

Tax changes may mean adjusting your investment strategy

By Andrew Menachem

If you're an investor, you need to pay close attention to the recent changes in the federal tax laws. The American Taxpayer Relief Act (ATRA), passed on Jan. 2, affects income and estate taxes, as well as capital gains and qualified dividends. Because tax rates, in general, went up, you may want to talk with your financial advisor or accountant this spring about potential adjustments to your portfolio.

For example, many investors own stocks and bonds – either directly or through mutual funds – that pay dividends or produce capital gains when sold for a profit. Under the ATRA, the top tax rate for long-term capital gains and qualified dividends rose from 15 to 20 percent for many high-income taxpayers.

If you own mutual funds that buy and sell gold, exchange traded funds (ETFs) or hold gold bullion yourself, those investments are considered "collectibles" and may be taxed at an even higher rate of 28 percent.

So, if your taxable income exceeded \$400,000 (single filer) or \$450,000 (filing jointly), you may want to consider swapping some of those securities for municipal bonds. Although "munis" typically have lower returns than corporate bonds, the income they generate is usually tax-free – a clear advantage to advantage to investors in higher tax brackets. In addition, municipal bonds avoids the new 3.8% tax on investment income.

On a more positive note, you can now contribute more to a tax-deferred retirement account, such as a 401(k) or a SEP-IRA for the self employed. For 2013, workers can choose to contribute up to \$17,500 to an employer's 401(k) plan. If you are age 50 or older, you can add another \$5,500 to your retirement account. The contribution limit for SEP-IRAs was raised to \$51,000.

If possible, you should try to maximize your retirement contributions, since they are subtracted from your taxable income and reduce your current tax bill. Since the ATRA raised the top 2013 income tax rate to 39.6 percent, compared with 35 percent in 2012, each \$100 you contribute to a retirement account would trim your 2012 tax bill by \$39.60.

In most situations, no taxes would be due until you withdrew those funds years later in retirement, when presumably your income would be much lower. This simple strategy of maximizing your contributions, when followed on a consistent basis, is one of the best ways to set aside funds for the future.

The ATRA also revises the federal estate and gift tax laws. You can now give away \$14,000 a year to any number of individuals without incurring a gift tax. Since you can give these gifts to non-family members, this strategy may allow unmarried partners to gradually transfer wealth between them. It's also an excellent way to begin funding a college education for a young grandchild.

Talk with your advisor about the best way to make such a gift. In some cases, it may make sense to sell shares of stock or a property at a loss to take advantage of a tax deduction that could offset your capital gains on other assets. Then, you could make the gift in cash.

Passage of the ATRA also raised estate tax provisions. Now an individual can convey up to \$5,250,000 million (\$10.5 million for a married couple) without paying federal estate taxes. You may want to review your will and any trusts you have created to see if they are still appropriate in the new financial landscape.

If you receive Social Security benefits – or expect to do so in the next few years – you may want to pull out your calculator, since those benefits may be subject to tax. For instance, if you are still working, those Social Security benefits may be taxable if you start getting those checks before you reach

full retirement age, which is now 66 for those born between 1943 and 1954. However, there is no limit on earnings if you keep working after you have reached the full retirement age.

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Interest in municipal bonds is generally exempt from federal income tax. However, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax-exemption applies if securities are issued within one's state of residence and, local tax-exemption typically applies if securities are issued within one's city of residence.

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