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FINANCIAL CONSIDERATIONS FOR 2013

It isn't too early to think about next year.

Provided by Frank DeMaio*

We are now in plain view of the "fiscal cliff". After the election, Congress may or may not end up keeping income and estate tax rates at their recent levels. Next year may bring some notable financial developments, and it isn't too soon for households to think about them.

You may want to prioritize tax reduction. If the Bush-era tax cuts sunset, *everyone* will see higher taxes. The federal income tax brackets (10%, 15%, 25%, 28%, 33%, 35%) that we have known for the last nine years would be replaced by five higher ones (15%, 28%, 31%, 36%, 39.6%) come 2013.[1]

High earners may want to watch their incomes. If your earned income for 2013 tops $200,000 - or exceeds $250,000, in the case of a couple – you may face two Medicare surtaxes. While the Medicare payroll tax on earned incomes above these levels is set to rise to 2.35% from the current 1.45%, the second surtax may prove to be the real annoyance: there is scheduled to be a 3.8% charge on net investment income for individuals and couples whose modified adjusted gross incomes surpass these levels.[1,2]

Some fine points about this second surtax must be mentioned. It would actually be levied on the lesser of two amounts – either your net investment income or excess MAGI above the $200,000/$250,000 levels. Most investment income derived from material participation in a business activity would be exempt from the 3.8% surtax, along with tax-exempt interest income, tax-exempt gains realized from selling your home, retirement plan distributions and income that would already be subject to self-employed Social Security tax.[2]

The bottom line is that a bonus, an IRA distribution, or a sizable capital gain may push your earned income above these thresholds – and it will be wise to consider the impact that would have.

You may have less take-home pay next year. Social Security taxes for paycheck employees are slated to return to the 6.2% level in 2013. They've been at 4.2% since

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the start of 2011. If you earn $75,000 during 2013, you will take home about $1,500 less of it than you would have in 2012. If you earn $50,000, we're talking $1,000 less.[3]

Any 2013 Social Security COLA may be minor. In 2012, the cost of living adjustment to Social Security benefits was 3.6%. Before that, Social Security recipients went three years without a COLA. As inflation is mild, whatever COLA is announced this fall in tandem with Medicare premium changes may not amount to much.[1]

Next year, medical expense deductions may shrink. If you are thinking about delaying a procedure or surgery until 2013, remember that the itemized deduction threshold for unreimbursed medical expenses is set to increase from 7.5% to 10% of adjusted gross income in 2013. Even if that happens, however, the threshold will remain at 7.5% through 2016 for taxpayers age 65 and older.[1]

You may be able to find a better Medicare Advantage plan for 2013. The Affordable Care Act has altered the landscape for these plans (and their prescription drug coverage). Using Medicare's Plan Finder (click on the "Find health & drug plans" link at Medicare.gov), you may discover similar or better coverage at lower premiums. The enrollment period for 2013 coverage runs from October 15 to December 7.[1]

Those without work may find a safety net gone. Extended jobless benefits may disappear for the long-term unemployed at the start of 2013. Will Congress extend them once again? Possibly – but that isn't a given.

The estate & gift tax exemptions may shrink significantly. The (unified) lifetime federal gift and estate tax exemption is currently set at $5.12 million – and it will drop to $1 million in 2013 if Congress stands pat. Federal gift tax and estate tax rates are also slated to max out at 55% in 2013, as opposed to 35% in 2012. Right now, an unused portion of a $5.12 million lifetime exemption is portable to a surviving spouse; in 2013, that portability is supposed to disappear.[4]

Many analysts and economists think that Congress will eventually abide by President Obama's wishes and take things back to 2009 instead of 2001 – that is, a $3.5 million estate tax exemption, a $1 million lifetime gift tax exemption, and a 45% maximum estate and gift tax rate.[4]

Prepare for year-end drama ... and for 2013. The last two months of 2012 will surely bring political theatre to Capitol Hill. As it unfolds, you may want to look ahead to next year and consider the impact that these potential changes could have on your financial life.

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Citations.

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