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INVESTMENT HOUSE, LLC

Financial Solutions Under One Roof

Estate Tax After the Fiscal Cliff



After threatening to go over the fiscal cliff, the gift tax, estate tax, and generation-skipping transfer (GST) tax have come in for a soft landing. The American Taxpayer Relief Act of 2012 (ATRA 2012),

enacted on January 2, 2013, permanently extended the \$5 million (as indexed) gift tax and estate tax applicable exclusion amount and GST tax exemption. It also permanently extended portability of the gift tax and estate tax applicable exclusion amount between spouses. However, it also increased the top gift, estate, and GST tax rate to 40% starting in 2013. A number of other provisions were also permanently extended.

Top gift, estate, and GST tax rate

In 2012, there was a 35% top tax rate for gift, estate, and GST taxes. It was scheduled to increase to 55% in 2013. ATRA 2012 provides a permanent 40% top rate, starting in 2013.

Applicable exclusion amount

You have an applicable exclusion amount that can protect a certain amount of property from the federal gift tax and estate tax. The basic exclusion amount was \$5,120,000 in 2012 (\$5 million as indexed for inflation), but was scheduled to drop to \$1 million in 2013. ATRA 2012 permanently extends the basic exclusion amount at \$5 million as indexed for inflation.

Portability of exclusion

The estate of a person who died in 2011 or 2012 could transfer the decedent's unused applicable exclusion amount to his or her surviving spouse, who could use the unused exclusion, along with his or her own basic exclusion amount, to shelter property from gift and estate tax (referred to as portability). The provision was scheduled to sunset in 2013. ATRA 2012 has permanently extended the portability provision.

GST tax exemption

You have a GST tax exemption that can protect a certain amount of property from the GST tax. The GST tax exemption was \$5,120,000 in 2012 (\$5 million as indexed for inflation), but was scheduled to drop to \$1 million (as indexed for inflation) in 2013. ATRA 2012 permanently extends the GST tax exemption at \$5 million as indexed for inflation (it is \$5,250,000 in 2013).

State death taxes

In 2012, your estate could take an estate tax deduction for death taxes (estate tax or inheritance tax) paid to a state. In 2013, it was scheduled to change back into a credit for state death taxes, as available back in 2001. However, ATRA 2012 permanently extends the deduction for state death taxes.

Conservation easement exclusion

An estate tax exclusion is available for qualified conservation easements. In 2012, the exclusion was generally available if the property was located anywhere in the United States. In 2013, the exclusion was scheduled to be available, as in 2001, only if the property was located within a limited number of miles from a National Wilderness Preservation System or an Urban National Forest. ATRA 2012 permanently extends the provision that the property can generally be located anywhere in the United States and the mileage requirements do not apply.

Estate tax deferral for closely held business

Where the value of a closely held business exceeds 35% of the value of the adjusted gross estate, payment of estate tax attributable to the business can be deferred for up to 5 years and then paid in installments over 10 years, all at favorable interest rates. In 2012, a closely held business could have 45 partners or shareholders. In 2013, the permissible number of partners or shareholders was scheduled to drop to 15, as in 2001. ATRA 2012 permanently extends the provision allowing up to 45 partners or shareholders.

April 2013

Estate Tax After the Fiscal Cliff

Understanding the New Medicare Tax on Unearned Income

Financial Tips for Obtaining a Mortgage Loan

I refinanced my mortgage loan last year. Can I deduct any of the costs associated with refinancing the loan?



Health-care reform legislation passed in 2010 included a new additional 0.9% Medicare tax on wages, compensation, and self-employment income over certain thresholds. This new tax also took effect on January 1, 2013. The 0.9% tax does not apply to income subject to the NIIT. So while you may be subject to both taxes, the taxes do not apply to the same types of income.

Understanding the New Medicare Tax on Unearned Income

Health-care reform legislation enacted in 2010 included a new 3.8% Medicare tax on the unearned income of certain high-income individuals. The new tax, known as the unearned income Medicare contribution tax, or the net investment income tax (NIIT), took effect on January 1, 2013.

Who must pay the new tax?

The NIIT applies to individuals who have "net investment income," and who have modified adjusted gross income (MAGI) that exceeds certain levels (see the chart below). (Estates and trusts are also subject to the new law, although slightly different rules apply). In general, nonresident aliens are not subject to the new tax.

Filing Status	MAGI over ...
Single/Head of household	\$200,000
Married filing jointly/ Qualifying widow(er)	\$250,000
Married filing separately	\$125,000

What is MAGI?

For most taxpayers, MAGI is simply adjusted gross income (AGI), increased by the amount of any foreign earned income exclusion.

AGI is your gross income (e.g., wages, salaries, tips, interest, dividends, business income or loss, capital gains or losses, IRA and retirement plan distributions, rental and royalty income, farm income and loss, unemployment compensation, alimony, taxable Social Security benefits), reduced by certain "above-the-line" deductions (see page one of IRS Form 1040 for a complete list of adjustments).

Note that AGI (and therefore MAGI) is determined *before* taking into account any standard or itemized deductions or personal exemptions. Note also that deductible contributions to IRAs and pretax contributions to employer retirement plans will lower your MAGI.

What is investment income?

In general, investment income includes interest, dividends, rental and royalty income, taxable nonqualified annuity income, certain passive business income, and capital gains--for example, gains (to the extent not otherwise offset by losses) from the sale of stocks, bonds, and mutual funds; capital gains distributions from mutual funds; gains from the sale of interests in partnerships and S corporations (to

the extent you were a passive owner), and gains from the sale of investment real estate (including gains from the sale of a second home that's not a primary residence).

Gains from the sale of a primary residence may also be subject to the tax, but only to the extent the gain exceeds the amount you can exclude from gross income for regular income tax purposes. For example, the first \$250,000 (\$500,000 in the case of a married couple) of gain recognized on the sale of a principal residence is generally excluded for regular income tax purposes, and is therefore also excluded from the NIIT.

Investment income does not include wages, unemployment compensation, operating income from a nonpassive business, interest on tax exempt bonds, veterans benefits, or distributions from IRAs and most retirement plans (e.g., 401(k)s, profit-sharing plans, defined benefit plans, ESOPs, 403(b) plans, SIMPLE plans, SEPs, and 457(b) plans).

Net investment income is your investment income reduced by certain expenses properly allocable to the income--for example, investment advisory and brokerage fees, investment interest expenses, expenses related to rental and royalty income, and state and local income taxes.

How is the tax calculated?

The tax is equal to 3.8% of the lesser of (a) your net investment income, or (b) your MAGI in excess of the statutory dollar amount that applies to you based on your tax filing status. So, effectively, you'll be subject to the additional 3.8% tax only if your MAGI exceeds the dollar thresholds listed in the chart above.

Example: Sybil, who is single, has wages of \$180,000 and \$15,000 of dividends and capital gains. Sybil's MAGI is \$195,000, which is less than the \$200,000 statutory threshold. Sybil is not subject to the NIIT.

Example: Mary and Matthew have \$180,000 of wages. They also received \$90,000 from a passive partnership interest, which is considered net investment income. Their MAGI is \$270,000, which exceeds the threshold for married taxpayers filing jointly by \$20,000. The NIIT is based on the lesser of \$20,000 (the amount by which their MAGI exceeds the \$250,000 threshold) or \$90,000 (their net investment income). Mary and Matthew owe NIIT of \$760 (\$20,000 x 3.8%).

Note: The NIIT is subject to the estimated tax rules. You may need to adjust your income tax withholding or estimated payments to avoid underpayment penalties.

Financial Tips for Obtaining a Mortgage Loan



You're entitled to a free copy of your credit report once a year from each of the three major credit reporting agencies. Visit www.annualcreditreport.com for more information.

In January 2013, the Consumer Financial Protection Bureau released a new mortgage regulation, which sets forth stricter underwriting requirements for mortgage lenders. The regulation requires lenders to ensure a borrower's ability to repay a loan by taking a variety of underwriting precautions, including verifying income and assets and increasing debt-to-income ratios.

The regulation implements sections of the 2010 Dodd-Frank Act, and is aimed at protecting consumers by providing for a standardization of the mortgage loan underwriting process. However, some mortgage-industry experts fear there's a chance that the regulation may end up making obtaining a mortgage loan more difficult than it has been in the past. And while lenders have until January 2014 for final compliance with the regulation, some have already begun to tighten up their mortgage lending requirements. As a result, you may want to consider the following tips when applying for a mortgage loan.

Clean up your credit report

A borrower's credit history is the cornerstone to any lender's underwriting process. As a result, it's important to make sure that your credit report is in good shape before you apply for a mortgage loan. Your credit report contains information about your past and present credit transactions and is used by mortgage lenders to evaluate your creditworthiness. A positive credit history will not only make it easier to obtain a mortgage loan, but can also result in a lender offering you a lower interest rate.

You should review your credit report and check it for any inaccuracies. If necessary, you may need to take steps to improve your credit history. To establish a good track record with creditors, make sure you always pay your monthly bills on time. In addition, try to avoid having too many credit inquiries on your report, which are made every time you apply for new credit.

Improve your debt-to-income ratio

In the past, lenders looked for borrowers to have a debt-to-income ratio of no greater than 36%. The new mortgage regulation suggests that borrowers have a debt-to-income ratio that is less than or equal to 43%. That means you should be spending no more than 43% of your gross monthly income on longer-term debt payments. If you find that your debt-to-income ratio is too high, there are a couple of steps you can take to lower it.

Your first step should be to look at your long-term debt payments. These include

student loans, credit cards, and car payments--any loans that won't be repaid within a year. Try to make it a priority to pay down your long-term debts as quickly as possible. This may require you to review your budget and make adjustments. If you are having trouble coming up with the extra money, take a look at your discretionary spending. By cutting back on discretionary expenses (e.g., going out to eat or to the movies), you may be surprised at how quickly you can free up money to put towards paying down your debt.

Another way to improve your debt-to-income ratio is to increase your income. Perhaps you can earn extra income by taking a second job or performing part-time consulting work in your chosen profession or field of expertise. If you are married and either you or your spouse is currently not working, you or your spouse may want to consider the possibility of reentering the workforce.

Increase the size of your down payment

While it is possible to obtain a mortgage with a minimal down payment--for example, Federal Housing Administration (FHA) mortgages require down payments of as little as 3.5% of the home's purchase price--a larger down payment will usually assure you a more attractive mortgage loan. In addition to requiring private mortgage insurance (PMI), lenders generally offer lower loan limits and higher interest rates to borrowers who have a down payment of less than 20% of a home's purchase price.

If you find that you don't have enough for a down payment, you may want to consider holding off on purchasing a home to give you time to increase your down payment fund. In the meantime, you can invest your down payment in a low-risk, interest-bearing account such as a money market deposit account.

Or, consider looking into alternative ways to fund your down payment, such as:

- Converting/liquidating assets to cash.
- Using gifts.
- Borrowing from a cash value life insurance policy or employer-sponsored retirement plan. (Keep in mind, however, that if you take a loan against your cash value, the death benefit available to your survivors will be reduced by the amount of the loan. In addition, policy loans may reduce available cash value and can cause your policy to lapse. Finally, you could face tax consequences if you surrender the policy with an outstanding loan against it.)

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I refinanced my mortgage loan last year. Can I deduct any of the costs associated with refinancing the loan?

Now more than ever, homeowners are taking advantage of historically low interest rates and refinancing their mortgage loans. Did you pay points to your lender when you refinanced your loan? If so, you may be able to deduct them.

Points are costs that a lender charges when you take out a mortgage loan or refinance an existing mortgage loan on your home. One point equals 1% of the loan amount borrowed (e.g., 2 points on a \$300,000 loan equals \$6,000).

In order for points to be deductible, they must have been charged by your lender as up-front interest in return for a lower interest rate on your loan. If the points were charged for services provided by the lender in preparing or processing the loan, then the points are not deductible.

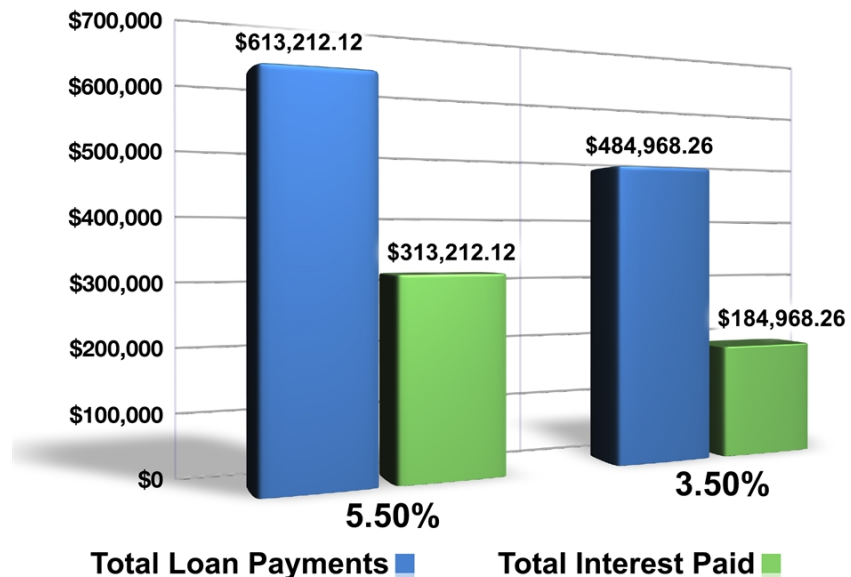
When deducting points, keep in mind that unlike points paid on a loan used to purchase a home, points paid on a refinanced loan usually cannot be deducted in the year that you paid them. Instead, the points may need to be amortized over the life of the loan.

For example, assume that you refinanced to a \$300,000/30-year mortgage loan and paid \$6,000 in points. You would be able to deduct 1/30 of those points each year over the 30-year loan period, or \$200 per year.

The one exception to the amortization rule is if part of your refinanced loan is used to make improvements to your primary residence. In that case, you may be able to deduct the portion of the points that is allocable to the home improvements in the year that the points are paid. In addition, if you choose to refinance again or sell your home in the future, you can generally claim the entire unamortized deduction that remains. For more information on the deductibility of points, you can refer to [IRS Publication 936](#).

As for other costs you may have incurred from refinancing, such as recording, title search, appraisal, and attorney's fees, they are not deductible. Furthermore, unlike costs associated with a home purchase, costs associated with a refinance cannot be added into the cost basis (value) of your home for income tax purposes.

The Potential Benefits of Refinancing Your Mortgage



Assuming a \$300,000/30-year fixed-rate mortgage

This is a hypothetical example and does not reflect all of the costs that may be associated with refinancing. Actual results may vary.