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Your Financial Future

Pursuing Life Goals Together

Mid-Year Planning: Accounting for New Tax Rules

The American Taxpayer Relief Act of 2012 (ATRA), passed in early January, permanently extended a host of expiring tax provisions. It also largely set the rules for tax planning for 2013 and beyond. As you take stock of your tax situation this year, here are a few new wrinkles to keep in mind.

New top tax rate

The six tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) that applied for the last several years have been made permanent for most individuals. That's really good news, since it removes a great deal of uncertainty going forward (it's always easier to plan when you know what the tax rates will be the following year).

But higher-income individuals and families will have to contend with a new top federal income tax bracket starting this year, paying tax on a portion of their income at a rate of 39.6%. The new 39.6% rate applies to individuals with taxable income exceeding $400,000; married individuals filing joint federal income tax returns with taxable income exceeding $450,000; married individuals filing separate returns with taxable income exceeding $225,000; and individuals filing as head of household with taxable income exceeding $425,000.

Higher rates on investment income for some

Most individuals won't see any change in the rate at which they're paying tax on long-term capital gains and qualifying dividends. If you're in the 10% or 15% marginal income tax bracket, a special 0% rate will generally apply. If you are in the 25%, 28%, 33%, or 35% tax brackets, a 15% maximum rate will generally apply.

If you're in the new top 39.6% tax bracket, though, it's going to be a little different starting this year--that's because in 2013 a new maximum rate of 20% will generally apply to some or all of your long-term capital gains and qualifying dividends.

And keep in mind that a new Medicare contribution tax now applies to some or all of the net investment income of individuals with more than $200,000 in modified adjusted gross income ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separate returns). The Medicare contribution tax is 3.8%, and is in addition to other taxes that apply.

Other considerations

- This year, if your adjusted gross income (AGI) is greater than $250,000 ($300,000 if you're married and file a joint return, $150,000 if married filing separately, and $275,000 if you file as head of household), your personal and dependency exemptions will be phased out in part or in full. Similarly, your itemized deductions may be limited.
- If you itemize deductions, note that the AGI threshold for deducting qualified medical expenses on Schedule A increased this year from 7.5% to 10% for most individuals. If you or your spouse will be 65 or older by the end of the year, though, the 7.5% threshold will continue to apply for 2013.
- The rules allowing qualified charitable distributions from IRAs were extended through 2013. This popular provision allows individuals age 70½ or older to make qualified charitable distributions of up to $100,000 from an IRA directly to a qualified charity; the charitable distributions are excluded from income and count toward satisfying any required minimum distributions for the year.

Make time to plan

It's never easy to set aside the time to analyze your current tax situation and project how you'll be affected by recent changes. But it's important to do so while you still have time to implement a plan and take action. This year, it's particularly important to consider all of your options if your income level brings you within range of one or more of the new provisions targeting higher-income individuals.

July 2013 Your Financial Future

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Happy Healthday! HSAs Turn 10

HSAs celebrate their 10th anniversary in 2013. If you are eligible to save money in an HSA but don't currently take advantage of it, you may want to consider whether its many potential benefits may be right for you.

Created 10 years ago as part of the Medicare Prescription Drug and Modernization Act of 2003, health savings accounts (HSAs) have gained in popularity over the past decade. According to the Employee Benefit Research Institute (EBRI), more employers and employees have been contributing to HSAs in recent years, and the amount contributed to HSAs has generally been on the rise. For example, the percentage of individuals in employee-only HSAs contributing $1,500 or more rose from 21% in 2006 to 42% in 2012, while the percentage of employees contributing nothing decreased from 28% to 15% over that same period. (Sources: "HRA/HSA Health Plan Contributions Continue to Grow," EBRI, February 20, 2013, and *EBRI Notes,* February 2013.) If you are eligible to contribute to an HSA, you may want to take another look at these savings plans, which could benefit your financial situation both now and in the future.

HSAs explained

Health savings accounts help individuals and families set aside money on a tax-advantaged basis to pay for health-care costs. HSAs are typically offered by employers along with what's known as "high-deductible health plans," or HDHPs--health insurance plans that generally offer lower premium payments in exchange for high annual deductibles (at least $1,250 for individuals and $2,500 for families in 2013).* You must be enrolled in an HDHP in order to participate in an HSA. If your employer provides an HDHP but does not offer an HSA, you may be able to establish an account on your own through a financial institution. Self-employed individuals can also use HSAs.

Here's how an HSA works:

- You can contribute up to $3,250 for individual coverage or $6,450 for family coverage to an HSA in 2013. If you are age 55 or older, you may also make "catch-up" contributions of up to $1,000.
- Your employer may also make contributions on your behalf.
- You can contribute in one lump sum or in periodic (e.g., monthly) amounts.
- You can make contributions for the current year up until your tax-filing deadline (generally, April 15 of the year following the year of coverage).

One of the key advantages of an HSA is that your contributions are tax deductible. If your plan is offered through your employer, you may be able to make automatic contributions on a pretax basis (similar to a work-based retirement savings plan) and any employer contributions are generally excluded from your gross taxable income as well. Moreover, you can typically select from a variety of savings and investment vehicles for your contribution dollars, and the earnings grow tax deferred until you withdraw them. Withdrawals then used for qualified medical expenses are tax free.

Permitted expenses

You can withdraw money from your HSA to pay for qualified expenses for yourself, your spouse, or your dependents. Permitted expenses include:

- Health insurance deductibles and co-payments
- Prescription drugs
- Vision care and eyeglasses
- Dental care
- Laboratory fees
- Hearing aids and more

For a complete list of eligible expenses, please see IRS Publication 502.

On the other hand, HSA distributions that you use for nonqualified expenses are subject to income taxes and a 20% penalty tax.

Eligibility rules

In order to be eligible for an HSA, you must have qualifying HDHP coverage. You won't be eligible if you're covered by another health plan (e.g., your spouse's nonqualified health plan), if you're 65 and enrolled in Medicare, or if someone else can claim you as a dependent. In addition, you may be ineligible if you're covered under a flexible spending account or health reimbursement arrangement that offers coverage similar to the HSA's.

Plans that won't affect your eligibility include dental and vision care insurance, long-term care insurance, and disability and accident insurance.

Rollovers

Unlike flexible spending accounts, where you have to use up all the funds you set aside for a plan year by a certain date or forfeit the money, HSA funds are yours to keep. If you leave your current employer and would like to roll your HSA money into another HSA, you are typically permitted to do so. And provided you are still eligible, you can continue to save in your account on a tax-deferred basis until you enroll in Medicare.

**Total out-of-pocket costs for HDHPs cannot exceed $6,250 for individuals and $12,500 for families.*

Portability of Applicable Exclusion Amount between Spouses

Portability allows a surviving spouse to use the unused applicable exclusion amount of the spouse who dies first to shelter property from federal gift and estate taxes. Portability of the exclusion between spouses would seem to make estate planning easier for many estates, but that may not always be the case.

Now that portability and the increased exclusion, which had been scheduled to expire in 2013, have been made permanent, it is probably a good time to review your estate plan and documents.

Transfers of property during life or at death are generally subject to federal gift or estate taxes. However, each taxpayer has an amount of property that can be sheltered from federal gift and estate taxes by the unified credit, called the "applicable exclusion amount."

Prior to 2011, each spouse was entitled to his or her own applicable exclusion amount, and any amount that a spouse did not use would be lost; so special planning was often used to insure neither spouse's exclusion was wasted.

In 2011 and later, the estate of the first spouse to die can elect to transfer any applicable exclusion amount that is not used to the surviving spouse. This is known as "portability." The applicable exclusion amount is redefined as equal to the sum of the basic exclusion amount of the surviving spouse and the unused applicable exclusion amount of the predeceased spouse, and the basic exclusion amount is equal to $5 million as indexed for inflation each year ($5,250,000 in 2013).

Now that portability and the increased exclusion, which had been scheduled to expire in 2013, have been made permanent, it is probably a good time to review your estate plan and documents. Portability of the exclusion between spouses and an increase in the basic exclusion amount should make estate planning easier for many estates.

Simple planning with portability

If you're planning today, you could transfer everything to your spouse at your death, and your estate can elect to transfer your unused applicable exclusion amount to your surviving spouse. Your spouse will then have an applicable exclusion amount equal to the sum of his or her own basic exclusion amount and your unused applicable exclusion amount, which your spouse can use for gift or estate tax purposes. For example, if you transfer your $5,250,000 unused applicable exclusion to your surviving spouse, who also has a $5,250,000 basic exclusion amount, your spouse then has a $10,500,000 applicable exclusion amount in 2013 to shelter property from gift and estate tax. Such simple planning might be very practical for some married couples, especially where the spouses' combined estates are expected to be less than their combined applicable exclusion amounts.

Potential need for more complex planning

There are a number of reasons why such simple planning with portability may not always produce the desired or best results. These might include (among others):

- You have family members or individuals other than your spouse who you would like to benefit prior to the death of your spouse.
- You have grandchildren or later generations who you would like to benefit. The $5,250,000 (in 2013) generation-skipping transfer (GST) tax exemption is not portable between spouses.
- State exclusion amounts may be different than the federal applicable exclusion amount and may not be portable between spouses.
- The unused exclusion is not adjusted for inflation after the first spouse's death, and may not fully protect appreciating property from estate tax in the surviving spouse's estate.

Use of A/B trust arrangement

Prior to 2011, many married couples with estates that were greater than the applicable exclusion amount would set up an A/B (or A/B/C) trust arrangement. In general, the first spouse to die would transfer an amount equal to the applicable exclusion amount to the "B" or credit shelter bypass trust. The B trust could benefit the surviving spouse and their children, but the B trust would be designed to bypass the surviving spouse's estate. The balance of the estate would be transferred to the surviving spouse, either outright or using an "A" marital trust, and qualify for the marital deduction. In some cases, a "C", "Q", or QTIP marital trust was also used if the first spouse to die wanted to control who received the marital trust property at the second spouse's death. The A/B trust arrangement typically assured that there would be no estate tax at the first spouse's death and that neither spouse's applicable exclusion amount was wasted.

An A/B trust arrangement may still be useful, even with the availability of portability. For example, the B trust can be used to provide for family members or individuals other than your spouse (and even your spouse) prior to the death of your spouse. You could also allocate your GST tax exemption or state exclusion to the B trust. Also, appreciation of property after the transfer to the B trust should not be subject to estate tax at your spouse's death. The A trust could use your spouse's applicable exclusion amount, GST tax exemption, and state exclusion.

The use of trusts can also provide other benefits, such as control over who receives your property and when, investment management of trust property for trust beneficiaries, avoidance of probate, and asset protection.

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I just bought a vacation home. Do I need to purchase a specific type of insurance?

Insuring a vacation home is different from insuring a primary residence. As a result, you'll want to purchase insurance that is specifically geared to provide coverage for this type of property.

When insuring a vacation home, the type and cost of coverage will vary, depending upon the insurance company and the state in which your vacation home is located.

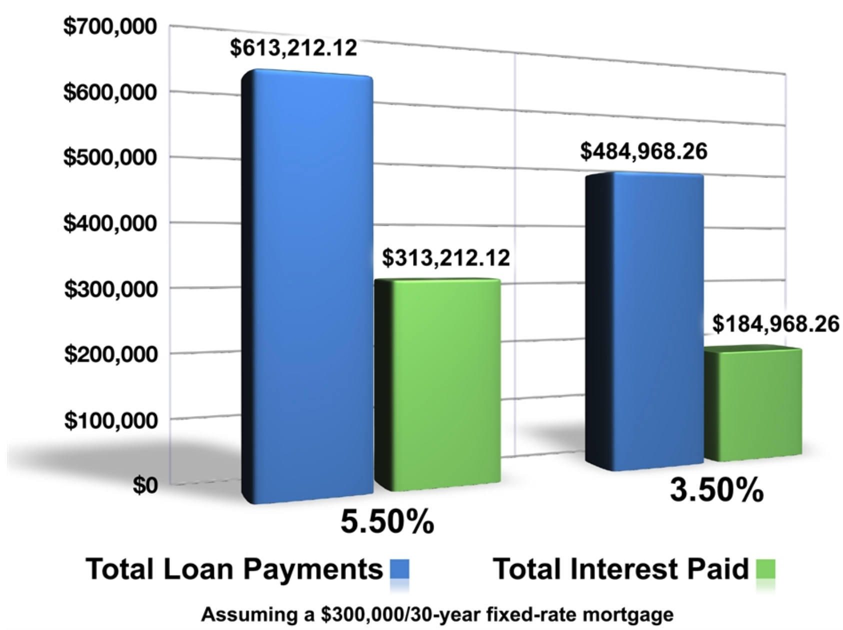
Most insurers offer at least some type of insurance that is specifically designed for second/vacation homes. Coverage under these types of policies can range from standard coverage that protects against certain named perils, to more comprehensive coverage that protects against all perils unless specifically excluded in a policy.

Keep in mind that, depending on what is covered under the policy, you may need to obtain additional protection (e.g., property or liability coverage) through either an endorsement or separate policy. In addition, if your vacation home is located in an area that is susceptible to flood damage--which is not covered under a standard vacation home policy--you'll want to look into obtaining separate coverage for that peril as well.

Due to some of the unique circumstances surrounding vacation homes (e.g., high-risk location, not being occupied for long periods of time), vacation home insurance premiums are usually much higher than those for a primary residence. However, you may be able to save money by insuring your vacation home with the same company that provides coverage for your primary residence (some insurers may require this). In addition, you may be eligible for other discounts, such as those offered for newly built homes, nonsmokers, and homes that have a security system installed. Policy discounts will vary by state and insurer.

Because of the vast array of vacation home insurance products on the market, you'll want to be sure to shop around for the best coverage and rates. You may also want to contact the state department of insurance where your vacation home is located for additional information on the coverage and rate options that may be available.

The Potential Benefits of Refinancing Your Mortgage



This is a hypothetical example and does not reflect all of the costs that may be associated with refinancing. Actual results may vary.