TAXES FOR 2013-2014: WHAT'S DIFFERENT

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Looking back, 2013 was the year that wasn't – at least when it comes to taxes. There was much political posturing about a massive tax overhaul — including Promethean but conflicting aims to (1) rebuild the tax code from scratch; (2) lower taxes and redistribute tax burdens; and (3) end corporations' off-shore tax holidays. But in the end, no major changes to the U.S. tax code were made. So what will be different?

FOR 2013

HIGHER TAX BILLS LIKELY

Your 2013 tax bill may surprise you – and not in a good way. This past year is the first full year that people with higher incomes will be subject to the American Taxpayer Relief Act of 2012.

RATE	SINGLE	MARRIED FILING JOINTLY
10%	0 - $8,925	0 to $17,850
15%	$8,925 - $36,250	$17,850 - $72,500
25%	$36,250 - $87,850	$72,500 - $146,400
28%	$87,850 - $183,250	$146,400 - $223,050
33%	$183,250 – $398,350	$223,050 - $398,350
35%	$398,350 - $400,000	$398,350 - $450,000
39.6%	Above $400,000	Above $450,000

Source: IRS

▪ HIGHER TAX RATES. A marginal tax rate of nearly 40% will apply to income above $450,000 for married couples filing jointly ($400,000 for singles). Also, for this same group, the tax on long-term capital gains rises to 20% (from 15%). NOTE: Trusts and estates face these higher rates at a much lower taxable-income threshold: just $11,950 annually.

▪ PHASING OUT OF PERSONAL EXEMPTIONS AND DEDUCTIONS. The phasing out of personal exemptions and itemized deductions will also affect higher-income people, for the first time since 2010. For married couples filing jointly, the phasing out starts at $300,000 in adjusted gross income and $250,000 for singles.

▪ NEW HEALTHCARE-RELATED TAXES. We're not done yet. For the first time in 2013, high-income investors will face an additional 3.8% tax on investment income to help pay for the new healthcare provisions (The Affordable Care Act).This new tax applies to most types of investment income – including interest, dividends, capital gains, rental and royalty income, and passive business income. And it kicks in for couples filing jointly with $250,000 in adjustable gross income ($200,000 for singles). Trusts face this same tax when income exceeds $11,950.

To help fund Medicare, there's an additional 0.9% tax on employment-related income that is above $200,000 for singles and $250,000 for married couples filing jointly. This applies to both wage earners and the self-employed.

THE ALTERNATIVE MINIMUM TAX (AMT)

First the good news: an estimated 20 million middle-income taxpayers will no longer be subject to the AMT, thanks to expanded exemptions made permanent in 2012. The bad news: For those still subject to the AMT, the amount owed becomes more complex to calculate. Starting in 2013, the AMT does include the new higher rate on long-term capital gains, but it does not incorporate the itemized deduction phase-out mentioned above.

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Tax software helps with the complicated math, but nothing much helps with the confusion when 2+2–1 does not come out to 3 on your tax return.

FOR 2014

WASHINGTON ESTATE TAX CHANGES

▪ ESTATES LARGER THAN $4 MILLION IN WASHINGTON STATE WILL FACE HIGHER RATES. For estates valued at $9 million or more, the new rate rises to 20%. This means the highest marginal estate-tax rate for WA residents – federal plus state — will be a hefty 50%.

▪ THE $2 MILLION IN ASSETS EXEMPT FROM WA ESTATE TAXES WILL BE INDEXED ANNUALLY FOR INFLATION, starting in 2014. We estimate the 2014 exemption amount will be $2,012,000.

▪ UP TO $2.5 MILLION OWNERSHIP IN A QUALIFIED FAMILY-OWNED BUSINESS WILL NOT BE COUNTED AS PART OF A WA ESTATE, AS LONG AS:

1. This interest is worth less than $6 million and is more than half of the decedent's WA estate;

2. The decedent or his/her family owned and operated the business for five of the eight preceding years;

3. The deceased was a U.S. citizen or resident;

4. The interest is passed on to a qualified heir: someone who in the three-year period following the transfer materially participates in the business; does not transfer his/her interest to a non-qualified owner; is a U.S. citizen; and does not move the business outside the U.S.

FEDERAL TAX BREAKS THAT MAY EXPIRE

Congress did not renew some very popular tax breaks that expired at the end of 2013. Given that 2014 is a Congressional election year, these may yet be re-activated. But of course, there's no way to know for sure. Included in this list:

▪ GENEROUS TAX WRITE-OFFS FOR NEW BUSINESS PROPERTY. From computers used in a home office to certain building improvements, a business can expense (fully depreciate) up to $500,000 in property acquired in 2013, subject of course to certain income limitations. But starting in 2014, only $25,000 in new personal property (not building improvements) can be expensed annually, assuming this economy-boosting tax break isn't adjusted or renewed this year.

▪ THE ITEMIZED DEDUCTION FOR STATE AND LOCAL SALES TAXES. Washington State residents have benefited from this tax break for years. And it will be sorely missed if not renewed.

▪ TAX-ADVANTAGED TRANSFERS FROM AN IRA TO A CHARITY, FOR THOSE AGE 70 ½ OR OLDER. Through 2013, up to $100,000 could have been transferred directly to a qualified charity and not count as income. At the same time, the transfer did count toward the IRA's required minimum distribution. Note that for this purpose, donor-advised funds (DAFs) are not considered qualified charities. Congress has re-authorized this tax break three times in the past.

▪ THE ALTERNATIVE-ENERGY TAX CREDIT. This is for homeowners and non-business entities that install solar or other environmentally friendly energy sources or devices.

▪ THE 20% TAX CREDIT FOR RESEARCH AND DEVELOPMENT (R&D). This tax break has expired 15 times since it was introduced in 1981 and has been renewed each time.

KEEPING WATCH

At Laird Norton Wealth Management, we always consider the eroding effect of taxes on our clients' portfolios and finances. Now more than ever, we're helping clients minimize taxes through ongoing tax awareness coupled with multiyear cash-flow modeling. As 2014 progresses, rest assured that we'll closely monitor the tax situation so we can apply our best-thinking to your financial plans and investments. ■

ABOUT THE AUTHOR

Kristi Mathisen is Laird Norton Wealth Management's in-house expert on tax and estate planning issues. She provides advice on philanthropic strategies to the firm's client service team and to clients directly. She is an attorney and CPA and has more than 20 years of finance-related experience, much of it in accounting.

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