GUNSTER
PRIVATE WEALTH SERVICES

Year-End Update At A Glance
November 18, 2013

Dear Clients and Friends:

As a service to our clients and friends, we have prepared the following summary of income, estate, and gift tax planning opportunities that should be considered by you prior to the end of the year. Although this review is necessarily general in nature, we are happy to discuss any item of specific interest in more detail with you.

As we come to the end of 2013, for better or worse, we certainly seem to have more clarity than we have had for a number of years. 2013 has been a year of learning to cope with the important changes made by the American Taxpayer Relief Act of 2012 ("ATRA") and the implementation of the so-called Medicare "surtax" attached to the Patient Protection and Affordable Care Act of 2010.

That is not to say that there is nothing new in the world of tax since our February tax update which discussed the passage and provisions of the ATRA. The U.S. Supreme Court and the IRS have issued significant rulings on the tax rules which apply to same-sex married couples and certain indexed exemptions increased in 2013 and will once again increase in 2014. Additionally, there are certain beneficial tax provisions that are set to expire at the end of 2013.

*** INCOME TAX, MEDICARE SURTAX, ROTH IRA & EXPIRING DEDUCTION ISSUES ***

▸ *Spreading Income Across Tax Years*

For most U.S. citizens and residents, federal income tax rates remained stable for 2013 (even if payroll taxes increased), but for top earners ATRA reintroduced the pre-Bush Era tax cuts rate of 39.6%. Top earners also face increased capital gains and qualified dividend rates along with the 3.8% Medicare surtax for 2013. As a result, you should be even more mindful of opportunities to divide large income recognition transactions such as asset sales or Roth IRA conversions across multiple tax year to avoid spikes in income. For example, if you are selling an asset and will receive payments over more than one year, you should consider taking advantage of the installment method for recognizing gain in the year in which you receive the payment instead of all in the year of sale. The benefit of spreading income over multiple years is greater today than it has been in decades.

▸ *Year-End Stock and Security Sales*

Additionally, as year-end approaches, one way to reduce overall income is to recognize paper losses on stocks and use them to offset other gains taken earlier this year. If you have stocks in your portfolio that have unrealized losses, you may want to consider selling them before the end of the year. Realized losses will offset realized capital gains and up to an additional $3,000 ($1,500 if married filing separately) of ordinary income. In order for the deduction to be effective, you cannot repurchase the same securities within thirty days of the sale. Also, if you already have net realized losses over $3,000, which otherwise must be carried forward, you might consider taking enough long-term capital gains to eliminate the excess losses. Taking the gains will not increase your tax. If you own appreciated mutual fund shares held over twelve months and are contemplating selling in any case, you may wish to sell before the December dividend so that the entire gain - including the amount attributable to the upcoming dividend - will be taxed at capital gain rates. You should avoid incurring any short-term capital gains since any gain realized on stocks held for less than twelve months will be taxed at ordinary-income tax rates.

- ***Specific 3.8% Medicare Surtax Planning***

The lower your net investment income, the less likely you will pay significant Medicare surtax. Net investment income includes interest, dividends, investment gains, rental income and income from certain types of business activities. Net investment income does not include income generated by an activity in which you materially participate. You might consider whether it would be possible (or worthwhile) to increase your participation in an income generating activity in which you are involved before year-end so as to qualify as a material participant in the activity. Further, if you own interests in a number of passive activities, in order to satisfy material participation requirements, you might consider whether it is possible to treat one or more of those activities as a single activity.

If you are a trustee or a beneficiary of a trust it is important to know that effective January 1, 2013, trusts are subject to the Medicare surtax on net investment income in excess of $11,950 (a relatively low threshold). For trust accounting purposes, net investment income is treated like taxable income. If the trust distributes income to a beneficiary, net investment income will also be distributed. Thus, by distributing the net investment income, the trust will not be subject to the additional 3.8% surtax. The beneficiary however, will have to include the net investment income as part of their individual income. If the beneficiary's adjusted gross income (AGI) is below $200,000 for single individuals or $250,000 for married couples (much higher thresholds than the threshold for trusts) the beneficiary will not have to pay the 3.8% Medicare surtax. Of course, if the beneficiary's AGI exceeds the applicable amount then the beneficiary will be required to pay the additional 3.8% surtax. We recommend that, as a trustee or beneficiary of a discretionary trust, you consider whether income should be distributed before year end.

- ***Payment of Quarterly Tax Estimates***

For those of you who will pay tax at the top bracket this year, if you typically pay quarterly estimated tax using what is known as the "prior year safe harbor" you may very well wind up owing considerably more tax on April 15, 2014 than to which you are accustomed. Alternatively, some of you might use the 90% of current year estimated tax method in order to avoid giving the U.S. government a short-term interest free loan. Given the 8.8% difference in the top rate for dividends, interest and capital gains and the 4.6% increase in the top federal income tax rate, those of you who use the 90% method will need to pay extra close attention to the tax effect of end of the year transactions. If you don't accurately estimate your tax liability, you could wind up owing penalties.

- ***AMT Survives Another Year***

Although the ATRA "fixed" the AMT patch problem by indexing the AMT exemptions for inflation, AMT continues to frustrate taxpayers. If you are not liable for AMT for 2013 but have paid AMT in a prior tax year, you may be eligible for a tax credit against your regular tax this year.

▶ ***Roth IRAs Look Even Better to Top Earners***

Distributions from regular IRAs are subject to both income tax and, even though such distributions are not considered Net Investment Income, the income created by the distribution is subject to the Medicare surtax. However, distributions from a Roth IRA that has held assets for at least five years to a participant who is over the age of 59 ½ are not subject to either income tax or the Medicare surcharge. As a further benefit for those of you who do not use your IRA for living expenses, Roth IRAs have no required minimum distributions. However, if you are considering a Roth IRA conversion, as discussed above, care should be given to timing so as to minimize income spikes.

▶ ***Departing Tax Incentives After 2013***

There are a variety of beneficial tax provisions that disappear at the end of 2013 unless Congress acts to extend them. The option to deduct state and local sales taxes in lieu of state and local income taxes is currently set to end this year. Thus, if you are considering the purchase of a big ticket item, you may want to make the purchase this year. The same is true for the exclusion from cancellation of indebtedness income for personal residences. In 2014, mortgage insurance premiums will no longer be treated as deductible qualified residence interest. Further, with respect to charitable contributions in 2014, deductions for contributions of real property for conservation purposes will revert back to 30% of a taxpayer's annual income and may only be carried-forward for 6 years. Also, the limited ability to make tax free distributions from IRAs to charity will no longer be available in 2014. Before the end of this year, an IRA participant who is age 70 ½ or older may distribute up to $100,000 from his or her IRA directly to a public charity. This distribution to charity will not result in income or a charitable deduction for you, but it will allow you to make contributions to charity while satisfying your required minimum distribution for the year.

▶ ***Recognition Period for Subchapter S Corporation Built In Gains***

The income and losses experienced by a Subchapter S corporation ("S-Corp") passes through to its owners. This pass-through treatment is often preferred to the corporate level and shareholder level taxes associated with Subchapter C corporations ("C-Corp"). When an existing C-Corp elects to be treated as a S-Corp, despite the new pass-through tax status of the corporation, the corporation continues for a period of time to be subject to a corporate level tax at the highest marginal rate on gains from the sale of corporate assets that arose prior to the change in tax status. For the last few years, gains on assets held by the corporation prior to the S-Corp election but for at least 5 years from the first day of the first year S-Corp status applied were not subject to the corporate level tax. In 2014, however, the required holding period for appreciated assets returns to its traditional 10 year period. If you have a S-Corp. which was originally taxed as a C-Corp and are considering the sale of appreciated corporate assets in the near term, you should look at whether you have been an S-Corp for a least 5 years but less then 10 years and whether now is the time to sell.

***** GIFT TAX AND ESTATE PLANNING ISSUES *****

▶ ***Gifts Excluded from Gift Tax***

<u>Annual Exclusion Gifts</u>

The "annual exclusion" gift amount for 2013 is $14,000 and this $14,000 amount will remain unchanged in 2014. This means that you may give any one or more persons up to $14,000 (each) during the year (by December 31st) without incurring gift tax. A married couple, however, can effectively double this amount ($28,000) either by: (i) writing a check from a joint account; (ii) writing separate checks from separate accounts; or (iii) consenting to a "gift-split" on a Federal Gift Tax Return. In connection with a "gift-split", one spouse may write the check(s) (up to $28,000 in the aggregate per donee) but both spouses will be treated as having made the gift equally for federal gift tax purposes. The annual exclusion cannot be carried into a succeeding year and 2013 donees must cash any checks given to them on or before December 31, 2013.

Note that the marital deduction is not allowed for gifts made to spouses who are not U.S. citizens. However, the annual exclusion for gifts to non-citizen spouses is $143,000 in 2013 (increasing to $145,000 in 2014) for gifts to non-citizen spouses that would otherwise qualify for the gift tax marital deduction.

Special Rule for Contributions to 529 Plans

Section 529 Plans are tax-advantaged accounts to save for educational expenses. Earnings from 529 Plans are tax-deferred, and distributions are tax-free if used for qualified educational expenses. Unlike tuition payments that are excluded from gifts, 529 Plan distributions can be used for all qualified post-secondary education costs, including room and board; mandatory academic fees; books; supplies (including computers), and certain other expenses. If paid to parties other than the school, such as landlords or grocery stores, such amounts must be within the school-budgeted amount for students. If funds are withdrawn from a 529 plan but not used on an eligible college expense, the withdrawing person is subject to income tax and a 10% federal tax penalty on the earnings attributed to the withdrawal(s).

Although not eligible for the gift tax tuition exclusion, contributions to 529 Plans can be "front-end loaded" by electing to treat a current contribution, for gift tax purposes, as though it had been made over a five-year period. Using the current annual exclusion amount, this means you could contribute as much as $70,000 (5 x $14,000) to the 529 plan, yet use none of your lifetime gift tax exclusion nor incur any gift tax – if you file the appropriate tax return making that five-year election (a separate return is required for each year during the five-year term). If you use this technique and contribute the maximum amount, it means you will have used up all your personal annual exclusion gifts for the plan beneficiary for the next five years. However, if you made the "front-end loaded" gift in 2012 or an earlier year, you may still makes gifts to the 529 Plan this year and the next three years equal to the difference between the annual exclusion in the year of the gift and the current annual exclusion. For example, if you made a $65,000 gift to a 529 Plan in 2012, you could make an additional $1,000 gift to the 529 Plan this year. If you use the five-year averaging method to front-end load a 529 plan, and you do not live beyond the fourth calendar year, your estate will include a portion of any contribution made with that election. Among the attractive features of using 529 plans is that your contributed funds are out of your estate but, because you can remain the owner of the account, the funds are not necessarily out of your control during your life.

Tuition & Medical Expense Gift Tax-Exclusions

Direct payments of medical expenses (including insurance premiums) and tuition (including advance payments) are allowed in addition to the available annual exclusion. The key to these exempt gifts is that they must be made directly to the service provider rather than going through the hands of a third party or given to reimburse otherwise qualified expenses. Only the "tuition" costs paid directly to the educational institution are exempt. Tuition is generally defined to include school fees required for enrollment. Room, board, student health fees, transportation, field trips, books, supplies, equipment, optional school fees, testing costs, etc. are generally outside this exemption.

Direct payment of medical expenses that are excluded from treatment as gifts include expenses for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or for related transportation. Costs of glasses, contact lenses, dentures, braces and other orthodontic or dental work are also included. Additionally, direct payments of medical and dental insurance premiums, if paid directly to the insurer, are excluded from treatment as gifts. The medical exclusion does not apply to amounts paid for medical care that are reimbursed to the donee by the donee's insurance.

▶ *Advanced Gifting Strategies*

Taxable Gifts – Use of Increased Lifetime Gift Tax Exclusion Amount and GST Exemption

In 2013, the lifetime gift (and estate) tax exclusion amount and the GST exemption amount increased to $5,250,000 and will increase again in 2014 to $5,340,000. These $130,000 and $90,000 increases may not seem like much in relation to the large recent increases we have experienced but, historically speaking, an extra $220,000 of lifetime gift tax exclusion amount and GST exemption offers significant gift planning opportunities. Lifetime gifts are particularly beneficial from an estate planning perspective, as all post-gift appreciation accrues outside of the donor's transfer tax base.

Additionally, lifetime gifts can be made through irrevocable trusts that create asset protection benefits for the beneficiaries. You can allocate your GST exemption to lifetime gifts made to a multi-generational trust (i.e., a "Dynasty Trust"). If all the gifts to a Dynasty Trust are covered by an allocation of GST exemption, the Dynasty Trust will not be subject to a GST tax for as long as the property remains in the trust. Under Florida law, a Dynasty Trust could exist for up to 360 years; and certain other jurisdictions, such as Delaware, allow Dynasty Trusts to continue in perpetuity. However, under an Obama Administration proposal, Dynasty Trusts created or funded after the enactment date of new legislation would only be able to maintain their GST tax exemption for 90 years.

Continued Benefit of Historically Low Interest Rates

The Applicable Federal Rates ("AFRs") are the minimum rates of interest that must be charged on loans to avoid interest being imputed for tax purposes. Many estate planning techniques such as grantor retained annuity trusts ("GRATs") and charitable lead trusts ("CLTs") require use of an interest rate equal to 120% of the mid-term AFR (the "Section 7520 Rate"). Although the AFRs have been slowly increasing over the last few years, they remain historically low. The AFRs for November 2013 are 0.27% for short-term (3 years or less); 1.73% for mid-term (more than 3 years but not more than 9 years); and 3.37% for long-term (more than 9 years).

A number of estate planning transactions such as sales to grantor trusts, intra-family loans, GRATs, and CLTs can allow you to take advantage of the low interest rates and transfer appreciation in excess of the required interest rate without incurring any gift tax. For example, if a simple 5-year "zeroed-out" GRAT of $5,000,000 was created using the current AFR and the asset were invested to earn a return of 8% annually, over $1,100,000 could be transferred without any gift tax while consuming, at most, a nominal amount of your lifetime gift (and estate) tax exclusion. The Obama Administration, however, has also proposed to curtail the use of GRATs. The proposal requires that GRATs created after the enactment date of new legislation have a minimum term of 10 years and may not be zeroed-out. This proposal would introduce a risk element to the GRAT far greater than GRATs have now.

The use of grantor trusts (trusts in which the grantor is deemed to own the assets for income tax purposes) and sales of appreciating assets to those grantor trusts are also strategies that the Obama Administration wants to make much less attractive. According to the proposal, assets sold to a grantor trust after the enactment date of new legislation would be subject to estate tax upon the death of the grantor. Also, if the trust ceases to be considered a grantor trust for income tax purposes or if the trust makes a distribution to someone other than the grantor, the grantor would be treated as having made a gift to the trust at that time. If enacted into law, such a proposal would virtually eliminate the sale to a grantor trust strategy. If you are interested in this strategy, you should consider acting now.

► ***Estate Plan Review***

We recommend that you review your estate plan to ensure it is updated taking into account your current family situation, your current asset structure, your dispositive wishes and the tax provisions in effect at this time. You should also check to make sure that your assets are properly titled so that your estate plan operates as intended. If you are married, and have combined assets in excess of $10,680,000, or one of you has assets in excess of $5,340,000, care should be taken to ensure that both you and your spouse will fully utilize your available federal estate tax credits, which may require the gift tax-free transfer of ownership of some assets between spouses (assuming the donee spouse is a U.S. citizen). Although we are not sure whether any of the Obama Administration proposals or other tax deduction extensions will be enacted by Congress, the continued and continuously increasing estate and GST tax exemptions of the American Taxpayer Relief Act of 2012 combined with still depressed asset valuations, historically low interest rates, and the possibility of future legislation curtailing some common estate planning techniques make now an outstanding opportunity for estate planning transactions.

***** RECOGNITION OF SAME SEX MARRIAGES FOR FEDERAL TAX PURPOSES *****

On June 26, 2013, the U.S. Supreme Court released its decision in United States v. Windsor – a case brought by a surviving same-sex spouse against the government after the IRS, relying on Defense of Marriage Act, denied the federal unlimited marital deduction taken by her deceased spouse's estate. By a margin of 5 to 4, the U.S. Supreme Court allowed a federal unlimited marital deduction and held that Section 3 of the Defense of Marriage Act was unconstitutional as a violation of the principal of equal protection.

Just two months later, as practitioners where still digesting the potential huge ramifications of the Windsor ruling, the IRS issued Revenue Ruling 2013-17 announcing that the IRS will recognize "all legal same-sex marriages…for federal tax purposes." Further, the IRS outlined its adoption of a "place of celebration" principal for determining whether a couple will be considered legally married for federal tax purposes. In essence, if a same-sex couple has a marriage certificate issued by a state that, at the time of the marriage, recognized same-sex marriages, the IRS will consider the couple to be married for all federal tax purposes, even if they live in a state (such as Florida) that does not recognize the validity of same-sex marriages.

The Windsor ruling and Revenue Ruling 2013-17 now allow same-sex married couples to: file a joint tax return which could result in a lower combined tax liability; take advantage of more favorable stretch-out rules for retirement plans; make use of the unlimited marital deduction for transfers to spouses during life or at death; transfer the deceased spouse's unused estate tax exclusion amount to the surviving spouse; and other tax benefits (and burdens) of marriage. Further, married taxpayers are permitted to retroactively rely on the ruling and, if beneficial to them and within the statute of limitations, amend previously filed tax returns to establish a claim for past overpayments. Generally speaking, the statute of limitations for filing a refund claim is the later of: three years from the date the return was filed; or two years from the date the tax was paid.

We hope the information in this letter is helpful to you in your year-end planning. If you have any questions, we would be happy to assist you. Best wishes for a healthy and joyous holiday and New Year.

Private Wealth Services Group
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In this Year-End Letter, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Year-End Letter for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.