



Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

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Spring 2013

7 Major Tax Changes In The Fiscal Cliff Law

From the edge of the “fiscal cliff,” Congress took a step back and approved the American Taxpayer Relief Act (ATRA), a hodgepodge of tax extensions and modifications. But the agreement postponed decisions on spending cuts and failed to continue a 2% “payroll tax holiday” for employees. Moreover, upper-income taxpayers will have to shoulder a greater burden going forward. Here are seven noteworthy changes for individuals.



which has steadily been casting a wider net each year, is overhauled. Under ATRA, exemption amounts have been increased and nonrefundable personal credits can be used to offset AMT liability in full. In addition, the exemption amounts will be indexed for inflation in the future. Because the changes are retroactive to the 2012 tax year, it's been estimated they will save as many as 60 million taxpayers from the clutches of the AMT.

1. Individual Tax Rates. Across-the-board tax hikes are averted and the “marriage penalty” is eased. Nevertheless, ATRA creates an “extra” top tax rate of 39.6% for single-filers with income above \$400,000 and joint-filers with income above \$450,000. When you add in the new 3.8% Medicare surtax for certain upper-income investors, which begins in 2013, your effective top tax rate can reach 43.4%!

2. Capital Gains And Dividends. The “Bush tax cuts” for capital gains and dividends are generally preserved. The maximum tax rate remains 15% for net long-term capital gain and qualified dividends (0% for investors in the lowest tax bracket). Otherwise, the tax rate for capital gains would have soared to 20% (10% for investors in the lowest tax bracket). Even worse, dividends would have been taxed at ordinary income rates. But the upper crust still pays a steep price: a maximum 20% tax applies to single-filers with income above \$400,000 and joint-filers with income of more than \$450,000.

3. Alternative Minimum Tax. The onerous alternative minimum tax (AMT),

4. Itemized Deductions And Personal Exemptions. Two other “back-door” tax increases may affect taxes of wealthier individuals. Due to the revival of the “Pease rule,” most itemized deductions are reduced by 3% of the amount of adjusted gross income (AGI) above a specified threshold, beginning in 2013 (but the overall reduction can't exceed 80%). At least ATRA establishes higher thresholds of \$250,000 for single-filers and \$300,000 for joint-filers. A comparable provision begins to phase out the tax benefits of personal exemptions at the same thresholds.

5. Education Tax Breaks. ATRA generally extends several valuable tax incentives relating to higher education. Significantly, it allows parents to claim the maximum \$2,500 American Opportunity Tax Credit (AOTC) for another five years, subject to a phaseout based on modified adjusted gross income (MAGI). It also extends the above-the-line deduction for tuition and fees, also phased out based on MAGI, through 2013. This deduction may be claimed in lieu of a higher education credit. The

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2013 Updates

Please be aware of these 2013 tax-related updates:

- **Standard Mileage Rates.** Business: 56.5 cents per mile; Charitable: 14 cents per mile; and Medical/ Moving: 24 cents per mile.
- **Maximum IRA amounts increase in 2013 to \$5,500 (\$6,500 if at least age 50). Maximum 401(k) contributions have increased to \$17,500 (\$23,000 if age 50). The option to convert to a Roth IRA is still available regardless of income, but all conversion taxes must be paid this tax year.**
- **Maximum Simple IRA elective deferral amount is \$12,000 in 2013. For participants who are age 50 or over at the end of the calendar year can also make catch-up contributions of no more than \$2500 (\$14,000 total).**
- **The maximum Iowa tax deductible contribution to College Savings Iowa for 2013 is \$3,045 per person (participant) per child beneficiary.**
- **\$500 Energy-Efficient Home Improvement Tax Credit (lifetime maximum credit between 2006-2013 tax years) for the cost of specified energy-saving home improvements to your primary residence was extended into 2013.**

Congratulations to Dimensional Fund Advisors who ranked #1 in the U.S. Equity category in Barron's Fund Family Rankings for 2012. As an authorized fee-only Registered Investment Advisor that has been approved to use DFA funds in our client accounts, we applaud DFA's success in providing global investment solutions with state-of-the-art portfolio design and trading. To learn more about DFA funds, please contact us.

Steven L. Kane, CPA/PFS, CFP®

Take A Closer Look At Your RMDs

The IRS allows you to build up a sizeable nest egg for retirement inside your traditional IRAs.

But then the other shoe drops:

Whether you want to or not, you must begin taking “required minimum distributions” (RMDs) once you reach a certain age. Otherwise, you could be socked with a hefty tax penalty.

But the tax law does provide some flexibility. Depending on your situation, you might decide to withdraw funds from one of your IRAs, all of your IRAs, or any combination you prefer.

You have to start taking RMDs from your IRAs by April 1st of the year after the year in which you turn age 70½. In other words, if your 70th birthday was on June 1, 2012, you must take an RMD for the 2012 tax year by April 1, 2013. Then you still have to take another RMD for the 2013 tax year by December 31, 2013.

The amount of the RMD is based on the value in your accounts on December 31st of the tax year and is calculated according to IRS-approved life expectancy tables. For example, if you have a total balance of \$1 million in your IRAs and your age is 76, the distribution period under the life expectancy table is 22 years. Divide \$1 million by 22, and you arrive at an RMD of

\$45,454.55 for the current tax year.



The penalty for failing to take a timely RMD is equal to 50% of the required amount of the distribution (minus any distribution you actually received). Going back to our example, suppose you’ve taken an RMD for 2012 of \$20,454.55, or \$25,000 less than the required amount. In this case, you would owe a penalty of \$12,500 (50% of \$25,000) on top of the regular income tax. If you’re in

the 35% tax bracket in 2012, that’s a whopping total of \$28,409 (\$15,909 + \$12,500)!

Comparable rules apply to tax-deferred earnings within a tax-qualified retirement plan such as a 401(k). But you may postpone RMDs from qualified plans (not IRAs) if you continue working past age 70½ as long as you don’t own more than 5% of the company that employs you.

The amount of your annual RMD reflects the value of all your IRAs, but you can actually withdraw the funds from one or more of the IRAs. If you’re maintaining separate IRAs with different beneficiaries, you might want to keep the balances in all of them equal—and they may have gotten out of whack because of withdrawals, contributions, fees, and investment performance. So, for instance, if you have three IRAs and you’ve designated a different beneficiary for each one, you could withdraw the entire RMD amount from the IRA with the highest balance. Or you could get rid of underperforming assets in one of your accounts by liquidating those to provide cash for the RMD.

Keep in mind that you must give explicit instructions about your RMDs to each IRA custodian, and please call us if you have any questions. ●

Dig Deep Into “Treasure Assets”

Have you ever dreamed of owning a 1965 Aston Martin like the one driven by James Bond in the movies? Or a 17th century Stradivarius? A piece of your favorite sports team? It may not be as far-fetched as it once seemed. Increasingly, well-heeled investors are diversifying by adding a special kind of alternative investment—known as “treasure assets”—to their holdings.

Although you probably can’t afford the top items on your wish list, you may still be able to indulge your inner fantasies. In fact, some private funds allow investors to pool their money to buy treasure assets. A firm

will typically charge a 2% administrative fee in addition to taking a healthy cut of any profits, but the cost may be well worth it to aficionados.

Realize, however, that these undertakings are highly speculative and not for the faint-hearted. Frequently, items are illiquid and have no real intrinsic value. And commissions and other fees can eat into any gains you might eventually realize.

Still, for some investors, pride and joy trumps other factors. In any event, treasure assets should represent only a small part of your overall portfolio. Keeping that in mind, here

are three hot buttons.

1. Classic cars. It’s well-known that most cars lose value as soon as you drive them off the lot. But vintage automobiles can be an exception to that rule. According to the Historic Automobile Group International (HAGI), vintage Ferraris rose 28% in price during the first 10 months of 2012, while Porsches climbed 15% in value. The HAGI index of the top 50 classic cars shows prices increasing almost 64% since 2008.

2. String instruments. An auction house sold a 1721 Stradivarius violin for almost \$16 million in 2011. Maybe you will have to lower your sights, but

10 Reasons For The IRS To Flag Your Return

What sets off alarm bells at the IRS? Due to limited resources, the IRS only audits around 1% of all federal individual tax returns, while the other 99% skate through unexamined. Nevertheless, it pays to keep in mind these 10 “red flags” that could increase the chance you’ll be tapped for an audit.

1. High income. The audit rate for 2011 tax returns, which was about 1.11% overall, jumped to 3.93% for taxpayers with income of \$200,000 or more. That’s almost one out of every 25 returns. The IRS tends to chase the “big money,” and while that’s no reason to earn less, you should realize that higher income exposes you to a greater audit risk.

2. Unreported income. The IRS computers match up the income listed on W-2 and 1099 forms with the income reported on individual returns. You’re likely to draw IRS scrutiny if you don’t report all of your taxable income or if you underreport the total, even if an omission is inadvertent. Check your tax forms to ensure the information is accurate.

3. Large charitable gifts. Besides providing personal satisfaction, deductions for charitable gifts can offset highly taxed income on your return. But the IRS may become suspicious if the amount you deduct is disproportionate

to your income. In particular, make sure that deductions for gifts of property are legitimate and include an independent appraisal when required.

4. Home office deductions. If you qualify, you can write off your direct costs of using part of your home as an office, plus a percentage of everyday living expenses such as property taxes, mortgage interest, utilities, phone bills, insurance, etc. But the basic rule is that you must use the office “regularly and exclusively” as your principal place of business. Simply doing work at home when your main office is elsewhere won’t cut it.

5. Rental real estate losses. Generally, “passive activity” rules prevent investors from deducting losses on rental real estate. But a special exception allows a loss deduction of up to \$25,000 for “active participants,” subject to a phase-out between \$100,000 and \$150,000 of adjusted gross income (AGI). Another exception applies to qualified real estate professionals. The IRS may zero in on taxpayers claiming losses under either exception.

6. Travel and entertainment expenses. This is often a prime audit target. IRS agents particularly look for self-employed individuals and other business owners who claim unusually large write-offs for travel and entertainment expenses and meals. Note

that the tax law includes strict substantiation rules that must be followed in order to deduct any of these expenses.

7. Business use of cars. Another area ripe for abuse by taxpayers is the use of a vehicle for business purposes. The annual amount you can claim via depreciation deductions for the vehicle, based on percentage of business use, is limited by so-called “luxury car” rules. IRS agents have been trained to ferret out taxpayer records that don’t measure up. Another danger signal is a claim for 100% business use of a vehicle, especially if another vehicle isn’t available for personal use.

8. Hobby losses. As a general rule, you can deduct expenses for a hobby only up to the amount of the income it produces. You normally can’t claim a loss for the activity, unless your involvement rises to a level of a bona fide business. Usually, an activity is presumed not to be a hobby if you show a profit in any three out of the past five years, but the IRS can rebut this presumption.

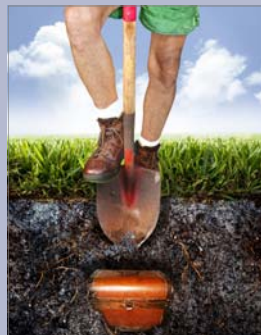
9. Foreign bank accounts. The IRS has started clamping down on taxpayers with offshore accounts in “tax havens” in which banks may not disclose account information. Failure to report foreign income can trigger steep penalties and interest. If you have foreign bank accounts, make sure you properly report the income when you file your return.

10. Cash businesses. Finally, if you operate a small business in which you’re generally paid in cash—for example, if you own a car wash, restaurant or tavern, or a hair or nail salon—the IRS is more likely to examine your return. Past history indicates that cash-heavy taxpayers may underreport their income or, in some cases, not report any income at all. Accordingly, the IRS remains on high alert.

These red flags certainly don’t mean you should shy away from claiming the tax breaks you rightly deserve. Just be prepared to defend your turf if the IRS ever comes calling. ●

investments in other string instruments, including vintage electric guitars, are available. A 2011 study tracking violin sales showed an average annual return of about 3.5% between 1850 and 2008 after inflation adjustments, and concluded that the instruments have a slight negative correlation with stocks and bonds (in other words, violin prices tend to rise when the value of those other assets falls).

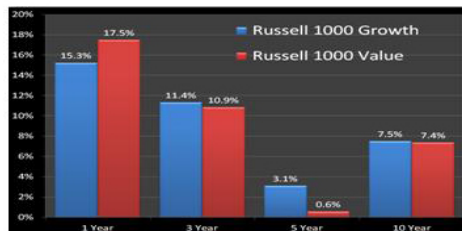
3. Wine. This category is attracting attention as an inflation hedge with potential for growth. But investing in



wine is risky enough to drive you to drink. The Liv-ex 100 Fine Wine Index, which tracks prices of 100 top wines worldwide, says it has produced an annualized return of 10% since 2002. However, the index is down nearly 10% for the first 10 months of 2012.

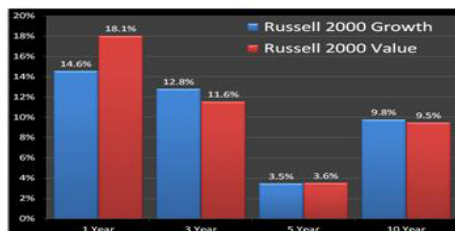
Other treasure assets, such as interests in major and minor league sports franchises, may strike your fancy. But be aware that glamorous investments are more likely to produce personal enjoyment than a steady return. View these offerings with your eyes wide open. ●

Market Data Bank: 4th Quarter 2012



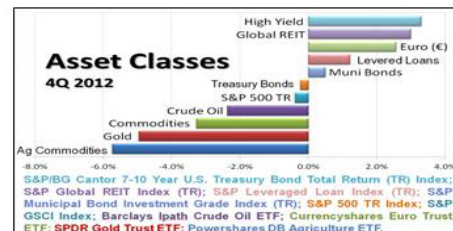
LARGE VALUE VS. LARGE GROWTH

In 4Q2012, large company stocks in the Russell 1000 index gained a fraction, but the big story was the excellent calendar-year performance of U.S. stocks. Stocks recovered from the global financial crisis.



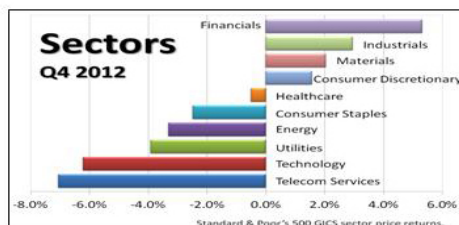
SMALL VALUE VS. SMALL GROWTH

The 18.1% annualized return on small-company value stocks in 2012 towers over annualized returns of small-cap growth as well as small-cap value companies for 3-, 5-, and 10-years. That's why rebalancing is important.



ASSET CLASSES

Showing why short-term results can mislead investors, only five of the 12 major asset classes showed a positive return in 4Q2012, while 10 of the 12 were in positive territory for the 12-month period ended December 31,



INDUSTRY SECTORS

The reversal in fortunes for some asset classes was also evident in U.S. industry sectors in the fourth quarter of 2012. Financial services stocks continued to lead, while technology stocks and telecom lagged.



S&P 500 VS. EARNINGS

Estimated earnings per share for companies in the S&P 500 on 1/3/13 was \$103 for 2012 and \$115 for 2013 and \$126 for 2014. Expectations have helped propel stock prices to reach toward the red squares.



FOREIGN STOCK MARKETS

In 2012, stocks across the globe posted strong returns. The Eurozone's 16% gain (not including dividends) was the biggest surprise. At the start of 2012, with Europe teetering, it seemed an unlikely region to stage a stock rally.

Actual S&P 500 index data through Dec.31, 2012 and actual earnings data through Sept. 30, 2012. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political or economic instability and currency fluctuation. Past performance does not indicate future results.

The Fiscal Cliff Law

(Continued from page 1)

tuition deduction extension is retroactive to 2012. Finally, ATRA permanently extends enhancements for Coverdell Education Savings Accounts (CESAs), the tax exclusion for employer-provided education assistance and the student loan interest deduction.

6. Extensions Of Other Rules.

Besides those already mentioned, ATRA extends a host of other tax provisions for individuals, many of them retroactive to the beginning of 2012 (i.e., for provisions that technically expired). Most of the extended tax breaks are limited by dollar amounts. The list includes:

- Optional state sales tax deduction (in lieu of state income tax)

- Enhanced child tax credit, dependent care credit and adoption credit (and tax exclusion for adoption program assistance)

- Credit for energy-saving at home

- Monthly tax exclusion for certain commuting benefits

- Deduction for mortgage insurance premiums

- Deduction for classroom expenses of educators

- Tax exclusion for mortgage debt forgiveness

- Tax benefits for donating real estate for conservation purposes

- Tax-free distributions of IRA funds to charity by those age 70 ½ or over

7. Estate And Gift Taxes. At long last, there's greater certainty in estate planning. Beginning in 2013, the unified

estate and gift tax system permanently retains a \$5 million exemption and will be indexed annually for inflation

(\$5.25 million in 2013), instead of plummeting from \$5.12 million in 2012 to \$1 million.

The top estate tax rate, which was scheduled to jump from 35% in 2012 to 55% in 2013, is bumped up to 40%. ATRA also retains the provision allowing "portability" of estate tax exemptions between spouses and coordinates various other

aspects, including implementation of the generation-skipping tax.

These are just some of the highlights of the fiscal cliff law. We will be offering further guidance on the tax law changes, but please don't hesitate to call us about how the changes affect you personally. ●

