2013/2014 Tax Update

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Overview of 2013/2014

- Increased Tax Rates for Higher Income Individuals
- New Net Investment Income Surtax
- Several Extenders Set to Expire
- Bonus Depreciation
- Recognition of Same-Sex Marriage Across the Nation
- Health Care Employer Mandate Delayed
- Individual Mandate Effective January 1st

Congress backed off the fiscal cliff temporarily with the passage of massive tax changes for 2013. These changes will now be reflected as you file this year's tax return. Here are things you will need to be prepared to notice.

Tax Rates

Starting in 2013, the individual income tax rate schedules will continue to reflect the rates set under the "Bush Era" with one exception. In 2013, there has been an addition of a new rate for the highest bracket at 39.6 percent. Due to this change, the individual income tax rates for 2013 are 10, 15, 25, 28, 33, 35, and 39.6 percent. Each year the taxable income rate bracket is increased slightly due to an inflation factor. The starting points for the 39.6 percent tax bracket for 2013 and 2014 are as follows:

	2013	2014
Married filing jointly & Surviving Spouse	$450,000	$457,600
Head of Household	$425,000	$432,200
Single/Unmarried	$400,000	$406,750
Married Filing Separately	$225,000	$228,800

Capital Gains/Dividends

For 2013 and subsequent years, ATRA (American Taxpayer Relief Act of 2012) has increased the top rate for capital gains and dividends from 15 percent to 20 percent. This increase in rate is generally to be aligned with the same income levels at which the new 39.6 percent income tax rate will be applied.

Qualified Dividends

As in the past, dividends received from a domestic corporation or a qualified foreign corporation, where the stock is held for at least 61 days within a specified 121 day period, are considered qualified dividends with regards to the reduced, capital gains tax rate. There are specific dividends that do not qualify for the reduced tax rates and are taxed as ordinary income. Dividends that are taxed at ordinary income rates include dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

Surtax on Net Investment Income

Starting in 2013, taxpayers who are in a higher tax bracket may be liable for 3.8 percent net investment income (NII) surtax. The NII surtax on individuals will be equal to 3.8 percent of the lessor of the following:

a.) Net investment income for the tax year, or
b.) The excess, if any, of:
   a. The individuals modified adjusted gross income for the tax year over the threshold amount.

The threshold amounts used for this assessment are equal to:

Joint Returns/Surviving Spouse	$250,000
Married filing separately returns	$125,000
Single/ Head of Household	$200,000

Additional Medicare Tax

The Additional Medicare Tax became effective for tax years 2012 and increases the employee-share of Medicare tax by an additional 0.9 percent of covered wages excess of particular "higher income-level" threshold amounts.

Threshold Amounts

The Additional Medicare Tax will be in imposed until an individual taxpayer's covered wages, compensation, and/or self-employment income exceeds the threshold amount for the individuals filing status. The threshold amounts are as follows:

Joint Returns/Surviving Spouse	$250,000
Married filing separately returns	$125,000
Single/ Head of Household	$200,000

Withholding

Employers are required to collect Additional Medicare Tax with respect to wages earned by the employee for the employer only to the extent that the employer pays wages to the employee in excess of $200,000 in a calendar year. This rule will apply without regards to the employee's filing status or other wages and compensation.

Alternative Minimum Tax

In the past couple of years, tax planning had become more difficult because of the uncertainty with regards to the alternative minimum tax (AMT). The original purpose of the AMT was to prevent wealthy taxpayers from escaping taxation. The alternative minimum tax has not been adjusted for inflation and because of this has affected middle income taxpayers. In order to prevent this, Congress usually makes changes like increasing the exemption amounts as a way to adjust the AMT.

For 2013, the exemption amounts for 2013 under ATRA are $51,900 for taxpayers filing as single individuals or head of household and $80,800 for married couples who are filing a joint return and surviving spouses. After 2013, ATRA has provided that the exemption amounts will be indexed for inflation. Taxable income that exceeds the exemption amounts will be subject to a 26 percent AMT rate on the first $175,000 of alternative minimum tax income (AMTI) and a 28 percent rate on any AMTI above the $175,000 amount. ATRA will also allow taxpayers to take all of the non-refundable personal credits against their regular liability and AMT liability.

Pease Limitation

The Pease limitation has been eliminated as part of the Bush-era tax cuts through 2012; however, ATRA has revived and modified the Pease limitation for itemized deductions for higher income taxpayers. The Pease limitation reduces the total amount of otherwise allowable itemized deductions by 3 percent for higher-income taxpayers. The threshold levels under ATRA for the Pease limitation in 2013 are:

Married filing jointly/Surviving Spouse	$300,000
Head of Household	$275,000
Single	$250,000
Married filing separately	$150,000

Personal Exemption Phase-out

Under the personal exemption phase-out, the total amount of exemptions that may be claimed by a taxpayer will be reduced by 2 percent for each $2,500 or portion thereof for married couples filing separately if the taxpayer's adjusted gross income exceeds the applicable threshold level. ATRA has modified the personal exemption phase-out (PEP) threshold amounts to be the same as the threshold amounts for the Pease limitation.

Married filing jointly/Surviving Spouse	$300,000
Head of Household	$275,000
Single	$250,000
Married filing separately	$150,000

Child Tax Credit

Before ATRA, the child tax credit was scheduled to revert to $500 per qualifying child. For 2013 and subsequent years, ATRA has made permanent that the child tax credit will be $1,000 per qualifying child.

Medical Expense Deduction

Before 2013, taxpayers who had itemized deductions could claim a deduction for qualified unreimbursed medical expenses to the extent that those expenses exceeded 7.5 percent of their adjusted gross income. For tax years beginning after December 31, 2012, the threshold has generally increased from 7.5 percent to 10 percent. However, taxpayers and/or their spouses who are age 65 or older before the close of the tax year may continue to apply the 7.5 percent threshold for tax years through 2016.

Health Flexible Spending Arrangements

Beginning in 2013, the Affordable Act limits annual contributions to health flexible spending arrangements (health FSAs) to $2,500. Any salary reduction that is in excess of the $2,500 will cause that employee to pay a tax on distribution from the health FSA. After 2013, the $2,500 maximum amount will be indexed for inflation; however, the cap is projected to be the same $2,500 limit in 2014.

Expiring "Extenders"

In 2013, a selection of temporary tax incentives known as "extenders" are scheduled to expire after 2013. The incentives that are set to expire include:

State & Local Sales Tax: In the past, taxpayers could elect to deduct state and local sales taxes in lieu of state and local income taxes. This incentive is scheduled to expire at the end of 2013, however, because of its popularity it is possible that the incentive be extended for another period.

Teachers' Classroom Expense Deduction: Primary and secondary education teachers may take an above-the-line deduction for qualified unreimbursed expenses paid during the year up to $250.

Exclusion of Cancellation of Indebtedness on Principal Residence: Taxpayers have been allowed to exclude from income cancellation of mortgage debt of up to $2 million on a qualified principal residence, however, only through 2013.

Transit Benefits: Equivalent to the amount of transit fringe benefits that are pre-tax to employees has allowed those using public transportation and van pooling to benefit at the same higher-level as is available to taxpayers receiving qualified parking benefits which is $245 for 2013. This incentive will expire after 2013 and will reduce the benefit for public transportation and van polling to $130 per month for 2014.

Mortgage Insurance Premium: In the past, mortgage insurance premiums have been allowed to be treated as qualified residence interest.

Contributions of Capital Gains Real Property for Conservation: Contributions of capital gain real property for conservation purposes have been allowed to be taken against 50 percent of an individual's charitable contribution base, resulting in an allowance for a larger charitable contribution amount.

IRA Distributions to Charity: As an alternative to taking an itemized deduction, taxpayers ages 70 ½ or older have been allowed to take tax free distributions of up to $100,00 per taxpayer per year from an individual retirement account to public charities.

Same-Sex Marriage

On June 26, 2013 the U.S. Supreme Court held that Section 3 of the Defense of Marriage Act which defined marriage for federal purposes as the union of one man and one woman was unconstitutional. Since this ruling, the IRS announced in Rev. Rul. 2013-17 that it now recognizes same-sex marriages nationwide.

Place of Celebration Approach: All same-sex marriages will be recognized for all federal tax purposes, regardless of whether that couple resides in a jurisdiction that recognizes same-sex marriage or in a jurisdiction that does not recognize same-sex marriage. Including income and gift and estate taxes, all legally married same-sex couples will be treated as married for federal tax purposes.

Filing Status: In regards to same-sex marriages, the IRS has issued different rules for filing status for different tax years.

- For 2013 and subsequent tax years, same-sex couples, generally, must file using a married filing jointly or separately status.
- Generally, for 2012 and all prior tax years, same-sex couples who file an original tax return on or after September 16, 2013 must file as married filing jointly or separately. For 2011 and earlier, same-sex couples

may choose to amend their federal tax returns to file using a married filing separately or jointly filing status, provided the statute of limitations has not expired.

Employee Benefits: As a result of DOMA, taxpayers may have paid taxes on the fair market value of employer-provided health care coverage for their same-sex spouse.

In Notice 2013-61, the IRS stated two optional special administrative procedures for employers to make claims for refunds or adjustments of employment taxes for certain benefits paid to same-sex couples.

1.) Employers may use the fourth quarter 2013 Form 941, Employer's Quarterly Federal Tax Return, to correct any overpayments of unemployment taxes for the first three quarters of 2013.
2.) Employers may file on Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, for the fourth quarter of 2013 to correct any overpayments of FICA taxes for all quarters of 2013.

Domestic Partners: Although the IRS has not recognized same-sex marriages for federal taxation purposes, this new rule does not apply to registered domestic partners, individuals in a civil union, or similar relationships. Even if taxpayers in these types of relationships are able to file state joint returns, they must still file their federal income tax returns as single individuals. Registered domestic partners may not file as married filing jointly or married filing separately because the individuals are not considered to be married or spouses for federal tax purposes.

Estate and Gift Taxes

Despite several years in the past where a significant amount of uncertainty was shown in regards to the federal estate and gift tax system, ATRA has finally established a permanent structure under which planning can suffice. ATRA will permanently provide for a maximum federal unified estate and gift tax rate of 40 percent with a $5 million exclusion, which will be adjusted for inflation, for gifts made and estates of decedents dying after December 31, 2012. ATRA has also preserved the annual gift tax exclusion which allows taxpayers to give up to $14,000 to any individual, gift tax free and without counting the amount of the gift toward the lifetime $5 million exclusion, which is adjusted for inflation as well. There is no limitation for the number of individual donees to whom gifts may be made if it is under the $14,000 exclusion. Taxpayers who are married may "split" their gifts to each done, resulting in a maximum exclusion of $28,000. Spouses may also give an unlimited amount of gifts to on another without resulting in any gift tax.

Planning for Businesses

Businesses that are seeking to maximize their tax benefits for 2013 and for subsequent years should consider a few strategies.

A.) Business may want to use traditional timing techniques for income and deductions
B.) Businesses should also consider the significant tax incentives that are scheduled to expire at the end of 2013.

New for Business Owners: Aside from the tax incentives that are scheduled to expire, businesses should also be aware of the tax rules that are new for 2013. One new tax rule that could impact business strategies for minimizing taxes could be the increased tax rates on higher-income individuals, especially those with pass-through or dividend income.

Code Section 179 Expenses

For 2013, taxpayers (other than estates, trusts, or certain noncorporate lessors) that elect to treat the cost of qualifying property as an expense rather than a capital expenditure will be able to utilize an enhanced Code Sec. 179 expense deduction. For tax years 2012 and 2013, the annual dollar limitation on Code Sec. 179 expense deductions is $500,000. Beginning in 2012 and 2013 an annual $2 million overall investment limitation will be applied before the maximum $500,000 deduction must be reduced, dollar for dollar, for amounts above the $2 million amount.

Carry Forward: The Code Sec. 179 deduction is limited to the taxpayer's taxable income that is derived from the active conduct of any trade or business during the tax year, without taking into account any Code Sec. 179 deduction, deduction for self-employment taxes, net operating loss carryback or carryover, or deductions suspended under any provision. Amounts that have been disallowed by this limitation may be carried forward and deducted in subsequent tax years, subject to the maximum dollar and investment limitations, or, if lower, the taxable income limitation in effect for the carryover year.

Qualifying Property: Generally, Code Sec. 179 property is generally defined as new or used depreciable tangible Code Sec. 1245 property that is purchased for use in the active conduct of a trade or business. For 2013, computer software that has been purchased off-the-shelf is considered to be qualifying property along with certain real property items.

Qualified Real Property: Qualified real property for expensing purposes includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. The Code Sec. 179 expensing allowance for qualified real property is scheduled to expire for property place in service after 2013.
Code Sec. 179 Expensing & Bonus Depreciation: Code Sec. 179 includes used property and has a dollar limit on the expense deduction. Bonus depreciation is limited to first-use property and does not have a limit on the amount of bonus depreciation that a business may claim.

Bonus Depreciation

For 2012 and 2013, ATRA generally allows for 50 percent bonus depreciation. Except for certain noncommercial aircraft and longer production period property which may be eligible for 50 percent bonus depreciation through 2014, bonus depreciation is scheduled to expire after 2013.

Qualifying Property: For bonus depreciation purposes, qualified property must be depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. Because bonus depreciation is scheduled to expire after 2013, the property must be new and placed into property before January 1, 2014.

Luxury Car Depreciation Caps: Like bonus depreciation, the additional $8,000 first-year depreciation cap for passenger automobiles under Code Sec. 280F to account for bonus depreciation is scheduled to expire after 2013.

Final Repair and Capitalization Regulations

In September 2013, the IRS issued final “repair” regulations that explain when taxpayers must capitalize costs and deduct expenses for acquiring, maintaining, repairing, and replacing tangible property. These regulations have made several significant taxpayer-friendly changes to the temporary regulations that were issued in 2011.

Compliance Timetable: The new regulations are set to begin after 2013 and will provide taxpayers the option to apply either the final or temporary regulations to tax years beginning after 2011 and before 2014. The IRS is scheduled to issue guidance later in the year to assist taxpayers regarding the regulations for years prior to 2014 as well as what types of accounting procedures to be followed.

Affordable Care Act

The Affordable Care Act was passed by Congress in 2010; however, the effective date of several key provisions has been delayed until 2014. The employers shared responsibility payment provision (employer mandate) has also been delayed as announced in July 2013. Despite this, Congress has not delayed the individual shared responsibility provision which means that in 2014, individuals must have health insurances, unless exempt, or otherwise pay a penalty.

Employer Mandate

The Affordable Care Act requires that an appropriately large employer pay an assessable payment if either:

- An employer fails to offer to its full-time employees (and dependents) the opportunity to enroll in the minimum essential coverage under an eligible employer-sponsored plan and any full-time employee is certified to the employer as having received a premium assistance tax credit or cost-sharing reduction
- An employer offers its full-time employees (and dependents) the opportunity to enroll in

minimum essential coverage under an eligible employer-sponsored plan and one or more full-time employee is certified as having received a premium assistance tax credit or cost-sharing reduction.

For any particular period, these two methods of calculating the tax are mutually exclusive. The amount of the assessable payment for an employer that does offer health coverage to its full-time employees will be capped so that it does not exceed the assessable payment if the employer had not offered coverage. In proposed regulations, the IRS has treated employers as offering coverage to its full-time employees even if it fails to offer coverage to up to 5 percent of them.

Delay: In 2013, the Obama administration had announced that, under the Affordable Care Act, employer reporting requirements will be delayed an additional year and therefore delaying the employer mandate for an additional year. Both the employer reporting requirements and the employer mandate are now scheduled to be enacted in 2015.

W-2 Reporting

The PPACA (Patient Protection and Affordable Care Act) requires that employers that provide applicable employer-sponsored coverage to report the cost of that coverage on the employee's Form W-2, Wage and Tax Statement. Employers who are generally filing 250 or fewer Form W-2 for the previous calendar year are temporarily exempt from reporting. Also, temporary exempt from reporting like other entities like multi-employer plans.

Small Employer Health Insurance Credit

The Affordable Care Act offers a tax credit to encourage eligible small employers to provide health insurance coverage to their employees. In order to be eligible for this credit, an employer must have fewer than 25 full-time employees, pay an average wage or less than $50,000 a year, and pay at least half of the employee health insurance premiums. For 2010 through 2013, the credit is a maximum of 35 percent of premiums paid for small business employers. For 2014 and subsequent years, the maximum credit is 50 percent of premiums paid for small business employers and will only be available to eligible employers for two consecutive years. Also, in order to be eligible, a small employer must pay premiums on behalf of employees enrolled in a qualified health plan offered through a Small Business Health Options Program (SHOP) Marketplace.

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