2013 YEAR-END TAX PLANNING

Facing the Impact of ATRA

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As 2013 comes to a close, we face the first season of year-end tax planning under American Taxpayer Relief Act of 2012 (ATRA). In 2012, we experienced a year-end filled with uncertainty. In 2013, we have certainty, challenges and opportunities, not just the "relief" referenced in the year-old Taxpayer *Relief* Act.

Whereas tax rate increases were anticipated from 2012 to 2013, at present 2013 and 2014 tax rates are schedule to remain the same, although there has been much discussion of tax reform in 2014. Time will tell. Following are some general year-end tax planning considerations. However, each individual's tax situation is unique and should be evaluated with the guidance of a tax professional.

YEAR-END INCOME TAX PLANNING

Be mindful of thresholds

With ATRA we have a number of tax changes for high income taxpayers – higher ordinary income, long term capital gain and qualified dividend tax rates, additional Medicare taxes on wages and self-employment income, the 3.8% Medicare contribution tax on net investment income and phase-out of itemized deductions and personal exemptions. Each of these changes is implemented at a defined threshold, but the thresholds are not uniform. If practicable, it is generally preferable to avoid spikes in income that will cause a taxpayer to cross a threshold triggering a higher tax rate or lower deduction. The question to be answered in this context is at what point one is considered "high-income".

2013 Rates	**39.6% ordinary income and 20% long term capital gain and qualified dividend tax rate**	**Phase-out personal exemptions and itemized deductions**	**Medicare contribution tax on net investment income**
Married filing jointly and surviving spouses	$450,000 taxable income	$300,000 adjusted gross income	$250,000 modified adjusted gross income
Head of household	$425,000 taxable income	$275,000 adjusted gross income	$200,000 modified adjusted gross income
Single filer	$400,000 taxable income	$250,000 adjusted gross income	$200,000 modified adjusted gross income
Married filing separately	$225,000 taxable income	$150,000 adjusted gross income	$125,000 modified adjusted gross income

Consider the timing of income, losses and deductions

With tax rate stability from 2013 to 2014, deferring income and accelerating losses and deductions can provide overall tax savings. Whereas many taxpayers accelerated income and deferred losses and deductible expenditures at the end of 2012 in anticipation of higher tax rates in 2013, at present we do not face the threat of higher individual tax rates in 2014. So the conventional wisdom of taking advantage of deductions and losses sooner and recognizing income later has come back into tax planning. However, decisions with respect to timing should take into consideration the Alternative Minimum Tax as well as the effect of future spikes in income as a result of current deferral given the various thresholds described above. In addition, the so-called "wash sale" rule limits the ability to sell an investment to recognize a loss and then buy it back within a short timeframe.

Optimizing the tax benefit of charitable contributions

Enhanced index strategies are one of the few modalities of investing that can suitably provide both the beta – asset class return – exposure, and the alpha for this rapidly evolving framework for institutional investors. The goal of enhanced indexation is to modestly minimal additional risk, thus achieving a high information ratio. Enhanced indexing world. Disappointment with active manager performance (and their associated higher fees) had already encouraged investors to boost allocations.

Accelerating charitable contribution

For individuals who are charitably inclined and desire to obtain the current tax benefit of a charitable contribution, but are uncertain as to the selection of specific charitable recipients, year-end contributions may be made to a donor advised fund. Further distributions may be made from the fund to specific charities in the current year and in subsequent years. You receive an income tax deduction (subject to applicable limitations) for a 2013 contribution to a donor advised fund in 2013 under the tax law now in effect. If there are restrictions on charitable gifts under future tax laws, your current deduction will not be affected. For additional information, read our Income Tax Charitable Deduction Summary.

Retirement planning

Retirement planning is a long-term commitment, not just a year-end "to do" activity. However, year-end is a good time to reassess and reevaluate. If you are considering converting a traditional IRA to a Roth IRA in 2013, take into account how the conversion will impact your 2013 tax bracket, Medicare contribution tax on net investment income computations and any phase-out of itemized deductions.

2014 tax season delayed

The 16-day October government shutdown is expected to delay the government's launch of the 2014 tax filing season. About 90 percent of the Internal Revenue Service's operations were closed during the shutdown. This put the Service approximately three weeks behind its customary timetable for the 2014 tax season.

YEAR-END WEALTH TRANSFER PLANNING

ATRA brought welcome guidance for gift, estate and generation-skipping transfer tax planning and we continue to have the benefit of traditional gift strategies.

Inflation-adjusted high level applicable exclusion

The gift and estate tax applicable exclusion amount and generation-skipping transfer tax exemption in effect in 2013 is $5,250,000. This reflects inflation adjustments to the basic $5,000,000 exclusion, which was $5,120,000 in 2012 and will be $5,340,000 in 2014. If you utilized your full exclusion of $5,120,000 in 2012 prior to the wealth transfer tax relief that ATRA provided, the incremental inflation adjustment ($130,000 from 2012 to 2013) provides an opportunity to make additional tax-free gifts. However, now that income tax rates have increased for high-income taxpayers and we have the benefit of the higher level gift and estate tax exclusion, the decision to make additional lifetime gifts should take the basis of the property into consideration. With lifetime gifts the donee generally receives the donor's basis, whereas with transfers at death, the recipient's basis is adjusted to the value of the property at death (or the alternate valuation date). For appreciated assets, a basis step-up at death provides an income tax advantage to the beneficiary.

Annual gifts

In 2013 you may make tax-free gifts of $14,000 to as many individuals as you choose. For a married couple, the combined gifts can total $28,000. This remains a simple and efficient wealth transfer strategy.

Gift trusts

If you have established irrevocable gift trusts designed to have you treated as the owner for income tax purposes, you should take the tax liability flowing through to you from the trust(s) into account in your year-end tax planning. If your trust was structured so as to allow for the termination of the grantor-as-owner income tax treatment during your lifetime, year-end is a good time to review your gift, estate and income tax circumstances with your advisor and determine whether any change in the tax status of the trust (from grantor with flow through tax treatment to non-grantor with separate taxpayer treatment) is desired and permissible for the new year.

Times have changed. The tax environment this year is quite different from the tax landscape we were navigating just a year ago. What has not changed is the need to review our circumstances and adjust our course as appropriate in advance of turning the calendar to the new year.

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If you'd like to learn more, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.

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