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TO: CLIENTS AND THEIR ADVISORS
RE: 2013 YEAR END TAX PLANNING

Year-end tax planning could be especially productive of 2013 because timely action could secure a host of tax breaks that will not be available next year unless Congress acts to extend them. For individuals, these include (i) the option to deduct state and local sales and use taxes instead of state and local income taxes; (ii) the above-the-line deduction for qualified higher education expenses; and (iii) tax-free distributions by those age 70— or older from IRAs for charitable purposes. For businesses, these include (i) 50% bonus first-year depreciation for most new machinery, equipment and software; (ii) an extraordinarily high $500,000 first-year expensing limitation; (iii) the research tax credit; and (iv) the 15-year writeoff for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements.

High-income-earners have other factors to consider when addressing year-end plans. For the first time, they must take into account the 3.8% tax surtax on unearned income and the additional 0.9% Medicare (hospital insurance, or HI) tax that applies to individuals receiving wages with respect to employment in excess of $200,000 ($250,000 for married couples filing jointly and $125,000 for married couples filing separately).

The surtax equals 3.8% of the lesser of: (1) net investment income (NII), or (2) the excess of modified adjusted gross income (MAGI) over an un-indexed threshold amount ($250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case). A taxpayer's approach to minimizing or eliminating the 3.8% surtax will depend on his estimated MAGI and NII for the year. Taxpayers should (i) minimize (e.g. through deferral) additional NII for the balance of the year, (ii) reduce MAGI other than unearned income, and consider ways to minimize both NII and other types of MAGI.

The additional Medicare tax may require year-end actions. Employers must withhold the additional Medicare tax from wages in excess of $200,000 regardless of an employee's filing status or other income. Self-employed persons must take the tax into account in figuring estimate tax. Some employees may need to have more tax withheld toward the end of 2013 to cover the tax. If an employee earns $200,000 from one employer and $200,000 from another employer in 2013, neither employer would know to withhold the additional Medicare tax because their respective wages paid do not exceed the $200,000 exemption amount. The opposite could occur as well if only one of two married spouses works and reaches the threshold for the employer to withhold, but the couple's income will not be high enough to actually cause the tax to be owed.

Year-End Tax Planning Moves for Individuals

- Increase the amount you set aside for next year in your employer's health flexible spending account (FSA) if you set aside too little for this year.
- If you become eligible to make health savings account (HSA) contributions anytime before December 31, 2013, you can make a full year's worth of deductible 2013 HSA contributions in December.
- Realize losses on stock while substantially preserving your investment position. There are several ways this can be done. For example, you can sell the original holding, then buy back the same securities at least 31 days later, or sell it in a taxable account and buy it simultaneously in a retirement account.
- Postpone income until 2014 and accelerate deductions into 2013 to lower your 2013 tax bill. This strategy may enable you to claim larger deductions, credits, and other tax breaks for 2013 that are phased out over varying levels of adjusted gross income (AGI). These include child tax credits, higher education tax credits, the above-the-line deduction for higher-education expenses, and deductions for student loan interest. Postponing income also is desirable for those taxpayers who anticipate being in a lower tax bracket next year due to changed financial circumstances. Note, however, that in some cases, it may pay to actually accelerate income into 2013. For example, this may be the case where a person's marginal tax rate is much lower this year than it will be next year or where lower income in 2014 will result in a higher tax credit for an individual who plans to purchase health insurance on a health exchange and is eligible for a premium assistance credit.
- If you believe a Roth IRA is better than a traditional IRA, and want to remain in the market for the long term, consider converting traditional-IRA funds invested in beaten-down stocks (or mutual funds) into a Roth IRA if eligible to do so. Keep in mind, however, that such a conversion will increase your adjusted gross income for 2013.
- If you converted assets from a traditional IRA to a Roth IRA earlier in the year, the assets in the Roth IRA account may have declined in value. In that case, you would pay a higher tax than is necessary. You can reverse the transaction by recharacterizing the rollover or conversion, by transferring the converted amount (plus earnings, or minus losses) from the Roth IRA back to a traditional IRA via a trustee-to-trustee transfer. You can later reconvert to a Roth IRA in a future year.
- It may be advantageous to try to arrange with your employer to defer a 2013 bonus until 2014.
- Consider using a credit card to prepay expenses that can generate deductions for 2013.
- If you expect to owe state and local income taxes for 2013, consider increasing withholding of state and local taxes (or pay estimated tax payments of state and local taxes) in 2013 if the benefit of the deduction will not be eliminated by the alternative minimum tax (AMT).
- To avoid the penalty for underpayment of estimated tax, take an eligible rollover distribution from a qualified retirement plan before the end of 2013 if the increased withholding option is

unavailable or will not sufficiently address the problem. Income tax will be withheld from the distribution and will be applied toward the taxes owed for 2013. You can then timely (within 60 days) roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2013, but the withheld tax will be applied pro rata over the full 2013 tax year to reduce previous underpayments of estimated tax.

- Estimate the effect of any year-end planning moves on the alternative minimum tax (AMT) for 2013, keeping in mind that many tax breaks allowed for purposes of calculating regular taxes are disallowed for AMT purposes. These include the deduction for state and local income and property taxes on your residence, state sales tax if you elect to deduct it, miscellaneous itemized deductions, and personal exemption deductions. Other deductions, such as for medical expenses, are calculated in a more restrictive way for AMT purposes than for regular tax purposes in the case of a taxpayer who is over age 65 or whose spouse is over age 65 as of the close of the tax year. As a result, in some cases, deductions should not be accelerated.
- Accelerate big ticket purchases into 2013 in order to assure a deduction for sales taxes on the purchases if you will elect to deduct sales taxes instead of state and local income taxes. Unless Congress acts, this election will not be available after 2013.
- You may be able to save taxes this year or next by applying a bunching strategy to your miscellaneous itemized deductions, medical expenses and other itemized deductions either before or after December 31, 2013.
- If you are a homeowner, make energy saving improvements to your residence, such as putting in extra insulation, installing energy saving windows, or installing an energy efficient heater or air conditioner. You may qualify for a tax credit if the assets are installed in your home by December 31, 2014.
- Unless Congress extends it, the up-to-$4,000 above-the-line deduction for qualified higher education expenses will not be available after 2013. Thus, consider prepaying eligible expenses if doing so will increase your deduction for qualified higher education expenses. Generally, the deduction is allowed for qualified education expenses paid in 2013 in connection with enrollment at an institution of higher education during 2013 or for an academic period beginning in 2013 or in the first 3 months of 2014.
- You may want to pay contested state and local taxes to be able to deduct them for 2013 while continuing to contest them next year.
- You may want to settle an insurance or damage claim to maximize your 2013 casualty loss deduction.
- Purchase qualified small business stock (QSBS) before the end of this year. There is no tax on gain from the sale of such stock if it is (1) purchased after September 27, 2010 and before January 1, 2014, and (2) held for more than five years. In addition, such sales will not cause AMT preference problems. To qualify for these breaks, the stock must be issued by a regular (“C”) corporation with total gross assets of $50 million or less, and a number of other technical requirements must be met. Our office can review the details with you.

- If you are age 70-1/2 or older, own IRAs and are thinking of making a charitable gift, consider arranging for the gift to be made directly by the IRA trustee. Such a transfer, if made before year-end, can achieve important tax savings.
- Take required minimum distributions (RMDs) from your IRA or 401(k) plan (or other employer-sponsored retired plan) if you have reached age 70-1/2. Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. If you turned age 70-1/2 in 2013, you can delay the first required distribution to 2014, but if you do, you will have to take a double distribution in 2014 (i.e. the amount required for 2013 plus the amount required for 2014). Think twice before delaying the 2013 distributions to 2014 by bunching income into 2014. That might push you into a higher tax bracket for 2014or have a detrimental impact on various income tax deductions that are reduced at higher income levels. However, it could be beneficial to take both distributions in 2014 if you will be in a substantially lower bracket in 2014, for example, because you plan to retire shortly.
- Make gifts sheltered by the annual gift tax exclusion before the end of the year and thereby save gift and estate taxes. You can give $14,000 in 2013 to each of an unlimited number of individuals. However, you cannot carry over unused exclusions from one year to the next. The transfers also may reduce overall family income taxes if income-earning property is given to family members in lower income tax brackets who are not subject to the" kiddie tax".

Year-End Tax-Planning Moves for Businesses & Business Owners

- Businesses should consider making expenditures that qualify for the business property Section 179 first-year expensing option. For tax years beginning in 2013, the expensing limit is $500,000 and the investment ceiling limit is $2,000,000. Also, a limited amount of expensing may be claimed for qualified real property. However, unless Congress changes the rules, for tax years beginning in 2014, the dollar limit will drop to $25,000, the beginning-of-phaseout amount will drop to $200,000, and expensing will not be available for qualified real property. In addition, the expensing deduction is not pro-rated for the time that the asset is in service during the year. This opens up significant year-end planning opportunities.
- Obtain a work opportunity tax credit (WOTC) by hiring qualifying workers (such as certain veterans) before the end of 2013. Under current law, this credit will not be available for workers hired after 2013.
- Make qualified research expenses before the end of 2013 to claim a research credit, which will not be available for post-2013 expenditures unless Congress extends the credit.
- If you are self-employed, considering setting up a self-employed retirement plan, such as a SEP or solo 401(k). SEP-IRA contributions for 2013 must be made by October 15, 2014 (if you obtain an extension to file your 2013 return). A solo 401(k) plan must be adopted on or before December 31, 2013.
- Depending on your particular situation, you may want to consider deferring a debt-cancellation event until 2014. You also may want to dispose of a passive activity by December 31, 2013 to allow you to deduct suspended losses on your 2013 tax returns..

- If you own an interest in a partnership or S corporation, you may need to increase your basis in your interest in the entity so you can deduct a loss generated by it in 2013.

These are just some of the year-end steps that can be considered to reduce taxes. We can tailor a particular plan that will work best for you.

Very truly yours,

T.W. Lewis & Co., LLC