

# The Kiplinger Tax Letter

CIRCULATED BIWEEKLY TO BUSINESS CLIENTS SINCE 1925  
1100 13th Street NW, Washington, DC 20005 • kiplinger.com • Vol. 88, No. 1

**SPECIAL**
**THIS YEAR'S  
NEW TAX RULES**

Dear Client:

Washington, Jan. 4, 2013

This year starts with a new set of tax rules.

Many important ones were not finalized until Jan. 1, when the fate of the Bush tax cuts was finally decided.

We will cover the changes in this Letter.

Despite the relief over a tax deal for 2013...

Payroll tax increases may spoil the party.

The payroll tax reduction expired Dec. 31.

Lawmakers did not renew the two-percentage-point cut in the employees' share of the Social Security tax.

They did not like the idea that government funding was required to make up the decrease in tax revenue

for the Social Security trust fund. As a result, they decided to let this break lapse.

Thus, employees will see smaller paychecks as the rate returns to normal, unless workers got a raise that offsets the impact. And the higher SECA tax rate means that self-employed individuals should boost their estimated tax payments.

A 0.9% Medicare surtax on earned income kicks in for higher-incomers.

This tax hike was passed in 2010 as part of health care reform, but the effective date was delayed to 2013. The levy applies to wages as well as to self-employment income. Singles and heads of household will owe it once total earnings exceed \$200,000.

Couples...over \$250,000. Marrieds filing separately...over \$125,000. So for earnings over the thresholds, the effective Medicare tax rate will be 3.8%...the usual 2.9% rate plus an extra 0.9%. The surtax applies only to the employee's share of Medicare tax. Employers don't owe it. Employers will withhold the surtax once an employee's wages exceed \$200,000. Employees will then calculate the actual tax due on their 1040s.

The 3.8% Medicare surtax on net investment income also begins this year,

another aspect of health care reform. It applies to unearned income of single filers and heads of household who have modified adjusted gross incomes above \$200,000.

It bites couples with modified AGIs over \$250,000...\$125,000 for separate filers.

Modified AGI is AGI plus any tax free foreign earned income. This surtax is levied on the smaller of the filer's net investment income or the excess of modified AGI over the applicable dollar threshold. Investment income includes interest, dividends, payments of substitute interest and dividends by brokers, capital gains, annuities, royalties and passive rental income. Tax free interest is exempted, along with payouts from retirement plans such as 401(k)s, IRAs, deferred pay plans and pension plans.

Now let's turn to other tax changes that are taking effect for this year:

The estate and gift tax exemption for 2013 increases to \$5,250,000.

The tax rate jumps to 40%. The annual gift tax exclusion rises to \$14,000 per donee.

Congress also revived the portability of the estate tax exemption between spouses.

Up to \$1,070,000 of farm or business realty can receive discount estate tax valuation.

And more estate tax qualifies for an installment-payment tax break.

If one or more closely held businesses make up greater than 35% of an estate, as much as \$572,000 of tax can be deferred, and IRS will charge only 2% interest.

## HIGHLIGHTS

[Personal Taxes](#) New tax brackets

[Investments](#) Mixed news on rates

[Social Security](#) Higher wage base

[Medicare](#) Premium increases

[Savings Plans](#) 401(k) limit rises

[Business Taxes](#) Faster write-offs

**PERSONAL TAXES**

The expiration date on the Bush income tax cuts has been eliminated. But tax rates on high-incomers increase for the first time since 1993.

A 39.6% rate now applies to taxable income over \$400,000 for singles, \$425,000 for heads of household and \$450,000 for married couples filing a joint return.

<b>Marrieds: If taxable income is</b>	<b>The tax is</b>
Not more than \$17,850	10% of taxable income
Over \$17,850 but not more than \$72,500	\$1,785.00 + 15% of excess over \$17,850
Over \$72,500 but not more than \$146,400	\$9,982.50 + 25% of excess over \$72,500
Over \$146,400 but not more than \$223,050	\$28,457.50 + 28% of excess over \$146,400
Over \$223,050 but not more than \$398,350	\$49,919.50 + 33% of excess over \$223,050
Over \$398,350 but not more than \$450,000	\$107,768.50 + 35% of excess over \$398,350
Over \$450,000	\$125,846.00 + 39.6% of excess over \$450,000
<b>Singles: If taxable income is</b>	<b>The tax is</b>
Not more than \$8,925	10% of taxable income
Over \$8,925 but not more than \$36,250	\$892.50 + 15% of excess over \$8,925
Over \$36,250 but not more than \$87,850	\$4,991.25 + 25% of excess over \$36,250
Over \$87,850 but not more than \$183,250	\$17,891.25 + 28% of excess over \$87,850
Over \$183,250 but not more than \$398,350	\$44,603.25 + 33% of excess over \$183,250
Over \$398,350 but not more than \$400,000	\$115,586.25 + 35% of excess over \$398,350
Over \$400,000	\$116,163.75 + 39.6% of excess over \$400,000
<b>Household heads: If taxable income is</b>	<b>The tax is</b>
Not more than \$12,750	10% of taxable income
Over \$12,750 but not more than \$48,600	\$1,275.00 + 15% of excess over \$12,750
Over \$48,600 but not more than \$125,450	\$6,652.50 + 25% of excess over \$48,600
Over \$125,450 but not more than \$203,150	\$25,865.00 + 28% of excess over \$125,450
Over \$203,150 but not more than \$398,350	\$47,621.00 + 33% of excess over \$203,150
Over \$398,350 but not more than \$425,000	\$112,037.00 + 35% of excess over \$398,350
Over \$425,000	\$121,364.50 + 39.6% of excess over \$425,000

The 2013 standard deductions rise a bit. Marrieds get \$12,200. If one spouse is age 65 or older...\$13,400. If both are...\$14,600. Singles can claim \$6,100...\$7,600 if they're 65. Household heads get \$8,950 plus \$1,500 more once they reach age 65. Blind people receive \$1,200 more (\$1,500 if unmarried and not a surviving spouse).

High-incomers resume losing some of their itemized deductions for 2013. Their write-offs are slashed by 3% of the excess of AGI over \$250,000 for singles, \$275,000 for household heads and \$300,000 for marrieds. But the total reduction can't exceed 80% of itemizations. Medicals, investment interest, casualty losses and gambling losses (to the extent of winnings) are exempted from this cutback.

Personal exemptions increase to \$3,900 for filers and their dependents.

But this write-off is phased out for high-incomers once again. It is cut by 2% for each \$2,500 of AGI over the same thresholds for the itemized deduction phaseout.

**INVEST-MENTS**

The top rate on capital gains and dividends rises to 20% for high-incomers... singles with taxable income above \$400,000 and couples over \$450,000.

The Medicare surtax can boost the rate to 23.8%. For others, a 15% rate applies, but filers in the 10% or 15% tax bracket can still qualify for the special 0% rate.

**MINIMUM TAX**

The AMT exemptions are going up for 2013. They jump to \$80,750 for couples and \$51,900 for both singles and household heads, up from 2012 by \$2,050 and \$1,300, respectively. The exemptions will automatically increase in future years, based on the rate of inflation. Also, personal tax credits, such as those for tuition and dependent care, will continue to offset alternative minimum tax liability.



Your subscription includes The Tax Letter online. Go to [KiplingerTax.com](http://KiplingerTax.com)

**SOCIAL SECURITY** The Social Security wage base rises this year to \$113,700, a \$3,600 boost. Tax rates are higher, as we noted earlier, with the expiration of the cut in the employee Social Security rate and the 0.9% Medicare surtax on high-earners. Social Security benefits go up 1.7% in 2013...less than half of 2012's hike. The earnings limits also increase. Individuals who turn 66 this year do not lose any benefits if they make \$40,080 or less a year before they reach that age. Folks who are at least 62 but are not 66 by the end of 2013 can make up to \$15,120 before they lose any benefits. There is no earnings cap once a beneficiary turns 66. And the amount needed to qualify for coverage goes up to \$1,160 a quarter. So earning \$4,640 anytime during 2013 will net the full four quarters of coverage.

**MEDICARE** The basic Medicare Part B premium increases to \$104.90 per month in 2013. But the Part B and D premiums are much higher for upper-income seniors if their modified adjusted gross incomes for 2011 exceeded \$170,000 for couples or \$85,000 for single people. Modified AGI is AGI plus any tax-exempt interest, EE bond interest that's used for education and excluded foreign earned income. The total surcharges on upper-incomers can be as large as \$297.40 a month.

**MEDICALS** The threshold for deducting medical expenses jumps to 10% of AGI for singles under age 65. The same goes for married couples who file a joint return, unless at least one of the filers is age 65 or older. If so, they get the 7.5%-of-AGI cap. Annual ceilings on deductible payins to health savings accounts inch up in 2013. The maximums are \$6,450 for account owners with family medical coverage and \$3,250 for single coverage. HSA owners born before 1959 can put in \$1,000 more. The limitations on out-of-pocket expenses such as deductibles and copayments increase to \$12,500 for those with family coverage and \$6,250 for single coverage. Minimum policy deductibles increase to \$2,500 for families and \$1,250 for individuals.

Payins to health flexible spending accounts are now capped at \$2,500. And the limits on deducting long-term-care premiums are a bit higher. Taxpayers who are age 71 or older can write off as much as \$4,550 per person. Filers age 61 to 70...\$3,640. Those who are 51 to 60 can deduct up to \$1,360. Individuals age 41 to 50 can take \$680. And people age 40 and younger...\$360. Also, the limit for tax free payouts under such policies increases to \$320 a day.

**SAVINGS PLANS** The maximum 401(k) contribution is \$17,500 this year, a \$500 increase over 2012. Individuals born before 1964 can put in as much as \$23,000. The contribution limits apply to 403(b) and 457 plans as well. The ceiling on SIMPLEs will rise to \$12,000. Folks age 50 or older in 2013 can put in an additional \$2,500. Employer payins to qualified plans can be based on up to \$255,000 of pay. As a result, the payin limitation for defined contribution plans increases to \$51,000. Anyone making over \$115,000 is highly paid for plan discrimination testing. And the benefit limitation for pension plans increases to \$205,000 this year. Employees now have an easier time switching a 401(k) to a Roth 401(k). A new law lets them transfer their 401(k) money straight to the plan's Roth account, even if they're ineligible to take a payout from the plan because they aren't 59½, etc.

The 2013 payin limits for IRAs and Roth IRAs will jump to \$5,500, \$500 more than for 2012. Anyone who was born in 1963 or earlier can put in an extra \$1,000. The income ceilings on Roth IRA payins go up. Contributions phase out at AGIs of \$178,000 to \$188,000 for couples and \$112,000 to \$127,000 for singles. The deduction phaseouts for regular IRAs start at higher levels, ranging from \$95,000 of AGI to \$115,000 for couples and from \$59,000 to \$69,000 for singles. If only one spouse is covered by a plan, the phaseout zone for deducting a contribution for the uncovered spouse begins at \$178,000 of AGI and finishes at \$188,000.



**BUSINESS TAXES** The standard mileage allowance for business driving is 56.5¢ per mile, up a penny. The allowance rises to 24¢ a mile for travel for medical purposes and job-related moves. But the rate for charitable driving remains stuck at 14¢ a mile.  
50% bonus depreciation stays in effect for assets placed in use in 2013.  
 This break can be claimed on new assets that have useful lives of 20 years or less.  
And up to \$500,000 of business assets can be expensed...a continuation of the rule that was retroactively reinstated for 2012 as well. The \$500,000 ceiling is reduced dollar for dollar after more than \$2 million of assets are put in service.  
The federally subsidized part of retiree drug plan costs is now nondeductible.  
The accumulated earnings tax and personal holding company tax rise to 20%.

A number of other lapsed business tax breaks continue to be available:  
 The R&D tax credit. The work opportunity credit for hiring disadvantaged workers. 15-year depreciation for restaurant renovations and leasehold improvements. And the 100% gain exclusion for investors who buy stock in a small regular corporation directly from the company and sell more than five years later. All of these provisions expired after 2011 and were revived by Congress retroactively for 2012 and for 2013.

**FRINGE BENEFITS** U.S. taxpayers working abroad have a larger income exclusion...\$97,600.  
The monthly limit on tax free parking jumps to \$245 for 2013. The exclusion for mass-transit passes also rises to \$245 a month in 2013. And Congress decided to retroactively boost the 2012 mass transit cap to \$240 a month, up from \$125.

**EDUCATION** The income caps are higher for tax free EE bonds used for education.  
 The exclusion starts phasing out above \$112,050 of AGI for married couples and \$74,700 for singles. It ends when AGI hits \$142,050 and \$89,700, respectively.  
And the lifetime learning credit starts phasing out at higher income levels...  
 from \$53,000 to \$63,000 of AGI for singles and \$107,000 to \$127,000 for couples.

**ADOPTION** The adoption credit can be taken on up to \$12,770 of costs, a \$120 boost.  
 If the credit is more than a filer's tax liability, the excess is not refundable. The full \$12,770 credit is available for a special needs adoption, even if it cost less. The credit starts to dry up for filers with AGIs over \$191,530 and ends at \$231,530.  
The exclusion for company-paid adoption aid also increases to \$12,770.

**REVIVED BREAKS** A set of tax breaks for individuals was restored. The income tax exclusion of up to \$2 million of forgiven home mortgage debt was revived for this year. And several provisions that expired after 2011 were reinstated for 2012 and 2013: The election to write off state and local sales taxes in lieu of state income taxes. Deductions for teachers' class supplies, private mortgage insurance and college tuition. The American Opportunity Tax Credit. And people age 70½ and older being allowed to directly transfer up to \$100,000 tax free from their IRAs to charity. Payouts received by IRA owners in Dec. 2012 can qualify for this special tax treatment if transmitted to a charity before Feb. 1, 2013. Also, donors can elect to treat direct transfers made in Jan. 2013 from their IRAs to charity as if the transfers were made in 2012.

More changes are sure to come this year...from IRS, Congress and the courts. And 2013 will mark the start of a major debate on overhauling the income tax code. We'll be here to report the changes being considered...and how you'll be affected.

Yours very truly,

*The Kiplinger Editors*  
 THE KIPLINGER WASHINGTON EDITORS

Jan. 4, 2013