JVL Associates, LLC NEWSLETTER

September 2012

Once again JVL Associates, LLC has been named one of the top wealth management firms in the country. Our firm was ranked #42 nationally in the ***2012 Advisor One Top Wealth Manager Rankings***. The annual ranking is for Registered Investment Advisory (RIA) firms with assets under management of $100 million or more. The ranking is based on average client relationship size. We are grateful to our clients for allowing us to serve them and once again achieve this national recognition.

Taxes & Health Care = Uncertainty ???

I recently returned from a 3 day trip to the Leelanau area in northern Michigan. The leaves had turned to vibrant reds, yellows and oranges. The grapes had been harvested in the vineyards and a chill was in the air. Could the year be coming to a close already?! While I may be "mourning" the close of another year, I am anxiously awaiting the end of the campaign season! November 6 cannot arrive soon enough!

I am a political "junkie". I have watched the debates, listened to the discussions over who "won" and read the follow up commentary both from the candidates' camps as well as the political "experts".

I enjoy a good debate but the fact twisting and half-truths can get discouraging. Why is 2 minutes the allotted time for questions that are critical to today's issues? Why can candidates recite their scripted speeches without addressing the issues? Since when has "my opponent is a bum" been a winning strategy? We are in serious times and we need serious answers.

As a planner, the most difficult environment for decision making is uncertainty of laws, rules and regulations. Planning, by its very nature, requires estimates of future economic conditions, markets and events. These we have dealt with over the years – but now we must plan when we cannot even see what the rules are going to be.

By now, most of you have heard or read about the "fiscal cliff" we are facing on January 1, 2013. This cliff is made up of various tax provisions that automatically expire on December 31, 2012 which will increase taxes on all taxpayers plus a reduction in Government spending mandated by Congressional inaction last spring. The combination of these two items has been estimated at approximately $670 billion in 2013.

First, let's start with a quick history lesson. In 2001, the *Economic Growth and Tax Relief Reconciliation Act of 2001* was passed. The provisions of this legislation have become commonly known as the "Bush tax cuts". One of the key components of this legislation was that all tax related provisions would expire on December 31, 2010. The provisions were extended in 2010 for an additional two years and are now set to expire on December 31, 2012. So, for 2013 - under current tax law - all provisions addressed in the original legislation revert back to the way they were before the 2001 tax act was enacted. The law has many components, but a few key ones are as follows:

a) Individual tax rates were reduced
   1) A new 10% tax bracket was introduced
   2) The 15% bracket was indexed to the new 10% bracket
   3) The 28% bracket was lowered to 25%
   4) The 31% bracket was lowered to 28%
   5) The 36% bracket was lowered to 33%
   6) The 39.6% bracket was lowered to 35%
b) The tax rate on long-term capital gains (assets held more than 1 year) was reduced to a maximum of 15% from a maximum of 20%
c) The tax rate on corporate dividends (distributions from tax-paying corporations) was reduced to a maximum of 15% as opposed to being taxed at the same rates as other ordinary income
d) The estate and gift tax exemptions were increased from $1,000,000 to $5,120,000

The other portion of the "fiscal cliff" is the mandated reductions in Government spending. Last fall, when Congress increased the debt ceiling, Congress and the president agreed to specific dollar amounts in reduced spending. They agreed that they would come to some decision on the details during the summer months. When no decision on the details was reached the mandated cuts kicked in.

Currently Congress is in recess awaiting the outcome of the elections. The election results will drive how we navigate the "fiscal cliff".

What have the candidates said about taxes? Without going into the details of the individual candidates' plans, let's take a brief look at the major differences between the candidates' tax positions.

President Obama has proposed extending the "Bush tax cuts" on all individuals making less than $200,000 and married couples making less than $250,000. He would increase the tax rate on income over these thresholds to the 39.6% rate in effect prior to the 2001 legislation. He would also increase the tax rate on capital gains to a maximum of 20% and treat dividends as ordinary income subject to regular tax rates. He is also on record as wanting to move the estate tax exemption to $3,500,000 and the gift tax exclusion to $1,000,000.

Governor Romney has proposed reducing tax rates by 20% across the board while also reducing the amount of deductions, exemptions and credits to make his plan revenue neutral. The details of which deductions, exemptions and credits affected would be left to negotiations in Congress. He would eliminate taxes on interest, dividends and capital gains for taxpayers making less than $200,000 while leaving current rates in place for those making over the threshold. He has also said he would abolish both the alternative minimum tax and the estate tax.

Tax rates do matter for individuals. Different investments have different forms of returns. Interest income is subject to ordinary tax rates while dividends from tax-paying corporations have been given favorable tax treatment to incentivize investment in the stock markets. Long term capital gains have been given tax preference over other forms of investment returns to incentivize investors to stay the course and withstand the inherent volatility in the markets over longer holding periods. Tax deductions were created to incentivize behavior; mortgage interest deductions to promote home ownership and charitable contribution deductions to incentivize social, educational and religious programs. Individuals who pay state, local or property taxes or incur medical costs have received tax deductions to reduce their taxable income by these non-discretionary expenses that are outside of their control.

Tax rates also matter for business owners. Today, many businesses are formed as LLC's or Subchapter S corporations – both of which do not pay business taxes but instead pass the business profits directly to the owners' individual tax return. Higher individual tax rates will be applied to this pass through business income thus raising the cost of doing business. These rates can impact the amount of cash businesses have available for capital investment or hiring additional personnel.

In a slow growth economy, business owners, retirees, individuals and families need some clarity and certainty in the tax code to be able to make long term plans for their investments and their financial future.

The election on November 6 will determine the players who get to make these tough decisions but the eventual outcome is far from determined as opposing views can stand in the way of enacting legislation. Let's hope that the players at the table will put economic interests ahead of political interests and get the uncertainty out of the way so this economy can get growing again.

Compounding the uncertainty is the status of *The Affordable Health Care Act* commonly known as "Obamacare". On June 28, 2012 the Supreme Court upheld the individual mandate portion of the law because it fell within Congress' power to tax. The Republicans say they will repeal the act if they have the votes to do so. Let's dig a little deeper and see where the law currently stands.

Certain provisions of the law are already in effect:

1) Health plans are required to cover children of enrolled parents until age 26
2) A small-business health insurance tax credit is available to employers with less than 25 employees
3) New health plans are required to cover certain preventive services without copayments
4) Flexible spending accounts may no longer pay for nonprescription drugs, except insulin
5) Employers with more than 250 employees must report the cost of health insurance on their employees' W2 (for information purposes only, it is not included in taxable income)
6) Indoor tanning parlors are subject to a new 10% excise tax on amounts charged to customers

Additional provisions that kick in for 2013:

1) A new 3.8% tax on investment income (interest, dividends, capital gains, rents and royalties) for individuals making over $200,000 and married couples making over $250,000. The tax is computed on the lesser of the:
   a) Investment income or
   b) The amount by which the modified adjusted gross income exceeds the threshold amount
2) A new 0.9% Medicare surtax on W2 wages and self-employment income exceeding $200,000 for individuals or $250,000 for married couples.
3) The threshold for taxpayers claiming itemized deductions for medical expenses rises from 7.5% to 10% of AGI (for taxpayers age 65 or older the threshold stays at 7.5%)
4) Contributions to flexible spending accounts are capped at $2,500 down from $5,000
5) Medical device manufacturers are subject to a new 2.3% excise tax on the sales price of certain products

Provisions that becomes effective in 2014:

1) Individuals will have to pay a penalty tax if they do not have health insurance
2) Individuals, based on income limitations, will be eligible for premium assistance in the form of refundable tax credits to help with the cost of their policy premiums
3) Employers with more than 50 full time employees will be assessed a penalty tax if they do not offer their employees certain minimum coverage at affordable rates
4) States must establish an exchange that offers health insurance to individuals and small employers
5) Insurers may not impose exclusions for pre-existing conditions, or annual or lifetime limits on health benefits

Adding to the uncertainty of the law is that the Department of Health and Human Services (HHS) recently mandated that all plans provide contraceptives, abortion inducing drugs and sterilization. This rule applies to certain religious employers as well. There are currently multiple court challenges to this specific provision in the bill.

Some estimate that numerous employers may terminate their health insurance coverage because it is cheaper to pay the penalty tax. That would leave employees to find their own coverage in the marketplace.

All of these items create more uncertainty for employers. What the effect of this legislation has on the cost of insurance and who ultimately pays the premium is an important consideration for both business owners and their employees. Only time will tell how this all plays out in the workplace.

At JVL Associates, our goal is to help clients navigate through the uncertain times. Whether it is by creating an investment portfolio to achieve the maximum after tax return or structuring estate and gift strategies to position assets for long term family asset preservation we work to achieve the objectives our clients lay out. We may not know the future but we can create, implement and monitor plans to achieve the client's stated goals. If you know of anyone who could benefit from our services please let us know.

All of our newsletters are archived on our website at www.jvlassociates.com

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