$125,846.00 + 39.6%	$450,000

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	8,925	0 + 10%	$0
8,925	36,250	$892.50 + 15%	$8,925
36,250	73,200	$4,991.25 + 25%	$36,250
73,200	111,525	$14,228.75 + 28%	$73,200
111,525	199,175	$24,959.75 + 33%	$111,525
199,175	225,000	$53,884.25 + 35%	$199,175
225,000	—	$62,923.00 + 39.6%	$225,000

For Individuals Filing as Head of Household

Taxable Income Over ($)	But Not Over ($)	The Tax Is	Of the Amount Over
0	12,750	0 + 10%	$0
12,750	48,600	1,275 + 15%	$12,750
48,600	125,450	$6,652.50 + 25%	$48,600
125,450	203,150	$25,865.00 + 28%	$125,450
203,150	398,350	$47,621.00 + 33%	$203,150
398,350	425,000	$112,037.00 + 35%	$398,350
425,000	—	$121,364.50 + 39.6%	$425,000

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers in the 25% to 35% Brackets* (%)	Taxpayers in the 39.6% Bracket* (%)
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0	15	20
Qualified Dividends	0	15	20
Collectibles***	28 maximum	28 maximum	28
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum	25 maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $1,000	0%
Next $1,000	child's rate
Over $2,000	parent's rate

2013 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$12,200
Single	$6,100
Married, Filing Separate	$6,100
Head of Household	$8,950

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,200
Single	$1,500

Additional—Blind	
Married (or Qualifying Widow)	$1,200
Single	$1,500

Personal Exemption

$3,900

Maximum Child Tax Credit

$1,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	56.5 cents
Medical Standard Mileage Rate	24.0 cents
Moving Standard Mileage Rate	24.0 cents
Charitable Serv Standard Mile Rate	14.0 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,500
If 50 or older	$6,500

Maximum 401(k) Employee Contribution

If younger than 50	$17,500
If 50 or older	$23,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$14,000

Estate Tax Exclusion

$5.25 million

2013 Other Tax Items

2013 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$113,700
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2013 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (7.5% if age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

2013 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2013 AMT Exemption Amount

Single	$51,900
Married, Filing Joint	$80,800
Married, Filing Separate	$40,400
Head of Household	$51,900

2013 Tax Benefit Phase-Out Levels

Personal Exemption

	AGI Phase-Out Level
Married, Filing Joint	$300,000
Single	$250,000
Married, Filing Separate	$150,000
Head of Household	$275,000

Itemized Deduction ("Pease" Limitation)

	AGI Phase-Out Level
Married, Filing Joint	$300,000
Single	$250,000
Married, Filing Separate	$150,000
Head of Household	$275,000

IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

	Modified AGI* Phase-Out Level
Married, Filing Joint	$95,000
Single	$59,000
Married, Filing Separate	$0**
Head of Household	$59,000
Married, Filing Joint not covered by pension plan, but spouse is	$178,000

Roth IRA Eligibility

Maximum $5,500 non-deductible contribution; if 50 or older, maximum is $6,500

	Modified AGI* Phase-Out Level
Married, Filing Joint	$178,000
Single	$112,000
Married, Filing Separate	$0
Head of Household	$112,000

Coverdell Education Account

$2,000 maximum non-deductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phase-Out Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$59,000 if strict criteria are met.*

Tax Forecasting Worksheet

This worksheet is designed for estimation purposes only and does not cover all the possible adjustments that may be required to arrive at actual taxable income (for example, Social Security benefits may be taxable in some circumstances) or to compute final income tax liability (for example, lump-sum distribution tax on retirement distributions). It should be adequate for most purposes and is a good starting point for discussions with your tax adviser, who can assist you in making exact calculations.

Go to www.aaii.com/files/PDF/Tax Guide 2013/page20.pdf for an online worksheet that calculates the math for you.

	2013	2014
Income		
1. Salaries per Form W-2	____________	____________
2. Non-qualified dividends and interest income	____________	____________
3. Net business income (losses)	____________	____________
4. Net capital gains and qualified dividend income[a]	____________	____________
5. Other gains (losses)	____________	____________
6. Passive income (losses) (subject to limitations)	____________	____________
7. Other income, including 85% of Social Security benefits, if applicable	____________	____________
8. Total income (sum of lines 1 – 7)	$ ____________	$ ____________
Adjustments		
9. Alimony paid	____________	____________
10. Keogh contributions	____________	____________
11. Deductible IRA contributions	____________	____________
12. Moving expenses (job-related, subject to limitations)	____________	____________
13. Other ______________	____________	____________
14. Adjusted gross income (AGI) (subtract lines 9 – 13 from line 8)	$ ____________	$ ____________
Deductions		
15. Medical and dental expenses (excess over 10% of line 14; 7.5% if age 65 or older) or self-employed health insurance	____________	____________
16. State and local income taxes (or sales taxes)[b]	____________	____________
17. Real estate and property taxes (non-business property)	____________	____________
18. Home mortgage interest	____________	____________
19. Investment interest (limited to investment income)	____________	____________
20. Charitable contributions	____________	____________
21. Casualty or theft losses (excess over $100 plus 10% of line 14)	____________	____________
22. Miscellaneous expenses (excess over 2% of line 14)	____________	____________
23. Total deductions (sum of lines 15 – 22 or the standard deduction if greater)[c]	$ ____________	$ ____________
24. Personal exemptions ($3,900 in 2013; $3,950 in 2014)[c]	____________	____________
25. Regular taxable income (subtract lines 23 and 24 from line 14)	$ ____________	$ ____________
26. Regular tax (see tax rate tables)[a]	____________	____________
27. Tax credits	____________	____________
28. Regular tax (net) (subtract line 27 from line 26)	____________	____________
29. Alternative minimum tax[d]	____________	____________
30. Other taxes (self-employment tax, household help, and so forth)	____________	____________
31. Total tax (sum of lines 28, 29, and 30)	____________	____________
32. Total withholding and estimated tax payments	$ ____________	$ ____________
33. Balance due (refund) (subtract line 32 from line 31)	$ ____________	$ ____________

a. If your taxable income includes net capital gain and qualified dividend income, you may be eligible for a tax rate on that income that is lower than the tax rate that applies to your other income. Refer to IRS Form 1040, Schedule D.

b. The option to deduct state and local sales taxes will expire at the end of 2013, without new legislation to extend it.

c. The standard deduction and personal exemptions are not allowed when calculating the alternative minimum tax; the 2014 personal exemption figure is a projected amount.

d. Use IRS Form 6251 as a worksheet and review the discussion on AMT starting on page 25.

2014 Tax Rates

Income Tax

For Single Taxpayers

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	The Tax Is Of the Amount Over
0	9,075	$0 + 10%	$0
9,075	36,900	$907.50 + 15%	$9,075
36,900	89,350	$5,081.25 + 25%	$36,900
89,350	186,350	$18,193.75 + 28%	$89,350
186,350	405,100	$45,353.75 + 33%	$186,350
405,100	406,750	$117,541.25 + 35%	$405,100
406,750	—	$118,118.75 + 39.6%	$406,750

For Married Taxpayers Filing Joint Returns

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	The Tax Is Of the Amount Over
0	18,150	$0 + 10%	$0
18,150	73,800	$1,815.00 + 15%	$18,150
73,800	148,850	$10,162.50 + 25%	$73,800
148,850	226,850	$28,925.00 + 28%	$148,850
226,850	405,100	$50,765.00 + 33%	$226,850
405,100	457,600	$109,587.50 + 35%	$405,100
457,600	—	$127,962.50 + 39.6%	$457,600

For Married Taxpayers Filing Separate Returns

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	The Tax Is Of the Amount Over
0	9,075	$0 + 10%	$0
9,075	36,900	$907.50 + 15%	$9,075
36,900	74,425	$5,081.25 + 25%	$36,900
74,425	113,425	$14,462.50 + 28%	$74,425
113,425	202,550	$25,382.50 + 33%	$113,425
202,550	228,800	$54,793.75 + 35%	$202,550
228,800	—	$63,981.25 + 39.6%	$228,800

For Individuals Filing as Head of Household

Taxable Income Over ($)	Taxable Income But Not Over ($)	The Tax Is	The Tax Is Of the Amount Over
0	12,950	$0 + 10%	$0
12,950	49,400	$1,295.00 + 15%	$12,950
49,400	127,550	$6,762.50 + 25%	$49,400
127,550	206,600	$26,300.00 + 28%	$127,550
206,600	405,100	$48,434.00 + 33%	$206,600
405,100	432,200	$113,939.00 + 35%	$405,100
432,200	—	$123,424.00 + 39.6%	$432,200

Capital Gains and Qualified Dividends

	Taxpayers in 15% Bracket or Below (%)	Taxpayers in the 25% to 35% Brackets* (%)	Taxpayers in the 39.6% Bracket* (%)
Short-Term Capital Gains	taxed as income	taxed as income	taxed as income
Long-Term Capital Gains**	0	15	20
Qualified Dividends	0	15	20
Collectibles***	28 maximum	28 maximum	28
Real Estate Unrealized Gain (Section 1250 Property)	15 maximum	25 maximum	25 maximum

**May also be subject to the 3.8% net investment income (NII) surtax.*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

Kiddie Tax

Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances)	
First $1,000	0%
Next $1,000	child's rate
Over $2,000	parent's rate

Revised with confirmed IRS rates January 6, 2014.

2014 Allowable Tax Benefits

Standard Deduction

Under Age 65	
Married, Filing Joint	$12,400
Single	$6,200
Married, Filing Separate	$6,200
Head of Household	$9,100

Additional—Age 65 or Older	
Married (or Qualifying Widow)	$1,200
Single	$1,550

Additional—Blind	
Married (or Qualifying Widow)	$1,200
Single	$1,550

Personal Exemption

$3,950

Maximum Child Tax Credit

$1,000 per child under age 17 at the end of the year

Standard Mileage Deductions

Business Standard Mileage Rate	56.0 cents
Medical Standard Mileage Rate	23.5 cents
Moving Standard Mileage Rate	23.5 cents
Charitable Serv Standard Mile Rate	14.0 cents

Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

If younger than 50	$5,500
If 50 or older	$6,500

Maximum 401(k) Employee Contribution

If younger than 50	$17,500
If 50 or older	$23,000

Self-Employed Medical Insurance Premium Deduction

100%

Annual Gift Tax Exclusion (per person)

$14,000

Estate Tax Exclusion

$5.34 million

2014 Other Tax Items

2014 Social Security Tax Rates

	Employers & Employees	Self-Employed	Wage Limits
Social Security	6.20%	12.40%	$117,000
Medicare	1.45%	2.90%	no limit
Total	7.65%	15.30%	

2014 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (7.5% if age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize state and local income taxes only; state and local sales tax deduction expired at the end of 2013

2014 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

2014 AMT Exemption Amount

Single	$52,800
Married, Filing Joint	$82,100
Married, Filing Separate	$41,050
Head of Household	$52,800

Revised with confirmed IRS rates January 6, 2014.

2014 Tax Benefit Phase-Out Levels

Personal Exemption

	AGI Phase-Out Level
Married, Filing Joint	$305,050
Single	$254,200
Married, Filing Separate	$152,525
Head of Household	$279,650

Itemized Deduction ("Pease" Limitation)

	AGI Phase-Out Level
Married, Filing Joint	$305,050
Single	$254,200
Married, Filing Separate	$152,525
Head of Household	$279,650

IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

	Modified AGI* Phase-Out Level
Married, Filing Joint	$96,000
Single	$60,000
Married, Filing Separate	$0**
Head of Household	$60,000
Married, Filing Joint not covered by pension plan, but spouse is	$181,000

Roth IRA Eligibility

Maximum $5,500 non-deductible contribution; if 50 or older, maximum is $6,500

	Modified AGI* Phase-Out Level
Married, Filing Joint	$181,000
Single	$114,000
Married, Filing Separate	$0
Head of Household	$114,000

Coverdell Education Account

$2,000 maximum non-deductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

	Modified AGI* Phase-Out Levels
Married, Filing Joint	$190,000 to $220,000
Single	$95,000 to $110,000
Married, Filing Separate	$95,000 to $110,000
Head of Household	$95,000 to $110,000

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$59,000 if strict criteria are met.*

Revised with confirmed IRS rates January 6, 2014.

2014 Tax Planning Calendar

Tax and financial planning are activities best pursued year-round. Although the timing of some activities is critical, you should review all tax considerations from the perspective of your specific needs and establish an individualized planning calendar.

If the last day for filing a return, paying tax or performing other activities falls on a Saturday, Sunday or legal holiday (in the District of Columbia), you have until the next day that is not a Saturday, Sunday or legal holiday to perform that act. Use the following list to remind yourself of important activities and dates:

First Quarter

General

- Complete Form W-4, Employee's Withholding Allowance Certificate, and adjust withholding, if needed.
- Evaluate before-tax and voluntary aftertax contributions to retirement plans.
- Apply for a Social Security number for any child who does not have one.

January 15

- Pay fourth-quarter 2013 estimated tax voucher if you did not pay your income tax for the year through withholding, or if you did not pay enough through withholding. You do not have to make this payment if you file your 2013 return and pay any tax due by January 31, 2014.
- Make quarterly defined-benefit Keogh contribution for preceding year.

January 31

- File your income tax return (Form 1040) for 2013 if you did not pay your last installment of estimated tax by January 15. Filing your return and paying any tax due by January 31 prevents any penalty for late payment of last installment.
- Make sure you have recieved a Form W-2 from each employer you worked for in 2013.

Second Quarter

April 1

- Comply with required minimum distribution (RMD) rules for qualified retirement plans if you attained age 70½ in the previous year.

April 15

- File individual and gift tax returns (or apply for an extension). If you want an automatic six-month extension of time to file the return, file Form 4868; or, you can get an extension (until October 15) by phone or over the Internet if you pay part or all of your estimate of income tax due with a credit card.
- File Schedule H (Form 1040) with your tax return if you paid cash wages of $1,800 or more in 2013 to a household employee.
- Report federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2012 or 2013 to household employees.
- Pay first-quarter estimated tax if you are not paying your 2013 income tax through withholding or you will not pay enough that way.
- Make prior-year IRA and Coverdell Education Savings Account contributions.
- Make prior-year Keogh or SEP plan contribution (unless you applied for an extension of time to file your return).
- Make quarterly defined-benefit Keogh contribution for the current year.

June 16

- Pay second-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Third Quarter

July 15

- Make quarterly defined-benefit Keogh contribution for the current year.

September 15

- Pay third-quarter estimated tax voucher if you are not paying your income tax for the year through withholding, or if you are not withholding enough.

Fourth Quarter

General

Begin your year-end tax planning:

- Project your current year and next year tax liabilities.
- Evaluate the applicability of the AMT and other taxes.
- Adjust withholding, if necessary.
- Evaluate year-end capital transactions.
- Establish a separate Keogh plan for self-employment income.
- Comply with minimum distribution rules for qualified plans.

October 15

- If you extended your individual tax return, file your 2013 income tax return and pay any tax, interest and penalties due.
- Make quarterly defined-benefit Keogh contribution for the current year.

December 31

- Comply with required minimum distribution (RMD) rules for qualified retirement plans. Can delay if obtained age 70½ during 2013.

Throughout the Year

- Re-evaluate your long-term strategies.
- Evaluate your tax and financial strategy for receiving discretionary and mandatory retirement plan distributions.
- Rebalance investment portfolio and re-evaluate your uses of debt.
- Consider making gifts up to the annual gift tax exclusion.
- Evaluate passive loss exposure and potential investment shifts.
- If you have excess cash flow, consider how to invest those funds.
- Optimize mix of interest expense items.
- Consider making charitable contributions of property.
- Consider ways to fund your children's education.
- Evaluate your mix of portfolio and passive income.

2014 Federal Legal Holidays (in the District of Columbia)

January 1—New Year's Day
January 20—Birthday of Martin Luther King Jr.
February 17—Washington's Birthday
May 26—Memorial Day
July 4—Independence Day
September 1—Labor Day
October 13—Columbus Day
November 11—Veterans Day
November 27—Thanksgiving Day
December 25—Christmas Day

(continued from page 16)

The annual required amount, based on either of the first two alternatives, is paid in equal installments. In the case of the third method, which is based on annualized income, the amount due each quarter is based on actual income received for each installment period. The third method is typically more beneficial if you do not earn income evenly throughout the year (e.g., you operate a seasonal business) or had an unexpected increase in income because it allows for lower required payments in the early quarters.

Income tax payments made through withholding from your paycheck (or from your pension or other payments) are given special treatment. The IRS treats income tax that is withheld as having been paid equally throughout the year (unless you prefer to use actual payment dates). This lets you make up for underpaid amounts retroactively because amounts withheld late in the year may be used to increase the amounts paid in earlier quarters.

State and Local Rules: Be aware that many states have underpayment rules that vary from the federal requirements.

Timing: Income & Deductions for Taxpayers Not Subject to AMT

You have opportunities to reduce your taxes if you can control the timing of either your income or expenses. However, it is important to make sure you understand whether you may be subject to the alternative minimum tax (AMT) before adopting these strategies. (See the online version of this article for more information.)

Income

Your income is generally taxed in the year of receipt, so having the ability to control when you receive it affords a strategic tax planning opportunity. Deferring income until a later year will, in most cases, delay the payment of tax. You cannot defer taxation by merely delaying receipt of the income if the funds are available to you and the time of payment is subject to your unrestricted discretion. Any decision to defer income must be weighed with the lost time value of the money and other risks that could alter or forfeit your right to the income.

The timing of bonuses, recognition of capital gains from the sale of stocks, and the exercise of non-qualified stock options are all events that can easily be delayed into a subsequent year. Consider the deferral of compensation through the use of various retirement plans and deferred-compensation arrangements. If you operate a business or collect rental income and report that income on the cash receipts and disbursements method, you have an opportunity to delay or accelerate the billing to your customers or tenants and determine the timing of the related income.

Deductions

You can reduce taxes by controlling the payment of deductible expenses. If paid by December 31, you may deduct certain expenses that are due the following year on your current year tax return. This strategy helps when you have a higher tax liability in the current year than you expect to have in the coming year. Again, you must balance this decision with the time value of money and other inherent risks.

For example, if you pay a deductible expense in December 2013 instead of April 2014, you reduce your 2013 tax instead of your 2014 tax, but you also lose the use of your money for three-and-one-half months. Generally, this will be to your advantage, unless you have an alternative use for the funds that will produce a very high return in that three-and-one-half-month period. You must decide whether the cash used to pay the expense early should be used for something more urgent or more valuable than the accelerated tax benefit.

For those who will pay 2014 estimated taxes based on their 2013 tax liability, reducing your 2013 taxes has another advantage: Your 2014 estimated tax payments may be smaller.

State Taxes

If accelerating deductions makes sense for you and you choose to claim a deduction on your state and local income taxes, you may want to prepay the balance on your estimated state tax liability in December 2013, rather than waiting until 2014. This secures that deduction on your 2013 tax return, even though the payment might not be required by the state until January 15, 2014, or April 15, 2014.

Charitable Contributions

If you are planning on making a gift to a charity in 2014, consider making the gift in 2013 to accelerate the tax benefit of the contribution. However, it is important to note that certain limitations exist with respect to deductions for charitable contributions.

You should also consider the benefits of gifting appreciated stock to a charity. If you donate long-term appreciated stock directly to the charity, you get a deduction for the full fair market value of the stock; whereas, if you sell the stock first and donate cash, you only get a deduction for the aftertax cash donated. (If you have an unrealized loss in the stock, however, it might be more beneficial from a tax standpoint to sell the stock and then donate the cash proceeds. Doing so would give you deductions for both the capital loss and the charitable donation.)

When making a gift to charity, you must have an appropriate record of the gift in order to properly support the deduction. In addition, cash contributions of any amount must be supported by a written record, either in the form of a bank record (for example, a cancelled check) or a written receipt from the charity. The record must include the name of the charity, the date and the amount of the contribution.

Prepaid Interest

A cash basis taxpayer may not deduct prepaid interest before the tax year to which the interest relates. However, there is some flexibility to prepay year-end interest that is due early in the following year. For example, if a mortgage payment is due on January 10, a taxpayer can accelerate the deduction of the portion of the interest relating to the period up to January 1 by mailing the check in December.

The most significant interest deductions currently available are for home mortgage interest and for investment interest expense to the extent of current-year investment income. Interest paid in relation to investments that earn a tax-free return is not deductible.

Medical Expenses

If the timing of certain medical and dental expenditures is flexible and your overall medical expenses are high in the current year, you may want to accelerate the timing of these expenses. Because unreimbursed medical expenses are only deductible to the extent that they exceed 10% of adjusted gross income (7.5% for those age 65 and older), it is best from a tax standpoint to incur expenses—such as replacement eyeglasses or contact lenses, elective surgery, dental work and routine physical examinations—in a year in which you have already gone over (or the added expenses would take you over) the 10% threshold.

Miscellaneous Itemized Deductions

Miscellaneous itemized deductions are only deductible to the extent that they exceed 2% of adjusted gross income. This category is large but includes:

- Tax preparation fees such as tax preparation software, tax publications and any fee paid for electronic filing; and
- Investment fees, custodial fees, trust administration fees and other expenses paid for managing your investments that produce taxable income.

Accelerating miscellaneous itemized deductions only benefits taxpayers who accumulate expenses sufficient enough to exceed the 2% threshold. If possible, it may be advantageous to pay these types of expenses in one year if, because of the 2% floor, you would not receive a benefit of the deduction in each of the two consecutive years.

Timing Caution for Taxpayers Subject to AMT

The alternative minimum tax (AMT) was originally designed to ensure that everyone would pay his or her fair share of income taxes. In 1987, only 140,000 taxpayers were subject to the AMT. Since then, however, it has evolved into a separate tax regime that required a permanent fix in the ATRA to prevent from it ensnaring millions of Americans.

The wisdom of conventional tax planning advice to defer income and accelerate certain types of deductions may not hold true if an individual expects to be subject to the AMT. Accordingly, during the tax planning process, it is critical that you determine whether you are subject to the AMT in both the current year and the following year.

If you are continuously subject to the AMT, avoid investing in private-activity (municipal) bonds. Income from these bonds is taxable for AMT purposes. (There are exceptions, including qualified 501(c)(3) bonds, New York Liberty bonds and Gulf Opportunity Zone bonds. Also, the interest on qualified bonds issued in 2009 and 2010 is not subject to the alternative minimum tax. Check with the bond issuer for the bond's tax status.) Furthermore, you should be aware that unusual combinations of income and deductions might require AMT planning that runs contrary to conventional tax-planning advice.

Although the exercise of an incentive stock option (ISO) does not give rise to regular taxable income for the employee, the difference between the exercise price and the market price of a stock must be recognized for AMT purposes for the year in which the option is exercised. Accordingly, the exercise of incentive stock options with a large bargain element often causes a tax liability under the alternative minimum tax regime.

The AMT arena is extremely complex, so generalizations are difficult to make. If you think you may be subject to the alternative minimum tax, you should consult with a tax professional to determine how best to minimize your exposure to it.

Year-End Estate and Gift Tax Planning

Year-end planning from an estate planning perspective typically involves ensuring that "annual exclusion" gifts are completed by the end of a calendar year.

Under the federal gift tax system, each donor is permitted to make non-taxable gifts of a certain amount each year to any donee. These gifts are called "annual exclusion" gifts and do not count against the donor's lifetime gifts exemption. The annual gift tax exclusion level is $14,000 for 2013 and is projected to stay at that level in 2014. To the extent not used, the annual exclusion evaporates at the end of each calendar year.

Annual transfers that take advantage of this exclusion can both diminish the donor's estate tax liability and improve the lives of the recipients. These gifts can take many forms (cash, stocks, real estate, partnership interests) and can be given outright through Uniform Transfers to Minors accounts, and even through a trust—provided it contains special provisions designed to allow the gift to qualify for the annual exclusion. ➤

AAII staff Charles Rotblut, Jean Henrich, Kate Peltz and Andrew Lautner contributed to this guide.