INVESTMENT UPDATE
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## Reminder: New Tax Regime!

Unlike last year, this December we head toward New Year's with a clear view of the Federal tax landscape. Even so, since none of us has yet lived through a full tax year or return season under the new regime, I want to lay out some of the key features. (Consult your tax advisor on all of it.)

First, some good news: The estate, gift and generation skipping tax exemptions are unified at $5.25 million ($10.5 million total for married couples) and will be indexed for inflation. Moreover, portability of the spousal lifetime exemption equivalent – which had been set to expire – has been made permanent for estate tax purposes; in case that sounds like gobbledygook, just know that it offers valuable estate planning flexibility – your attorney can assess how it bears on your situation. Lastly, the tax rate on non-exempt transfers has gone up from 35% to 40%; this is less than the 55% rate which was previously on the books for 2013 and after.

Next, we have some bad news/good news: The alternative minimum tax (AMT) continues (bad), but it will now be permanently indexed for inflation (good). Previously, the AMT required annual *ad hoc* adjustments to avoid snaring more and more of the middle class. While regular increases in the AMT had become somewhat a matter of routine, the need for them nonetheless had the potential to become a political bargaining chip, something that could be held hostage with destructive impact on millions of Americans whom the AMT was never intended to touch. Permanent inflation-indexing removes that menacing uncertainty.

Because evidently the prior set of six tax brackets wasn't enough, there's now a seventh bracket, for high earners ($400,000 single/$450,000 couples), along with new top rates for investment income:

- Top tax rate on ordinary earned income: 39.6% (up from 35%)
- Top tax rate on qualified dividends: 23.8% (up from 15%)
- Top tax rate on long-term capital gains: 23.8% (up from 15%)

Those dividend and gains rates embed a 3.8% net investment income tax (or NIIT) which has been instituted for individual taxpayers earning over $200,000 and couples over $250,000. This means well-heeled investors will be paying almost 60% more on the most tax-efficient sources of taxable income. Tax payers at those levels will also face a 0.9% bump in the Medicare tax on earned income, and it will be applied without limit.

From our perspective, all of this only increases the relative attraction of tax-exempt municipal bonds. What's more, because tax-exempt muni income does not count toward modified adjusted gross income (MAGI), it can help relieve the drift upward into the most punishing tax bracket. We believe municipal bond prices do not yet fully reflect their advantages under the new regime.

Last of all, great news in this season of giving: the IRA charitable rollover was extended for 2013. If you're at least age 70½ you can make a qualified charitable distribution (QCD) directly from your IRA to a qualified charity. Doing so can exclude up to $100,000 from your gross income, and the QCD can be used toward any IRA required minimum distributions (RMDs) for the year. Time is short, however, and this giving opportunity is <u>not</u> scheduled to be available in coming years, so don't delay if you're interested.

For now at least, we know the basic tax rules set to prevail for the next few years, though doubtless there will be efforts to chip away at various provisions. Altogether, this year's clarity is a vast improvement over last year's confusion.