PERSONAL FINANCIAL SERVICES

"The hardest thing in the world to understand is the income tax."

- Albert Einstein

American Taxpayer Relief Act of 2012 and Other 2012/2013 Tax Highlights

CEPC

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Agenda

- Income Taxes
- The Alternative Minimum Tax (AMT)
- Estate, Gift and Generation-Skipping Transfer Taxes
- Qualified Charitable Distributions
- Medicare Related Provisions
- Other Considerations

2013 Tax Highlights – Tax Rates

Averting the Fiscal Cliff:

- On January 1, 2013, the 112th Congress passed the American Taxpayer Relief Act of 2012 ("ATRA"). On January 2, 2013, President Obama signed the bill into law, effective January 1, 2013.

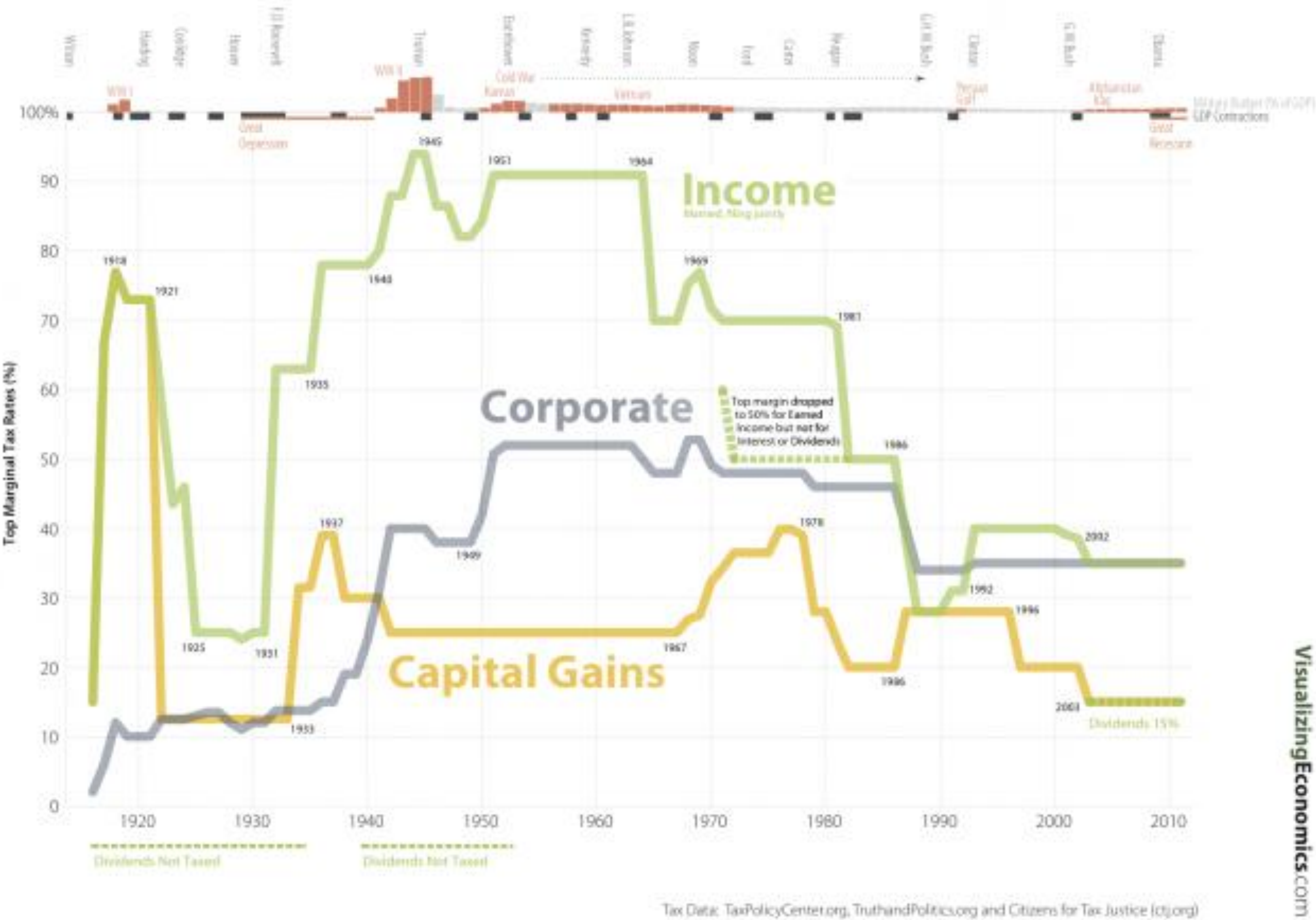
Income Taxes:

- New top marginal income tax rate – 39.6% on ordinary income above $400,000 for single taxpayers and $450,000 married taxpayers filing jointly. All other tax rates remain the same for individuals.
- No 35% tax rate bracket for estates and trusts.
- Long-term capital gains are taxed at three different rates:
  - 0% for taxpayers in the bottom two brackets (10% and 15%);
  - 15% for taxpayers in the 25%, 28%, 33%, and 35% tax brackets; and
  - 20% for taxpayers in the 39.6% tax bracket (single taxpayers with taxable income over $400,000 and married taxpayers filing jointly with taxable income over $450,000).
- "Qualified" dividends continue to be taxed at long-term capital gain rates.
- (The 25% rate for unrecaptured Code Section 1250 gain and the 28% for capital gain on collectibles still apply.)

Ordinary Income Tax Rates

	American Taxpayer Relief Act of 2012 (ATRA) 2013 Law
Individuals	10%, 15%, 25%, 28%, 33%, 35% and 39.6% on taxable income over $400,000 for singles and $450,000 for married filing jointly
Estates and Trusts	15%, 25%, 28%, 33%, and 39.6%

Historical Tax Rates 1916-2011



Individual Income Tax Extenders

- **Extension of expired or expiring individual tax provisions:**
  - Deduction for state and local sales taxes
  - Qualified tuition expenses
  - Qualified charitable distributions

2013 Tax Highlights – Deductions and Exemptions

One Way to Raise Taxes Is Limit Deductions:

- "Pease" limitation reinstated for 2013 and beyond –
  - Limits many itemized deductions for single filers whose Adjusted Gross Income (AGI) is greater than $250,000 and married filing jointly with AGI greater than $300,000.
  - The limitation is 3% of the amount in excess of the AGI thresholds listed above.
  - Maximum limitation is 80% of deductions.
  - The AGI threshold amounts are indexed for inflation.
- Medical deduction limitation increased (this was part of "Obamacare") –
  - Starting in 2013 the threshold to deduct medical expenses increases from 7½% of AGI to 10% of AGI.

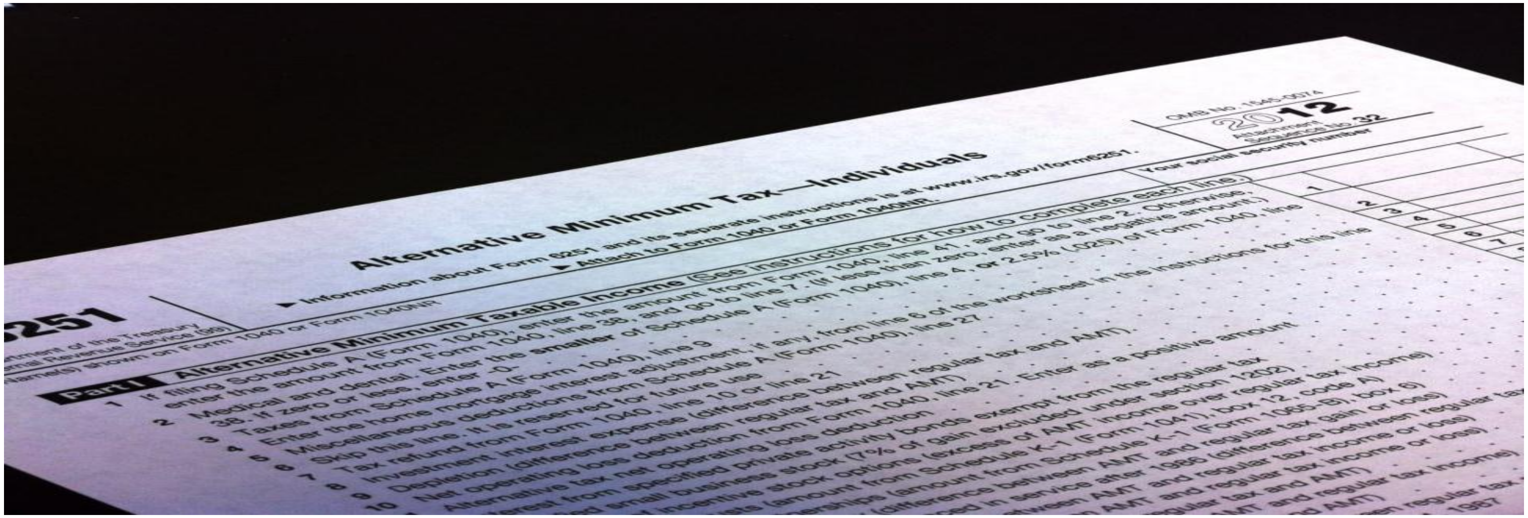
Personal Exemption Phaseout "PEP":

- In 2013, each taxpayer is entitled to a personal exemption of $3,900.
- The exemption is phased out in 2% increments above the same AGI thresholds delineated above for the Pease limitation.
- PEP may be fully phased out.

2013 Tax Highlights – Alternative Minimum Tax ("AMT")

The American Taxpayer Relief Act "Patches" the AMT:

- The "patch" applies to 2012.
- The 2012 "patch" is an income exemption from AMT taxes of $50,600 for single taxpayers and $78,750 for married taxpayers filing jointly.
- The AMT exemption amount is permanently indexed for inflation.
- It is estimated that the "patch" will keep approximately 60 million taxpayers out of AMT for the 2012 tax year.



AMT Thresholds

	2012 Law	Scheduled 2013 Law (had ATRA not been enacted)	American Taxpayer Relief Act of 2012 (ATRA) 2013 Law
Married Joint/ Surviving Spouse	$45,000 increased to $78,750 retroactively by ATRA	$45,000	$80,800
Married Separate	$22,500 increased to $39,375 retroactively by ATRA	$22,500	$40,400
Single/ Head of Household	$33,750 increased to $50,600 retroactively by ATRA	$33,750	$51,900

2013 Tax Highlights – Gift, Estate and GST Taxes

Gift, Estate and GST Taxes –

- ATRA makes gift, estate, and GST tax rates and exclusion and exemption amounts permanent.
    - The maximum federal gift, estate, and GST tax rate is 40%.
    - The "applicable exclusion amount" (the amount you can give without paying gift or estate tax) stays at $5,000,000 and is indexed for inflation.
    - The 2013 amount is $5,250,000.
- ATRA makes "portability" permanent. This means that a surviving spouse may utilize the unused estate tax applicable exclusion amount from a deceased spouse. (This is no reason to avoid estate planning.)
- The generation-skipping transfer tax exemption is $5,000,000 and indexed for inflation. Portability does not apply to the GST tax exemption.
- The 2013 annual gift exclusion amount is $14,000.
- Congress did not make any legislative changes to: the grantor retained annuity trust rules; the rules related to discounting closely held businesses; GST "dynasty" trusts; or the taxation of "grantor" trusts.

Gift, Estate and GST Exclusion/Exemption

	American Taxpayer Relief Act of 2012 Exclusion/ Exemption	2013 Exclusion/ Exemption Adjusted for Inflation	Highest Marginal Tax Rate
Gift	$5,000,000 adjusted for inflation	$5,250,000	40%
Estate	$5,000,000 adjusted for inflation (with portability)	$5,250,000	40%
GST	$5,000,000 adjusted for inflation	$5,250,000	40%

2013 Tax Highlights – An Opportunity to Give to Charity

Qualified Charitable Distributions

- ATRA allows qualified charitable distributions from IRAs for 2012 and 2013.
  - For 2012:
    - Distributions made **prior to February 1, 2013,** may be deemed to have been made on December 31, 2012; and
    - Distributions taken in cash in December of 2012 may be contributed to a qualified charity **before February 1, 2013** and be treated as a qualified charitable distribution.
  - For 2013:
    - Taxpayers may make qualified charitable distributions for the 2013 tax year any time through the end of the year.
- A qualified charitable distribution (QCD) is an otherwise taxable distribution from an IRA (other than an ongoing SEP or SIMPLE IRA) owned by an individual who is 70½ years of age or over paid directly from the IRA to a qualified charity. An IRA owner may exclude from gross income up to $100,000 of a QCD made for a year, and a QCD may be used to satisfy part or all of IRA required minimum distributions (RMDs) for the year.

Health Care and Education Reconciliation Act of 2010

Enacted in 2010 – some provisions of this law phase in over time.

Here are some:

- 2012 –
    - 2012 Forms W-2 will show value of employer provided health care.
- 2013 –
    - Medicare - 0.9% increase for wages over $200,000 and $250,000 for single and married filing joint taxpayers, respectively.
    - Medicare - 0.9% increase for self-employed individuals' self-employment income over $200,000 and $250,000 for single and married filing joint taxpayers, respectively.
    - 3.8% tax on the Net Investment Income of high-income taxpayers.
        - The new Medicare tax is levied on the lesser of "Net Investment Income" and the taxpayer's modified AGI in excess of $200,000 and $250,000 for single and married filing joint taxpayers, respectively.

New Medicare Related Taxes Effective January 1, 2013: Four Things to Know

1 Additional 0.9% Medicare tax on wages for high-income earners

- Currently, employees pay a Medicare tax of 1.45% on their earned income and employers pay a Medicare tax of 1.45% on employees' earned income.
- As of January 1, 2013: Same as above, PLUS a high-income employee will pay an additional 0.9% Medicare tax (for a total of 2.35%) on his or her high level earned income.

2 Additional 0.9% Medicare tax on high-income self-employed individuals' self-employment income

- Currently, self-employed individuals pay a Medicare tax of 2.9% on their self-employment income.
- As of January 1, 2013: Same as above, PLUS a high-income self-employed individual will pay an additional 0.9% Medicare tax (for a total of 3.8%) on his or her high level self-employment income.

ADDITIONAL TAX ONLY APPLIES TO WAGES IN EXCESS OF THE FOLLOWING DOLLAR AMOUNTS:

- $250,000 for married persons filing jointly
- $125,000 for married persons filing separately
- $200,000 for all others

NOTE: The threshold amounts are NOT indexed for inflation over time.

Example: Single individual, $300,000 in wage income in 2013

Wage Income	**$300,000**
Less: Threshold	**$200,000**
	$100,000

$100,000 X 0.9%= Additional Medicare tax on earnings of $900

New Medicare Related Taxes Effective January 1, 2013: Four Things to Know

3 A new 3.8% Medicare contribution tax on high-income taxpayers' Net Investment Income

- The 3.8% tax is assessed on the LESSER of:
  - Net Investment Income, and
  - The excess of Modified Adjusted Gross Income (MAGI) over a threshold amount ($250,000 for married persons filing jointly or a surviving spouse, $125,000 for married persons filing separately, and $200,000 for all others). **NOTE:** The threshold amounts are NOT indexed for inflation over time.
- Calculating the tax:
  - Step 1 - Determine if your MAGI is below the threshold amount. If it is below the threshold amount, you are NOT subject to this surtax. If it is above the threshold amount, proceed to Step 2.
  - Step 2 - Calculate the amount of your Net Investment Income.
  - Step 3 - Determine which number is lower, the excess of your MAGI over the threshold amount or your Net Investment Income. Multiply the lower of these two numbers by 3.8% --- this is the amount that you owe in tax due to the Medicare surtax on Net Investment Income.

Example: Married couple, Net Investment Income of $100,000 in 2013 along with taxable profit sharing plan distributions of $300,000

MAGI	**$400,000**
Less: Threshold Amount	**$250,000**
Excess	**$150,000**
Net Investment Income	**$100,000**
Lesser of $150,000 and $100,000	**$100,000**

3.8% x $100,000= Additional Tax of $3,800

New Medicare Related Taxes Effective January 1, 2013: Four Things to Know

4 For estates and trusts, the threshold is much lower

- The 3.8% Medicare surtax applies to the undistributed Net Investment Income of estates and trusts.
  - For purposes of this tax, business income from a passive activity for the trust or estate will also be considered as Net Investment Income.
- The threshold is the level at which the maximum marginal income tax rate is reached for an estate or trust ($11,950 in 2013).
- For trusts and estates, the 3.8% tax will apply to the LESSER of:
  - The undistributed Net Investment Income, and
  - The excess of Adjusted Gross Income over the dollar amount at which the highest income tax bracket applicable to a trust or estate begins (in 2013, $11,950).
- Remember: as written, the law does not apply to trusts and estates that are required to distribute, or do distribute, all of their taxable income annually—the law only applies to trusts and estates that are not required to distribute all of their taxable income and do not.

Other Items to Consider

- **Foreign Assets**
  - The IRS is focused on foreign assets. Failure to disclose foreign assets and accounts may result in significant penalties and increase the statute of limitations.
  - FATCA Tax Form 8938 – Certain disclosures of foreign assets are required. This is in addition to the FBAR Form TD 90-22.1.

- **1099 Reporting**
  - 1099-INT and 1099-DIV are mailed by January 31 if the account holder receives only one of these forms. Forms 1099-B are mailed by February 15, if the account holder only receives this form from the payor.
  - Combined Forms 1099 are due February 15, unless the payor receives an extension from the IRS to March 15.

Business Tax Extenders

- **Extension of expired or expiring business tax provisions:**
  - Research tax credit
  - Bonus depreciation (extended into 2014) and section 179 expensing
  - Subpart F active financing exemption
  - CFC lookthrough treatment
  - 15 year recovery period for leasehold improvements and restaurant property
  - Production tax credit for wind with new "placed in service" rule

A Recap of 2013 Considerations

1. High income earners affected by tax rate changes and the new Medicare tax should review their estimated payment amounts for 2013.

2. Taxpayers who earn wages above $200,000 should review their 2013 wage withholding.

3. The 2012 transition rule allowing certain taxpayers who are at least 70 1/2 and want to make charitable gifts from their IRA for 2012 expires January 31, 2013.

4. Be aware of reporting requirements if you have an interest in <u>any</u> foreign assets.

5. Keep an eye on the news for new tax legislation.

Looking Ahead

Upcoming “cliffs”–

- March 1, 2013, the Budget Control Act (BCA) sequestration:
  - The BCA established spending caps by directing $1.2 trillion in automatic, across the board spending cuts.
  - ATRA delayed the implementation of the cuts by two months, until March 1.
- March 27, 2013, appropriations provisions expire
- May 19, 2013, the debt limit

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Suzanne L. Shier is the Director of Wealth Planning and Tax Strategy for Personal Financial Services at Northern Trust. In this capacity, she is responsible for leading the Personal Financial Services wealth planning group and for providing thought leadership on federal tax issues of interest to clients, with a special emphasis on tax policy and legislation, charitable giving, cross-border trust design and fiduciary law.

Prior to joining Northern Trust, Ms. Shier spent 26 years as a partner at Chapman and Cutler LLP in Chicago, ultimately leading the firm's Trusts and Estates Practice Group, representing individuals, charitable organizations, and corporate fiduciaries in a full range of estate planning and fiduciary services, including cross-border planning, and fiduciary administration matters.

Ms. Shier is an adjunct professor in the Master of Laws in Taxation Program at Northwestern University Law School and also a frequent speaker and author. She has been quoted in publications such as the Wall Street Journal and Bloomberg and has received numerous professional honors and recognitions.

Ms. Shier earned her bachelor's degree with distinction in economics and sociology from the University of Michigan in 1982. She received her law degree, cum laude, from the Loyola University Chicago School of Law in 1985 and a master of laws in taxation from the DePaul University College of Law in 1997.

In the Chicago civic community, Ms. Shier is actively involved in many women's, diversity and education initiatives, including serving on the Boards of Directors of Gads Hill Center and the Chicago Coalition of Women's Initiatives in Law and as Chairperson of the Board of Directors of Chicago Scholars, a college access program for high potential urban students.

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