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First Quarter 2013

Congress Has Three Big Tasks to Do

by
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Now that we at least temporarily have avoided the dreaded "fiscal cliff," there are three very important things that the new 113th Congress must accomplish in the near future. The first of these is the least important but has been getting almost all of the attention from the media and the public.

That issue is the debt ceiling. No serious forecaster can possibly predict exactly what Congress will do about this or when they might act. However, we all agree they will raise the debt ceiling before the federal government fails to pay any of its $3.5 trillion of obligations as they come due.

You should note that all the rhetoric about the US defaulting on its debt is just persiflage. The Secretary of the Treasury has wide latitude in deciding which bills to pay if there's not enough money in the bank to pay all of them. No one can doubt that the holders of obligations backed by "the full faith and credit of the United States of America" would get their interest and principal payments on time.

If you really would like to know how debt-ceiling deals do or don't get done in Washington, DC, then you need to read Bob Woodward's recent book, *The Price of Politics.* While that book was published in September 2012 and concerns the cantankerous negotiations in the summer of 2011 over the last debt ceiling increase, it is quite relevant to the current situation.

That's because the elections on November 6, 2012, made no significant changes in the political environment. The Democrats still hold the presidency and a majority (55-45) in the Senate while the Republicans comfortably control the House of Representatives with a 233 -200 margin with two vacancies.

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We may well see a series of votes on the debt ceiling with the result that it gets increased for only a few months each time one version is enacted. The House leaders unveiled this new strategy on January 18 after completing a three-day retreat in Williamsburg with all the Republican members.

This proposal includes an intriguing piece that would withhold the salaries of members of Congress if they fail to pass a budget for fiscal year (FY) 2014 by April 15, as required by the provisions of “The Congressional Budget and Impoundment Control Act of 1974” (Public Law 93-344). This very important law created the Congressional Budget Office (CBO), the Budget Committees in both houses and changed the start of the fiscal year from July 1 to October 1 among other things.

The Senate has not passed a budget since 2009. This new proposal is an attempt to force them to do that and to specify the actual reductions in future spending plans they would enact.

The horribly mislabeled “American Taxpayer Relief Act of 2012” (the fiscal cliff bill—PL 112-240—passed on January 1) not only raised taxes on 77 percent of us but also postponed the dreaded “sequester” of $110 billion in FY 2013 and $1.2 trillion in FY 2013-2022. These are the mandatory budget cuts (half from defense and half from all other spending excluding interest, Medicaid and Social Security with the only cut in Medicare being a two percent reduction in reimbursements to physicians) contained in the “Budget Control Act of 2011” (PL 112-25). This law was the result of the 2011 fight over the debt ceiling.

The new deadline for these cuts is March 1. That’s five months into FY 2013, so the cuts are likely to be fairly dramatic. Of course, if Congress decides to value them at an annual rate, they won’t be so large this year, but that shortfall would have to be made up in fiscal year 2014 and beyond.

No one knows what spending will be cut. There are several reasons for this. One is that while the overwhelming majority of the members of Congress and the public support the need to reduce spending to eventually turn the federal budget deficit back into a surplus and begin reducing the national debt, no one agrees with any of the details of exactly how to do that. Any one person can easily go through the millions of line items of the federal budget and find ways to cut spending. The difficulty lies in getting a majority of both houses of Congress to agree to a program. You can read the CBO November 8 report, “Choices for Deficit Reductions” (http://www.cbo.gov) to see many of the most likely options.

The biggest problems are in health care (Medicaid and Medicare) and Social Security. Those cost $251 billion, $469 billion and $762 billion respectively in FY 2013. Defense expenditures were $651 billion and net interest on the national debt was $258 billion in 2013.

On January 16 the Business Roundtable (an association of CEO’s of major US companies, see {http://www.businessroundtable.org}) released a series of proposals to save money and ensure the survival of Social Security and Medicare for the long run. The two biggest

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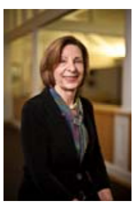
cost savings would involve raising the full retirement and eligibility age to 70 for people under 55 now and to set up government subsidized private alternatives to Medicare by 2015. These proposals would work to significantly reduce future government spending and will be popular in the House, but not in the Senate.

The third big thing Congress must do soon is decide on spending for the second half of FY 2013. They passed a bipartisan "Continuing Resolution" (CR) last September that expires on March 27. There is currently no authority to spend money after that.

All these issues should make you very glad you are not a member of Congress. You should pay attention to the outcome of all of them as they have a great deal to do with the future of the US economy.

2013 IRA Contribution Rules



Barbara Gray, CFP®
Partner

2013 contribution limits have been raised to $17,500 (from $17,000) on 401(K), 403b and 457 plans. The catch-up contribution for those over age 50 has remained the same - $5,500. Your maximum contribution amount if you are over 50 is $23,000.

Traditional and Roth IRA contribution limits are increased to $5,500 (from $5,000). The catch-up contribution for those over age 50 has remained the same at $1,000, making $6,500 the new maximum for the over 50 crowd.

Simple IRAs have increased to $12,000, from $11,500. The catch-up contribution for those over age 50 has remained the same at $2,500. Thus, if you are over 50, the maximum would be $14,500.

There is an income limitation on the ability to contribute to a Roth. For married couples filing jointly, the contribution is phased out if your income is between $178,000 to $188,000. For singles, the phase-out range is $112,000 to $127,000.

If you cannot contribute to a Roth because of the income limitation, you can always contribute to a non-deductible traditional IRA and then convert it later on to a Roth. This works best if you do not otherwise have a traditional IRA, because the tax accounting gets complicated if you do. If you have questions, please contact your advisor.

Fiscal Cliff Tax Changes

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2012 was full of both market moving events and political headlines. With all the uncertainties brought about by the Presidential election and "fiscal cliff," perhaps the biggest surprise was the way the markets shrugged off these concerns and logged an impressive 16% return (S&P 500). In my opinion, the event that will have the most profound effect on both the market and our pocketbooks in 2013 is the legislation that was written in the wee hours on the 31st of December. Mitch McConnell and Joe Biden averted the fiscal cliff by deferring spending cuts and compromising on future tax law. Although this legislation was stuffed full of over 50 specific alterations to the US tax code, the following is a summary of the tax changes that will have the largest impact on our clients:

1. The bill permanently extends the current 10%, 15%, 28%, 33% and 35% rates on income at or below $450,000 (married filing jointly) for tax years after 12/31/12 ($400,000 for single filers).
2. The bill reinstates the 39.6% tax rate on marginal income over the $450,000 threshold ($400,000 for single filers).
3. The bill permanently extends the 0% and 15% long-term capital gain and dividend rate for taxpayers with income below $450,000 ($400,000 for single filers). Under 2012 law, the capital gains and dividend rates for taxpayers in the 10% and 15% bracket is equal to 0%. For those in the 25% bracket and above, the long-term capital gains and dividend rates were 15%. For incomes in excess of $450,000 JTWS ($400,000 single), the rate for both long-term capital gains and dividends will be increased 20%. Short-term capital gains did not change and will continue to be taxed as regular income.

    a. Some investors will also pay an additional 3.8% tax on certain investment income as part of a separate tax previously enacted to pay for the Affordable Care Act. The threshold for this tax set is at $250,000 (MFJ) and $200,000 (Single).

4. The bill made permanent the current indexed exclusion ($5,120,000 for 2012) for federal estate tax, gift tax and federal generation skipping transfer (GST) tax and indexes that account for inflation going forward. All estates in excess of the current indexed exclusion will be taxed at a top tax rate of 40% (increased from 35%). The law also made permanent the portability of any unused exemption for married filers. This allows an executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse. The bill also permanently extends the unification of the estate and gift tax law.
5. The bill failed to extend the "Payroll Tax Holiday." Wage earners will now pay 6.2% payroll tax on the first $113,700 in wages since the deal did not extend the 4.2% rate that had been in place for two years.

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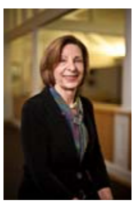
6. The bill made permanent and indexed the AMT patch. Under 2012 law, taxpayers receive an AMT exemption of $45,000 (MFJ) and $33,750 (Single) without allowing nonrefundable credits against the AMT. The bill increases the exemption amounts to $78,750 and $50,600 respectively and indexes the exemption for inflation going forward.
7. The bill also included the following smaller tax breaks:

    a. Filers can continue to deduct state and local sales taxes.
    b. Eligible students can continue to deduct tuition and other education related expense.
    c. IRA holders over 70 ½ can continue to make tax-free distributions directly to qualified charities.
    d. A 5-year extension of the American Opportunity Tax Credit, Child Tax Credit and the Earned Income Tax Credits.

If you have any questions, please feel free to contact your advisor.

Qualified Charitable Distributions for 2013



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Partner

The American Taxpayer Relief Act of 2012 extended the qualified charitable distribution (QCD) provisions for 2013. This provides an opportunity for taxpayers over 70 ½ to make a contribution of up to $100,000 directly to a qualified charity. The contribution can be used to satisfy all or part of your required minimum distribution and is not considered a taxable withdrawal. However, you cannot take a charitable deduction for the QCD.

Your broker will distributed a 1099R that confirms the amount withdrawn from your retirement account. You must keep records to substantiate the withdrawal as a charitable contribution. You cannot make a qualified charitable distribution from a SEP or a Simple that is still active and receiving contributions or from any employer plans (401k, 403b).

If you are charitably minded and do not need all of the income from your required minimum distribution, this is an excellent program that also saves on your tax bill! Please call your advisor with any questions.

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Parsec Spotlight: Mark Lewis

Mark Lewis is the Director of Operations. He joined the firm in 2007 and holds a Bachelor of Science degree in economics from the University of North Carolina at Wilmington. He has worked in diverse fields ranging from yacht management to mortgage banking. Prior to joining Parsec, he was the head trader at a local investment management firm.

Whenever they can get away, Mark, his wife Libby, and daughter Eliza enjoy spending time on the Outer Banks. Mark dreams of someday adopting a Clumber Spaniel. In the meantime, he must be content with the family's miniature poodle, Coco.

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