TAX UPDATE HIGHLIGHTS FOR 2013

Tax Facts - Affordable Care Act

3.8% Tax on Net Investment Income

- Imposed on the lesser on Net Investment Income (NII) or the excess of modified AGI over $200,000 for single filing status and $250,000 for married filing joint status.
- NII is the sum of:
  - Gross income from interest, dividends, annuities, royalties and rents, <u>unless derived in the ordinary course of business;</u>
  - Income from a passive business, business income from trading in financial instruments or commodities;
  - Capital gains and other net gains from the disposition of property, except for gains attributed to property held in a material participation business. No net losses;
  - Reduce by deductions properly allocable to the gross income or net gain.
- Net investment income excludes:
  - Material participation business income, pass through gain from S corporations;
  - Gain from the sale of an interest in a partnership or S corporation can be excluded if the individual materially participates in the business. Not C corp;
  - Qualified retirement plan and IRA distributions;
  - Self employed income, wages
  - Interest on tax exempt bonds, veteran's benefits, excluded gain from the sale of a principal residence.
- Side-bar tax:
  - An individual with high AGI and negative taxable income can still be subject to this tax.

Adding the New Medicare Tax

A quick look at the impact of the Medicare surtax on top federal rates.

	2012			2013		
	Top Federal Tax	Medicare Tax	Total	Top Federal Tax Increase	Medicare Surtax	Total
Earned income	35.00%	1.45%	**36.45%**	4.60%	0.90%	**41.95%**
Capital gains	15.00%	0.00%	**15.00%**	5.00%	3.80%	**23.80%**
Dividends	15.00%	0.00%	**15.00%**	5.00%	3.80%	**23.80%**
Interest	35.00%	0.00%	**35.00%**	4.60%	3.80%	**43.40%**

High Earner Medicare Tax

- Employees pay 1.45% medicare tax on their wages. Self-employed workers pay this same tax on their 1040. In 2013, high earners will pay an additional .9% medicare tax on earned income. Self-employment losses are not counted.
  - Single filers - additional medicare tax is imposed on wages and SE income in excess of $200,000;
  - Married filers - additional medicare tax is imposed on wages and SE income in excess of $250,000.
- Employers will withhold the additional medicare tax on wages paid in excess of $200,000 per individual.

Determining The Marginal Tax Rate for Various Types of Income in 2013

<table>
<tr><th>Individual income above...</th><th>Couple's income above</th><th>Income "type"</th><th>Ordinary income</th><th>AMT rate</th><th>L/T gains & qual. dividends</th><th>Wage earned income</th><th>Self-employed earned income</th><th>Net inv. Income</th><th>Itemized deduction phaseout</th><th>Personal exemption phaseout*</th><th>AMT Exemption phaseout</th></tr>
<tr><td>$0</td><td>$0</td><td>Taxable</td><td>10%</td><td rowspan="8">26%</td><td rowspan="2">0%</td><td rowspan="3">7.65%</td><td rowspan="3">15.3%</td><td rowspan="11">0%</td><td rowspan="12">0%</td><td rowspan="12">0%</td><td rowspan="5">0%</td></tr>
<tr><td>$8,950</td><td>$17,900</td><td>Taxable</td><td>15%</td></tr>
<tr><td>$36,250</td><td>$72,500</td><td>Taxable</td><td rowspan="2">25%</td><td rowspan="15">15%</td></tr>
<tr><td>N/A</td><td>$113,700</td><td>Earned</td><td rowspan="3">0% - 1.45%</td><td rowspan="3">0% - 2.9%</td></tr>
<tr><td>$87,850</td><td>$146,400</td><td>Taxable</td><td rowspan="5">28%</td></tr>
<tr><td>$112,500</td><td>N/A</td><td>AMTI</td><td rowspan="2">6.5% - 0%</td></tr>
<tr><td>$113,700</td><td>N/A</td><td>Earned</td><td rowspan="4">1.45%</td><td rowspan="4">2.9%</td></tr>
<tr><td>N/A</td><td>$150,000</td><td>AMTI</td><td>6.5%</td></tr>
<tr><td>$175,000</td><td>$175,000</td><td>AMTI</td><td rowspan="11">28%</td><td rowspan="5">7%</td></tr>
<tr><td>$183,250</td><td>$223,050</td><td>Taxable</td><td rowspan="6">33%</td></tr>
<tr><td>$200,000</td><td>$250,000</td><td>Earned</td><td rowspan="9">**2.35%**</td><td rowspan="9">**3.8%**</td></tr>
<tr><td>$200.000</td><td>$250,000</td><td>AGI</td><td rowspan="8">**3.8%**</td></tr>
<tr><td>$250,000</td><td>$300,000</td><td>AGI</td><td rowspan="3">**1%**</td><td rowspan="2">**1%**</td></tr>
<tr><td>$323,000</td><td>N/A</td><td>AMTI</td><td rowspan="5">0% - 7%</td></tr>
<tr><td>$372,500</td><td>N/A</td><td>AGI</td><td>**0% - 1%**</td></tr>
<tr><td>$398,350</td><td>$398,350</td><td>Taxable</td><td rowspan="2">35%</td><td rowspan="2">**1.05%**</td><td>**0% - 1.1%**</td></tr>
<tr><td>N/A</td><td>$422,500</td><td>AGI</td><td rowspan="3">**0%**</td></tr>
<tr><td>$400,000</td><td>$450,000</td><td>Taxable</td><td rowspan="2">**39.6%**</td><td rowspan="2">**20%**</td><td rowspan="2">**1.2%**</td></tr>
<tr><td>N/A</td><td>$473,000</td><td>AMTI</td><td>0%</td></tr>
</table>

Income thresholds based on estimated 2013 inflation adjustments (where applicable).
Where two rates are shown, the first applies to individuals, the second to married couples.
****Phaseout per exemption***

Take Aways - The New Laws Will Not Impact Many Filers

- $250,000 is the threshold for 3.8% net investment tax
- $250,000 is the threshold for 0.9% additional Medicare tax
- $300,000 is the threshold for itemized deduction and personal exemption phaseout
- $450,000 is the threshold for additional 5% tax on capital gains and 39.6% tax rate (thresholds based on married filing status)

Snapshot of 2013 Federal Capital Gain Tax Rates

Single Taxpayer	Married Filing Jointly	Capital Gain Tax Rate	Section 1411 Medicare Surtax	Combined Tax Rate
$0-$36,250	$0-$72,500	0%	0%	**0%**
$36,250-$400,000	$72,500-$250,000	15%	0%	**15%**
$200,000-$400,000	$250,000-$450,000	15%	3.8%	**18.8%**
$400,001+	$450,001+	20%	3.8%	**23.8%**

2013 Phaseout of Exemptions and Itemized Deductions

- No phaseouts in 2012 - permanent phaseouts for 2013

Thresholds for 2012:

- Phaseout begins at adjusted gross income over:
  - Single status - $250,000;
  - Married filing joint - $300,000 (Separate - $150,000).

Exemptions:

- For each $2,500 of AGI over the threshold, taxpayers lose 2% of their personal exemptions;
- Can lose up to 80% of exemptions.

Itemized Deductions:

- Reduction is equal to 3% of the AGI over the threshold;
- Excluded from calculation are deductions for medical expenses, investment interest expense, casualty or theft losses, and gambling losses;
- Can lose up to 80% of deductions.

Example: Married Filing Joint, 2 Exemptions, AGI of $340,000

Phaseout for exemptions is $340,000-$300,000 = $40,000/$2,500 = 16 * 2% = 32%.

Exemptions are worth $3,900 x 2 = $7,800 * 32% - $2,496 reduction in exemptions.

Phaseout for itemized deductions is $340,000-$300,000 = $40,000 * 3% - $1,200 reduction in itemized deductions.

Washington State Credits and Exemptions for Manufacturing

Name	What it Does	Who it is Available To	Pitfalls
High Technology R&D Sales & Use Tax Deferral/ Waiver and Biotechnology & Medical Device Manufacturing Deferral/ Waiver	These programs allow businesses to defer paying sales/use tax on certain applicable projects for eight years. Over this deferral period, a 1/8th of the tax is waived as long as the activity continues to take place at that location. Businesses must apply with the DOR ahead of beginning an applicable project so the DOR can examine the project plan. If the DOR approves, it provides a special exemption certificate to the business which it can use to purchase without paying sales/use tax. Once the project is complete, the DOR does a limited scope audit of the business' records to determine the amount of unpaid tax that can be deferred/waived in the program	Businesses who do research, development and pilot manufacturing in high technology fields (as defined in RCW 82.63.010), biotechnology and medical device manufacturers (as defined in RCW 82.75.010)	Must be applied for in advance, DOR audit of final project may result in certain items not being subject to the deferral, requires an annual survey to be filed or all unpaid tax becomes due, if the qualifying activity ceases, the unwaived portion of sales/ use tax becomes due immediately.
Machinery and Equipment Sales & Use Tax Exemption	Exempts machinery and equipment from sales/ use tax when used in a manufacturing and/or research and development process at a manufacturer.	Manufacturers and processors for hire.	Defining the item as qualifying is complex, generally speaking the property must be both directly used and integral to the operation of the process.
High Technology B&O Tax Credit for R&D Spending	Offers a B&O tax credit for certain R&D expenditures of 1.5% of the expenses exceeding 0.92% of the taxable gross receipts.	Businesses that are conducting research in advanced technology fields are defined in RCW 82.63.010.	Computation can be complex, requires an annual survey to be filed with the DOR in order to maintain availability.
B&O Credit for Aerospace Preproduction Development Expenditures	Provides a credit of 1.5% of aerospace preproduction development expenditures.	Manufacturers and processors for hire who produce commercial airplanes and parts, business engaged in aerospace development, FAR repair stations and aerospace tooling manufacturers.	Requires an annual report to be filed with the DOR, an affidavit must be submitted for each reporting period the credit is taken.

Name	What it Does	Who it is Available To	Pitfalls
Sales & Use Tax Exemption for Aerospace Manufacturers for Computer Hardware/ Software/Peripherals	Similar to the machinery and equipment exemption but extends the exemption to computers and components that are primarily used in engineering, developing, or otherwise designing parts for commercial airplanes or the airplanes themselves.	Aerospace manufacturers	None, on purchase the business provides the vendor with a Retail Sales Tax Exempt Certificate. No annual reports are necessary.

Federal 50% First-Year Bonus Depreciation 2013

Above and beyond the bumped-up Section 179 deduction, your business can also claim first-year bonus depreciation equal to 50% of the cost of most new (not used) equipment and software placed in service by December 31 of this year. For a new passenger auto or light truck that's used for business and is subject to the luxury auto depreciation limitations, the 50% bonus depreciation break increases the maximum first-year depreciation deduction by $8,000 for vehicles placed in service this year. The 50% bonus depreciation break will expire at year-end unless Congress extends it.

Note: First-year bonus depreciation deductions can create a Net Operating Loss (NOL) for your business's 2013 tax year. You can then carry back a 2013 NOL to 2011 and 2012 and collect a refund of taxes paid in those years, Please contact us for details on the interaction between asset additions and NOLs.