Jim Williams

Tax Law Changes

Earlier this month, a gridlocked Washington managed to pass a tax bill. The process was certainly ugly, and the results were not all favorable, but there are things to like about the outcome. After twelve years of uncertainty about tax rates at the end of the "Bush tax cuts" which were always temporary, tax rates are "permanent." Let's not take that to mean that tax rates and tax provisions cannot ever change again, but now, changes will require an actual act of congress.

Although most taxpayers avoided a tax increase, rates did rise for top earners. Taxpayers who earn more than $400,000 ($450,000 for married taxpayers filing jointly) have a marginal tax rate of 39.6%. All other existing rates remain the same. The same individuals who are subject to the new 39.6% top rate on income now face a 20% rate on capital gains and dividends, up from 15%. Taxpayers in the 10% and 15% income brackets have a zero capital gains rate and those in the middle will continue to pay 15%. The payroll tax cut was allowed to lapse. The FICA (Social Security) payroll tax increased from 4.2% to 6.2%.

Also, taxpayers who have net investment income beginning in 2013 will face a surtax of 3.8% on categories of certain unearned income, potentially increasing the total tax rate to 43.4%. This tax was already slated to go into effect as a result of health care reform. The phase-out levels for personal exemptions and itemized deduction have been raised to $300,000 for married couples and surviving spouses and $250,000 for individuals.

The alternative minimum tax (AMT) originally was intended to prevent high-income individuals from avoiding taxes. In the absence of a patch for last year, more than 60 million middle-income taxpayers might have been subject to the AMT on their 2012 income. This provision alone has been like the sword of Damocles hanging over the head of taxpayers and tax advisers and preparers. After years of last-minute AMT "patches," the new law permanently indexes the AMT to inflation starting in tax year 2012. For income you earned in 2012, the exemptions are $50,600 for individuals and $78,750 for married filing jointly.

After years of uncertainty with respect to estate and gift taxes, the new law holds the estate and gift-tax exclusion at $5 million, indexed for inflation ($5.12 million in 2012). The top tax rate jumped to 40% from 35% as of Jan. 1, 2013, but without this change, it would have soared to 55% with a $1 million exclusion amount. The act made permanent the estate tax portability election, which allows a surviving spouse to use a deceased spouse's unused exemption amount.

Optimism

You may recall that in an earlier newsletter (First Quarter 2011) I reviewed the book <u>The Rational Optimist</u> by Matt Ridley. The book makes the case that things just keep getting better for the human race. In its December 15th 2012 issue, the British magazine Spectator, seconds that motion with the assertion that 2012 was the best year ever.

> *It may not feel like it, but 2012 has been the greatest year in the history of the world. That sounds like an extravagant claim, but it is borne out by evidence. Never has there been less hunger, less disease or more prosperity. The West remains in the economic doldrums, but most developing countries are charging ahead, and people are being lifted out of poverty at the fastest rate ever recorded. The death toll inflicted by war and natural disasters is also mercifully low. We are living in a golden age.*

But aren't the rich just getting richer? Read on.

> *Take global poverty. In 1990, the UN announced Millennium Development Goals, the first of which was to halve the number of people in extreme poverty by 2015. It emerged this year that the target was met in 2008. Yet the achievement did not merit an official announcement, presumably because it was not achieved by any government scheme but by the pace of global capitalism. Buying cheap plastic toys made in China really is helping to make poverty history. And global inequality? This, too, is lower now than any point in modern times. Globalisation means the world's not just getting richer, but fairer too.*

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And aren't we running out of energy?

> *The doom-mongers will tell you that we cannot sustain worldwide economic growth without ruining our environment. But while the rich world's economies grew by 6 per cent over the last seven years, fossil fuel consumption in those countries fell by 4 per cent. This remarkable (and, again, unreported) achievement has nothing to do with green taxes or wind farms. It is down to consumer demand for more efficient cars and factories.*
>
> *And what about the concerns that the oil would run out? Ministers have spent years thinking of improbable new power sources. As it turns out, engineers in America have found new ways of mining fossil fuel. The amazing breakthroughs in 'fracking' technology mean that, in spite of the world's escalating population — from one billion to seven billion over the last two centuries — we live in an age of energy abundance.*

You may feel that the Spectator is overly optimistic and that this article presents too narrow a picture to be realistic. Maybe so. I will grant you that even if everything in the article is true, it is clearly not the whole truth. Keep this in mind as you encounter the ubiquitous and relentless media barrage peddling doomsday: it may be true, but it is not the whole truth.

And remember how fortunate we are to live in this time and in this country.

We appreciate your referrals

The table below shows the returns through December 31, 2012 for selected investment asset classes. In most cases, the results below are appropriate benchmarks for the related mutual funds in your investment portfolio.

Asset Class	**Data Series**	**YTD**	**3 Yrs.**	**5 Yrs.**
Ultrashort Bonds	BofA Merrill Lynch Three-Month US Treasury Bill Index	0.11	0.11	0.52
Short Term Municipal Bonds	Barclays Capital Municipal Bond Index 3 Years	1.86	2.38	3.67
Short Term Government Bonds	Barclays Capital Treasury Bond Index 1-5 Years	0.89	2.66	3.36
Short Term Corporate Bonds	BofA Merrill Lynch 1-5 Year US Corporate and Government Index	2.47	3.24	3.85
Short Term Global Bonds	Citigroup World Government Bond Index 1-3 Years (hedged)	1.36	1.38	2.34
Intermediate Term Municipal Bonds	Barclays Capital Municipal Bond Index 7 Years	4.20	6.29	6.21
Intermediate Government Bonds	Barclays Capital US Government Bond Index Intermediate	1.73	4.25	4.51
Intermediate Corporate Bonds	Barclays Capital Credit Bond Index Intermediate	8.10	7.07	6.71
Intermediate Global Bonds	Citigroup World Government Bond Index 1-5 Years (hedged)	2.10	2.13	3.04
US Marketwide Core 1 & 2	Russell 3000 Index	16.42	11.20	2.04
US Marketwide Vector	Russell 2500 Index	17.88	13.34	4.35
US Large Cap Market	S&P 500 Index	16.00	10.87	1.66
US Large Cap Value	Russell 1000 Value Index	17.51	10.86	0.59
US Small Cap Market	S&P Small Cap 600 Index	16.33	14.07	5.13
US Small Cap Value	Russell 2000 Value Index	18.05	11.57	3.55
Real Estate Investment Trusts	Dow Jones US Select REIT Index	17.12	17.94	5.08
International Marketwide Core & Vector International Large Cap Market	MSCI World ex USA Index (net div.)	16.41	3.65	-3.43
International Large Cap Value	MSCI World ex USA Value Index (net div.)	17.29	2.78	-3.72
International Small Cap Market International Small Cap Value	MSCI World ex USA Small Cap Index (net div.)	17.48	7.19	-0.70
Emerging Markets	MSCI Emerging Markets Index (net div.)	18.22	4.66	-0.92

January 19, 2013

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