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Same-Sex Marriage Law Alters Key Tax Rules

On June 26, 2013, the U.S. Supreme Court handed down its landmark decision in *Windsor v. U.S.,* declaring that section 3 of the Defense of Marriage Act (DOMA) is unconstitutional. That section, which legally defined "marriage" for federal purposes as a union between a man and a woman, is now gone. Same-sex couples now have new financial and tax rules that they could benefit from significantly.

In the majority opinion, Justice Anthony Kennedy pointed out that the Supreme Court ruling affects more than a thousand federal statutes. We can't cover all of the implications of the new law, but here are five key areas where the change can have a significant impact:

1. Income taxes. Now, same-sex couples will be eligible to file joint tax returns and claim the same benefits as other joint filers. Although filing jointly may save tax dollars for some couples, others in high tax brackets likely will pay more tax, thanks to the so-called marriage penalty, which is a quirk of the tax code that can penalize joint filers. The new law also could affect state incomes taxes, although it's not yet clear how that will play out. Additional guidance from the IRS and individual states is expected.

2. Estate taxes. The same principles affecting federal and state income taxes also extend to estate and gift taxes, and the demise of DOMA opens new estate planning opportunities for same-sex couples. For instance, either spouse now may benefit from the federal marital deduction, which lets most spouses inherit an unlimited amount from each other with no estate tax liability. That provision leaves intact the generous estate tax exemption ($5.25 million in 2013) that can be used to transfer assets to other heirs. The "portability" provision of the federal law also now applies to same-sex couples, enabling the estate of a surviving spouse to use any remaining unused portion of the other spouse's exemption. Other provisions, such as a limited exemption for non-citizen spouses ($143,000 in 2013), also apply. State estate laws also will be affected, though not uniformly.

3. Employee benefits. The *Windsor* ruling will result in numerous complexities involving employee benefits, such as health insurance, for same-sex couples. For instance, a non-working spouse of an employee now may be eligible for insurance coverage or extended benefits under COBRA. While same-sex couples will be treated the same way as traditional married couples in terms of federal statutes, differences still may exist under state laws.

4. Retirement plans and IRAs. The ruling will create many changes relating to employer-sponsored

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Free Application For Federal Student Aid

Recently, several of our clients have been working with the FAFSA form for their children attending college. Many others don't even bother completing the form. Over the years we've learned a few things that just might help save you time or better yet save you money in this process.

Completing the FAFSA is the first and most important step in the college financial aid process. A few resources that will help explain things for you are: **http://freefafsagov.com/what-types-of-federal-student-aid-are-available-to-students/** ; **www.fafsa.ed.gov** ; and **http://freefafsagov.com/fafsa-deadline/**.

There is absolutely nothing to lose when you complete a FAFSA form even if you don't think (or you know) you won't get financial aid. In a recent case, we found that a client had disclosed assets that didn't belong on this form. This resulted in their child being overlooked for things which they may have otherwise been qualified. While it may not earn you scholarship money, it might make work study an option or defer interest on their loans.

Completing this form correctly may not change anything, or it might just save you (or your child) significant money. Call us to discuss how we can help you with this part of your planning.

John

A New Asset Class To Watch — Carefully

For the five-year period that ended September 30, 2013, four of 12 major asset classes lost value while eight posted positive total returns. Master Limited Partnerships, an asset class that did not exist a decade ago and mainly invests in oil and gas companies, trounced all asset classes in five-year cumulative returns. What are they?

MLPS are considered an "alternative investment" that can help diversify a portfolio. They combine unusual tax benefits with the possibility of a favorable return. Like other "pass-through" entities, such as S corporations and most limited liability companies, MLPs aren't subject to corporate income taxes. Instead, MLP partners are personally responsible for their share of an MLP's income. That eliminates the "double taxation" problem of regular corporations, which are taxed at both the corporate and shareholder levels.

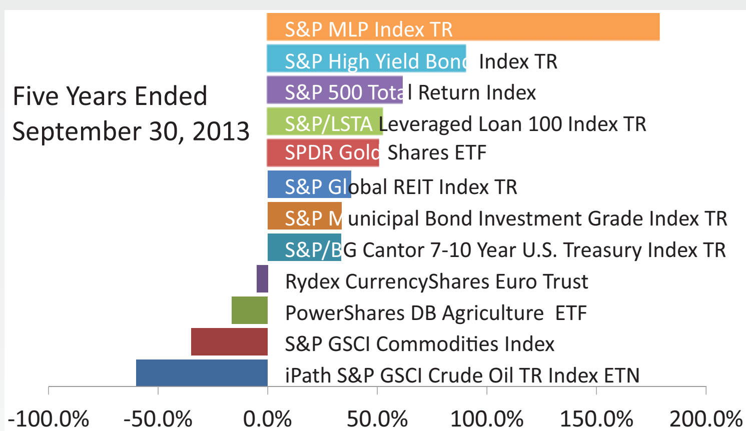
MLPs make periodic distributions to the owners of partnership units, much as a corporation may pay dividends to shareholders. However, MLP cash distributions aren't guaranteed. And all of the unit holders remain responsible for the taxes on their share of the MLP's income—even if it isn't distributed.

Your initial tax basis is the amount that you pay for the units. Subsequently, your basis will be adjusted downward for distributions and upward for allocations of income. Also, a portion of certain distributions may qualify as a return of capital, thereby reducing your basis. When an MLP pays more in distributions than it earns in taxable income, your basis is decreased by the difference between the cash you receive and your share of the MLP's taxable income. If you sell any MLP units, your gain is taxed at ordinary income rates. (Currently, the top tax rate on ordinary income is 39.6%.)

MLP income must be reported annually to the IRS on K-1 forms, which shows your allocated items of income, gain, loss, deductions, and credits. If you have negative taxable partnership income for the year, it will be treated as a "passive activity loss," which can only offset income from other passive investments. Thus, the losses may be less valuable tax-wise than other types of investment losses.

Although your personal liability for an MLP generally is limited, creditors may have the right to seek a return of distributions made to shareholders if the liability occurred before distributions were made. That liability remains in place even if you later sell your units.

Because MLPs have been huge outperformers, expect to see more of them. But past performance does not tell you about what will happen in the future. And before you invest, it's important to understand that MLPs have unusual tax characteristics that suit some tax situations but not all. Plus, they carry the risk of the underlying investment, which may be a good energy deal or not. MLPs are a new asset class to watch—carefully.



Don't Chase After The Market News

Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as the recent U.S. government shutdown. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you'll probably be much too late to benefit.

2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as

Building On Four Tax Pillars Of Real Estate

Commercial real estate can be a productive investment. If rental income flows in, it will provide a steady return on the capital you've invested, and if prices rise, you may be able to sell your interest at a profit. Of course, it doesn't always work out that way. But there also are potential tax advantages that can make such investments very appealing.

There are four key tax advantages relating to rental real estate that you may be able to tap, although a few obstacles could stand in the way.

1. Annual deductions. When you acquire real estate, you likely will have to take a loan and pay interest on it, and you'll also owe property taxes to the local authorities. Both of those expenses are tax-deductible and can help offset the taxable rental income you receive. Moreover, you can recover the cost of investment property through depreciation deductions. IRS rules specify a cost recovery period of 27.5 years for residential property and 39 years for commercial property. Depreciation is one of the biggest tax advantages on the books and can go a long way toward making an investment in real estate worthwhile.

2. Capital gains on property sales. If you sell a property at a profit, you may be able to pay tax on the gain at the 15% rate that applies to most long-term capital gains (for holdings you've owned for more than a year). If you are a single filer with taxable income of more than $400,000 ($406,750 in 2014) or a joint filer with more than $450,000 ($457,600 in 2014), the long-term rate is now 20%—still much better than ordinary income tax rates that currently reach as high as 39.6%. In recent years, of course, selling property at a profit often has been problematic, though values now are rising in many parts of the country and investments in real estate have tended to provide favorable returns over extended periods of time.

3. Section 1031 exchanges. One way to avoid a taxable gain on the sale of commercial or investment real estate is to "swap" property with another investor. Under Section 1031 of the tax code, "like-kind" exchanges can be tax-free if certain requirements are met, and the tax law definition of like-kind is quite liberal. For instance, you might be able to swap an apartment building for raw land. Also, to facilitate Section 1031 exchanges involving multiple properties, you're allowed to utilize a qualified intermediary. Such exchanges allow the indefinite deferral of the taxable gain you would have realized on the sale of appreciated property.

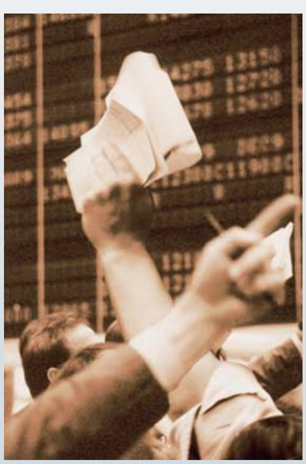
4. Step-up in basis at death. If you never sell your real estate property, your heirs will benefit from a "step-up" in the property's cost basis for income tax purposes. The basis of inherited property is adjusted to its value on the date of the death of the person it's coming from. That lets you and your heirs completely avoid tax on the appreciation of the property during your lifetime. There also may be no tax on the transfer of the property. If it goes to your spouse, he or she will be able to take advantage of an unlimited marital deduction, while other heirs may be protected by a $5.34 million exemption (in 2014) for transfers to non-spouse beneficiaries.

There are, however, some restrictions on the tax breaks for real estate owners. Among the most significant is a series of rules relating to "passive activities," such as the ownership of rental real estate by most investors. Those rules could limit the annual loss you can claim for such property. You'll generally be able to deduct no more than the amount of your income from that passive activity for the year.

Still, you might be able to claim at least a partial tax loss (beyond the amount of your income from the property) if you "materially participate" in rental real estate activity—for example, by managing tenants, arranging repairs, and other such activities. If you qualify, you will be entitled to deduct a loss of up to $25,000. But that benefit begins to phase out when your adjusted gross income exceeds $100,000, and it ends at $150,000.

You also might be able to deduct losses on a property in full if you qualify as a "real estate professional," although those requirements are more stringent than the test for active participation. Generally, you'll be eligible only if more than half of your personal services for the year are devoted to real estate trades or activities and you spend at least 750 hours annually on those trades or businesses. In other words, real estate normally has to be your principal occupation. ●

the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely that the sky is falling!



4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

What To Do When You're Suddenly Widowed

If your spouse should suddenly pass away, you could find yourself overwhelmed—not just emotionally, but also by a host of financial decisions. Your financial situation is probably about the last thing you'd want to be thinking about, and many things could wait, at least for a little while. Indeed, after such a dramatic event in life, it's probably best not to rush into anything. However, time isn't always on your side, and some decisions may be required immediately—especially if you have not planned properly. And sooner or later, you'll need to address certain financial issues. Here are some practical suggestions that may be helpful:

Deadlines. After losing a loved one, it can be easy to neglect deadlines. You'll generally need to file an estate tax return for your spouse within nine months of death, for example, and you still must file a federal income tax return for the year of death by April 15. Don't let letters from places like the IRS and financial institutions fall to the bottom of a pile. Missing deadlines can cost you dearly.

Retirement Accounts. Review benefit options for 401(k)s, pensions, and other retirement accounts. You'll likely need to decide between taking a lump sum or periodic distributions, rolling the funds into an IRA, or leaving the plan assets where they are. Each option has pros and cons.

Cash-Flow. Estimate your expenses for the next five to 10 years. Will you be paying for one or more children to attend college? When do you expect to retire, and what sort of lifestyle do you envision? This requires a thorough analysis of your finances and also might entail adjusting your investment strategy.

Insurance. Don't ignore insurance concerns. Typically, a surviving spouse inherits most, if not all, of the other spouse's assets and will be the primary or sole beneficiary of life insurance death benefits. This is a time to consider what you can do to protect your children's future. Meanwhile, in light of your changed situation, review all of your insurance policies. Be sure your health, disability, long-term care, umbrella and other polices still meet your needs.

Retirement. After losing a spouse, your retirement goals may change. You may want to consider retiring earlier or later. How much in Social Security benefits will you receive based on earnings history? Social Security is complicated, and you'll need to gather all of the facts to make good decisions.

Investments. Pull together all of the relevant records for your spouse's investments and any assets you held jointly. Once you know where you stand, be sure you understand all of the investments you own and are comfortable with the risk they entail. Set a long-term course for the future, but realize that adjustments may be needed now.

We're available to provide any assistance you need. ●

Same-Sex Marriage Law

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retirement plans, IRAs, and Social Security. For instance, a 401(k) generally is required to pay a married participant's benefits in the form of a "qualified joint and survivor annuity," unless the participant elects otherwise. In addition, if a participant is married, funds in the account can be left to a non-spouse heir only with the consent of the spouse. Rules for "required minimum distributions" from retirement plans tend to be more favorable for married couples, and same-sex couples now should be able to take advantage of beneficiary rollover options when an IRA owner dies. Social Security benefits also will be affected.

5. Divorce. Like traditional married couples, same-sex couples who split up will face wide-ranging legal and financial consequences, and they may want to take precautions that could minimize the fallout. For example, spouses might decide to protect their retirement plan benefits with a qualified domestic relations order (QDRO). When a QDRO is used, a spouse has the right to share in benefits available to the other spouse, but the spouse who receives the benefits will be taxed on them. Otherwise, the spouse who earned the benefits would be liable for the entire amount of the tax.

Remember that the *Windsor* ruling applies only on the federal level—and that makes it essential to investigate possible implications under varying state laws. Under current rules, a marriage that is recognized in one state may not remain legally enforceable if a couple moves to a state in which same-sex marriages are not recognized—a confusing situation. Same-sex couples would do well to research the impact of DOMA and seek professional guidance because the rules are likely to be clarified in the months ahead and the financial consequences can be significant. ●