HIGHLIGHTS OF PERTINENT TAX CODE CHANGES
(TY 2014)

Tax Extenders: Fifty-five Code provisions which had expired at the end of 2013 were retroactively extended for 2014 *only* with the enactment of the Tax Increase Prevention Act (TIPA) on December 19th, 2014. Here are a few that might affect you: State & local sales tax deduction, $250 teachers' deduction for classroom supplies, debt discharge on principal residence, and the Qualified Charitable Deduction (QCD). IRA owners over the age of 70½ must withdraw their Required Minimum Distribution (RMD) every year before December 31st. In years past, seniors could elect to make a *direct* IRA-to-charity transfer, thereby avoiding the inclusion of income of any transferred amounts, minimizing the taxability of Social Security benefits, lowering Adjusted Gross Income (AGI) thresholds for various itemized deductions, and potentially avoiding the Medicare Surtaxes. The QCD provision expired at the end of 2013 but was retroactively reinstated for the 2014 but Congress has given no indication whether it would be extended for 2015 and beyond. ⚠ If you choose to postpone your RMD until we have certainty regarding the QCD, *do not to forget* to make the withdrawal before year-end and *leave enough time* for your IRA custodian to process any withdrawal or transfer request.

Affordable Care Act (ACA): Affected taxpayers may be subject to *two* separate "penalties" in 2014:

- Shared Responsibility Payment – greater of 1/12th of $95 or 1% of household income for every month in which members of taxpayer's household did not have qualifying medical coverage. ⚠ The "household" includes any individual who could be claimed as a dependent (even if not claimed)! Everyone must fill out Line 61 of Form 1040 to indicate "full year coverage" or pay penalty which may reduce anticipated tax refunds. The maximum penalty increases to $325 or 2% of household income in 2015.
- Repayment of Premium Tax Credit – Taxpayers may be required to refund advance credits received during 2014 to subsidize the cost of monthly premiums for insurance obtained through the Marketplace if actual income reported on the tax return exceeds the amount of income used to determine the premium credit when the insurance was purchased. Even taxpayers who otherwise have no filing requirement must file a tax return to reconcile the advance credit.

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 AGI and beyond. Seniors – those who reach age 65 before year-end in 2014 through 2016 – may still benefit from the lower AGI limitation.

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. Expenses in excess of net business income may not be carried-forward under the simplified method.

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. Some taxpayers may be subject to *both* earned and investment income surtaxes!

Rules for the 21st Century:

- The IRS has announced that bitcoins and other cyber-currencies will be treated as capital assets for tax purposes, requiring gain and loss recognition on Schedule D.
- Funds raised through Kickstarter and other crowdfunding websites must generally be treated as income by the recipient less ordinary and necessary business expenses. If the donor receives an interest in the product or venture to be funded, he has a capital investment. ⚠ If the business is not incorporated or organized as a legal entity, the business becomes a partnership by default and will be required to file a partnership return. If crowdfunding is used to fund a charitable purpose – albeit not approved under IRC §501(c)(3) – the donor's contribution is a non-deductible potentially gift subject to gift tax.

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Tax Rules for California (CA):

- Turf removal rebates ($0.50/ft² up to $1K) designed to encourage replacement of grass with drought-tolerant landscaping are not taxable in CA but are federally taxable.
- CA Dept. of Forestry's Fire Prevention Fee ($152.53/habitable structure) is not deductible for federal or state purposes.
- College Access Tax Credit is available for tax years 2014-16 for cash contributions to fund Cal Grants for low-income college students. While there is no federal credit, taxpayers may claim an itemized charitable deduction. Contribute early since the maximum total contribution for each year is $500 million and the credit is reduced from 60% in 2014 to 55% in 2015 to 50% in 2016.
- Taxpayers exchanging CA property and acquiring an out-of-state like-kind property during or after 2014 must now file Form 3840 *annually* to help track CA-source deferred gains, regardless of whether the taxpayer would otherwise have a CA filing requirement. Failure to file will result in an assessment of tax on the previously deferred gain plus penalties and interest.
- Business returns must now be e-filed.

Foreign Tax Issues:

- The IRS has eliminated the annual filing requirement of Form 8891 for US citizens and residents who own Canadian Registered Retirement Savings Accounts (RRSP). Instead, these taxpayers qualify for automatic tax deferral as if they had invested in US-based retirement accounts. However, CA taxpayers are not eligible for tax deferral and must report all income earned inside the RRSP each year.
- Non-Mexican citizens wishing to own Mexican land near international borders or the coastline are required to establish a Mexican Land Trust (MLT or "fideicomis"). The IRS has issued a Revenue Ruling that MLTs do not constitute "trusts" which generally are formed to protect and conserve trust property for beneficiaries; therefore, it appears that MLT owners will not be required to file Form 3520 which must otherwise be filed by owners of foreign trusts whenever there is a reportable transaction.
- Taxpayers must electronically file FinCEN 114 on or before June 30th if they have authority over financial accounts, including bank, brokerage, or mutual fund accounts, held abroad with a combined value in >$10K.
- Taxpayers must also file Form 8938 and attach it to the tax return if the aggregate value of foreign financial assets exceeds $50K.

New Tax-advantaged Savings Programs (available in 2015):

- QLAC – Qualified Longevity Annuity Contracts allow a taxpayer to defer the RMD requirement past the age of 70½, although distributions must begin no later than age 85. This fixed annuity may be funded with 25% of the taxpayer's IRA up to $125,000 and guarantees a lifetime income stream which may be passed to spousal and other beneficiaries in the event that the plan owner dies before the contract payouts have been fully distributed.
- ABLE – state-managed plans for disabled individuals (blind/disabled before age 26 and eligible for SSI or has filed a disability certification with IRS for permanent physical or mental disability). Maximum contribution is $14K in 2015. Tax-free distributions, if used to pay for qualified expenses related to disability.
- myRA – plans offered through employers, backed by US Treasury. Savers with AGI under $129K ($191K if married) can establish no-fee accounts with $25, add $5/pay period and earn a government-guaranteed rate (currently 1.6%) for up to 30 years at which time the balance is automatically rolled over to a ROTH.

IRA Rollovers: The Tax Court has ruled that taxpayers are allowed only one rollover per year effective on January 1, 2015. The rule applies to the aggregate of *all IRAs and* the year begins on the date of distribution (regardless of calendar or taxable year). As before, any distributed amounts must be re-deposited into the original or a new account within 60 days. Trustee-to-trustee transfers are excluded from this limitation.

Estate & Gift Tax: ATRA permanently increased the estate tax exemption ($5.43 million in 2015), set the maximum rate at 40%, and made the spousal portability election permanent. The annual gift tax exclusion for 2015 remains at $14,000.

Filing Season: The IRS has announced that e-filed returns will be processed beginning January 20th. The California filing season, on the other hand, opened January 8th. National Taxpayer Advocate Olson has warned that this tax season "could be the worst in years" due to budgetary cut-backs. The IRS' budget for 2015 is 10% less than it was 5 years ago, staffing has dropped by 8%, the budget for staff training has dropped by 85%. Yet the Code has become ever more complex and the number of taxpayers has grown by roughly 7 million since 2010. As a result, the IRS estimates that 47% of all calls made to the tax authority will not be answered; the remaining callers will have to wait an average of 34 minutes to be connected to a telephone agent! Much of the Treasury's focus will be on administering new rules implemented under the ACA and the Foreign Account Tax Compliance Act (FATCA) designed to recapture unpaid taxes on overseas accounts. IRS Commissioner Koskinen warns that tax refunds will likely be delayed and that taxpayer dissatisfaction may result in reduced voluntary compliance at a cost of $30 billion/year for every 1% drop in the compliance rate.

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