HILGHLIGHTS OF PERTINENT TAX CODE CHANGES
(TY 2013)

Medical Insurance: Despite the fact that the federal Healthcare Exchanges were off to a rocky start, roughly 2.2 million folks managed to enroll before year-end. Success of the program hinges on its ability to spread the actuarial risk from older insureds to those who are younger and healthier; yet, only 24% of sign-ups were attributable individuals aged 18 – 34. As a result, House Speaker Boehner predicts that insurance premiums will rise. Indeed, some of us are already facing significant cost increases. NOTE: Taxpayers who do not have the minimum mandated insurance coverage in 2014 will be subject to a penalty equal to the greater of 1% of their taxable income or a flat fee of $95/adult and $47.50/child (up to $285/family). The maximum penalty in 2015 increases to $325 ($695 in 2016).

Deducting Medical Expenses: Medical insurance premiums are tax-deductible – sometimes. If you are self-employed, you may claim an above-the-line deduction for 100% of the premiums paid. Others must itemize to obtain a tax benefit and will be surprised to discover that aggregate medical expenses will have to exceed 10% (rather than 7.5%) of Adjusted Gross Income (AGI) in 2013 and beyond. NOTE: Seniors – those who reach age 65 before year-end in 2013 through 2016 – may still benefit from the lower AGI limitation.

Itemized Deduction Phase-out: The phase-out for high income earners is back. Taxpayers with incomes in excess of roughly $250K may lose up to 80% of their otherwise allowable itemized deductions (as well as personal exemptions).

Tax Brackets: In addition to already familiar federal brackets, wealthy taxpayers will encounter the 39.6% bracket which has been reintroduced and will affect single taxpayers with income in excess of $400K ($450K for those filing jointly). NOTE: The 35% bracket is nearly non-existent for singles since its effective range begins at only $1,650 below the start of the highest bracket.

Capital Gains: The 0% and 15% rates on long-term capital gains and qualified dividends are now permanent but a new 20% rate applies to taxpayers with incomes in excess of $400K.

Investment Income Surtax: Net investment income in excess of threshold amounts ($200K if single, $250K if married) are now subject to a Medicare tax of 3.8%. Investment income includes dividends, interest, net capital gains, annuities, royalties and net rents as well as the gain on sale of a principal residence in excess of the allowable exclusion. Income sources specifically excluded are tax-exempt interest, VA benefits, self-employed income, IRA and pension distributions.

Earned Income Surtax: Wage-earners and self-employed taxpayers with incomes in excess of $200K ($250K if married) will see the Medicare portion of the FICA payroll tax increase from 2.9% to 3.8% payable by the employee or self-employed individual, not the employer. NOTE: Some taxpayers may be subject to *both* earned and investment income surtaxes!

Marriage: Last summer's Supreme Court Ruling that struck down the 1996 Defense of Marriage Act (DOMA) and granted individual states the right to define "marriage." *Legally married* same-sex couples(not domestic partners) will be treated in the same manner as opposite-sex couples for all federal purposes, including filing status, phase-outs, gift-splitting and estate tax issues, whether they reside in a state that recognizes same-sex marriage or have since moved to a jurisdiction that does not recognize such marriages. Some couples will find that these new rules will reduce their collective tax burden while others – particularly if the partners have comparable income – will see their combined tax liability increase. Low-income taxpayers will continue to enjoy a reprieve from the Marriage Penalty while all other married taxpayers will suffer the effects of compressed tax brackets that are not simply double the amounts assigned to those who are unmarried. NOTE: Two-income families should be particularly careful to adjust withholding allowances and/or increase estimated tax payments to avoid coming up short at year-end.

Home Office Deduction: Under a new optional safe harbor method, taxpayers may now claim a deduction equal to $5/ft² (maximum $1,500) in lieu of separately detailing allowable expenses and depreciation presuming, of course, that they have an area in the home used *regularly* and *exclusively* for business and that the business use of an employee's home is for the *convenience of his employer*. The election is irrevocable for the year in which it is claimed but taxpayers may alternate between methods from year to year. NOTE: Expenses in excess of net business income may not be carried-forward under the simplified method.

Alternative Minimum Tax (AMT): The American Taxpayer Relief Act (ATRA) of 2012 permanently raised the AMT exemption amounts and indexed them for inflation ($51,900 for single and $80,800 for married in 2013), along with the threshold amounts for the 26 and 28% tax brackets. However, the refundable credit that previously afforded partial relief in a current tax year for AMT tax paid in a prior year was not extended and expired at the end of 2012.

Expired Tax Breaks: The following popular tax saving provisions, scheduled to sunset at the end of 2013, have so far (?) not been renewed for 2014 and beyond: Deduction for state and local sales tax, educators' deduction for classroom supplies, tuition and fees deduction, §179 deduction and bonus depreciation, credit for energy efficient appliances, mortgage debt relief for homeowners who are underwater [NOTE: CA's exclusion expired at the end of 2012, although the FTB has just announced that it will conform to an IRS Information Letter which determined that taxpayers who sell their principal residences for less than what is owed through a *short sale* – not a foreclosure or loan modification – will not incur cancellation of debt (COD) income], mortgage insurance premium (PMI) deduction, §181 expensing for certain film and television productions, §1202 exclusion for small business stock, amongst many others.

Estate & Gift Tax: ATRA permanently increased the estate tax exemption ($5.34 million in 2014), set the maximum rate at 40%, and made the spousal portability election permanent. The annual gift tax exclusion for 2014 is $14,000.

Filing Season: Due to the 16-day government shut-down in October 2013, the IRS has announced that they will not accept filed returns until January 31st. In contrast, the FTB officially opened the California filing season on January 6th. NOTE: Taxpayers who file paper returns may no longer use Form 540A. On the other hand, taxpayers may now choose amongst 3 additional state funds (including the American Red Cross) should they wish to make a tax-deductible voluntary contribution.

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