Tax Law Snapshot for Individuals

2014 Filing Season

Getting trusted advice has never been more important than now. The American Taxpayer Relief Act of 2012 (ATRA) brought significant changes that will affect your 2013 tax liability. In addition to extending a number of tax provisions that had lapsed or were set to expire, the ATRA increased tax rates and curtailed deductions for many high-income taxpayers. The law also extended tax benefits for many middle-income taxpayers (though some will expire on Dec. 31, 2013). These changes affect millions of taxpayers, as will select provisions of the Patient Protection and Affordable Care Act of 2010.

Tax Law Snapshot for the 2014 Filing Season provides an overview of these key tax law provisions that may you. Information is current as of Dec. 10, 2013.

As a trusted financial adviser and tax consultant, your CPA can navigate the complexities of these laws and offer guidance to enhance your financial position in the future. In addition to preparing your returns, your CPA can:

- Be your go-to person for all your tax and financial questions
- Identify both the short- and long-term consequences of spending and investment decisions
- Design strategies to help you reduce your tax liability

As you prepare to file your 2013 tax return, your CPA can help by reviewing your overall financial position and providing you with expert tax return preparation and planning advice. By combining unrivaled education, training and experience with adherence to the most rigorous ethical standards in the industry, your CPA provides trusted advice during the tax season and throughout the year.

Table of Contents

1. New Tax Rates on Ordinary Income and Capital Gains 2

2. New 3.8% Tax on Net Investment Income 2

3. Alternative Minimum Tax 3

4. New Rules for Higher Income Taxpayers 4

5. Tax Benefits for Families, Homeowners 4

6. New Rules and Filing Requirements for Same-Sex Couples 5

7. Tax Help for Higher Education Costs 6

8. Donations and Other Expenses — What Can You Deduct? 7

9. Estate and Gift Tax 8

10. Reporting of Foreign Bank and Financial Assets 8

1. NEW TAX RATES ON ORDINARY INCOME AND CAPITAL GAINS

The ATRA increased the highest income tax rate to 39.6% for single individuals with taxable income of $400,000 or higher and married couples with taxable income exceeding $450,000. Taxpayers subject to the new 39.6% rate also will see an increase in their tax rate on dividend income and long-term capital gains from 15% to 20%. Taxpayers with taxable incomes below the top 15% ordinary income tax bracket will continue to enjoy a zero percent rate on dividends and long-term capital gains with other taxpayers paying a 15% rate. The ATRA also eliminated the marriage penalty for taxpayers in the 15% tax bracket.

2. NEW 3.8% TAX ON NET INVESTMENT INCOME

The new 3.8% tax on net investment income went into effect in 2013 as a result of the passage of the Patient Protection and Affordable Care Act of 2010. The 3.8% tax applies to individuals with net investment income if their income (after certain deductions) exceeds $250,000 for married couples filing joint returns or $200,000 for single taxpayers. Net investment income includes capital gains, interest and dividend income received from investment assets such as stocks, bonds, certificates of deposit and mutual funds and may include rental income and royalties. Your CPA can determine if the new tax applies to you in 2013 and provide suggestions to minimize its impact in 2014.

Key Fact: The employer only withholds the extra tax once compensation exceeds $200,000 *for that job*. Taxpayers who change jobs during the year may find themselves needing to calculate the additional tax when they file their 2013 returns.

How the Tax Breaks Down

Single Taxpayers	Joint Filing Taxpayers
1.45% tax on first $200,000	1.45% tax on first $250,000
2.35% on amounts more than $200,000 (new)	2.35% on amounts more than $250,000 (new)

3. ALTERNATIVE MINIMUM TAX

The Alternative Minimum Tax (AMT) was designed to ensure that high-income taxpayers who benefit from certain exemptions, deductions and credits still pay a minimum amount of tax. Over time, the AMT affected more and more middle-income individuals as well. When the AMT is triggered, the taxpayer pays a higher tax than their regular federal income tax.

The ATRA increased the AMT exemption to $51,900 for single taxpayers and heads of household and $80,800 for surviving spouses and married couples filing jointly. These amounts will be indexed for inflation after 2013. These changes should help ensure that middle-income taxpayers are not routinely subject to this tax. However, the ATRA did not increase the income levels at which those exemptions phase out. Accordingly, taxpayers may find themselves unexpectedly subject to the AMT in certain situations — for example, when they recognize large capital gains (even though the capital gains income itself is not subject to the AMT or exercise certain stock options).

The good news? Taxpayers who have been subject to AMT in the past but find themselves not owing AMT in 2013 may be eligible for a minimum tax credit. Your CPA can help determine whether you qualify.

PHASE OUTS

What is a phase out exactly? Many tax benefits are reduced or phased out as income rises as a way to target tax benefits on middle- and lower-income households and to limit the loss of revenue. For example, a person earning $45,000 may be able to claim the entire value of a tax credit, while a person earning $70,000 may only be able to claim 40% of it.

4. NEW RULES FOR HIGHER INCOME TAXPAYERS

The ATRA revives both the phase out of personal exemptions and the limitation on itemized deduction for high-income taxpayers. Under the phase out of personal exemptions, the total amount of personal exemptions for taxpayers and dependents is reduced if the taxpayer's adjusted gross income is more than $300,000 for married couples and $250,000 for single taxpayers. In a similar fashion, certain itemized deductions of high-income taxpayers are reduced if their adjusted gross income exceeds certain thresholds. The rules are complex and your CPA can help determine if these limitations apply to you.

5. TAX BENEFITS FOR FAMILIES, HOMEOWNERS

The ATRA extended many credits and other benefits that otherwise were scheduled to expire after 2012. Child-related tax credits and benefits that were extended include:

- The $1,000 child tax credit
- The tax credit for qualified adoption expenses ($12,970 in 2013)
- The exclusion for qualified adoption-assistance programs offered by employers

The child and dependent care credit, which applies to care for children age 12 or younger and certain individuals (e.g., a spouse) who are physically or mentally incapable of self-care, was made permanent.

For homeowners, the law extends the provision to shield taxpayers from tax on income from the cancellation of debt of up to $2 million on a principal residence. Individuals who made qualified energy-saving improvements (such as high-efficiency furnaces and air conditioners) to their home in 2013 will be glad to know related tax credits are still available.

Provisions like the energy credits and the exclusion for debt forgiveness income are not in the law for next year, so talk to your CPA about which tax benefits you can use.

6. NEW RULES AND FILING REQUIREMENTS FOR SAME-SEX COUPLES

As a result of the Supreme Court's decision in *United States v. Windsor* and an IRS ruling on the issue, a same-sex couple legally married in a jurisdiction that recognizes the marriage will now be treated as married for federal tax purposes. This includes taxpayers who were married in a state that permits same-sex marriage but who no longer live in that state. The rules will be applied retroactively so taxpayers may be able to file amended returns for tax years not closed by the statute of limitations.

The implications are many and affect not only the federal income tax but also estate and gift taxes as well. The new rules require married same-sex couples to file as either married filing jointly or married filing separately.

With respect to estate and gift taxes, the new rules allow a same-sex married couple to take advantage of the unlimited marital deduction and the right to "split gifts," thereby increasing the amount they can pass to others without incurring an estate or gift tax. Other tax benefits may include tax-free fringe benefits (such as health insurance) from the employer of their spouse, special provisions granted to taxpayers filing joint returns, and new options for treating inherited IRAs.

Key Fact: While many couples will find that filing jointly results in the lowest income tax liability, filing separately may be advised in some situations.

7. TAX HELP FOR HIGHER EDUCATION COSTS

The ATRA extended several education-related incentives for taxpayers who are in college or have children in college. The American Opportunity Tax Credit was extended through 2017 and allows eligible taxpayers to claim a tax credit for post-secondary education expenses such as books or equipment. The Lifetime Learning Credit remains available as does the deduction for tuition and related higher education expenses.

Other education incentives that will be permanently available are:

- The $5,250 exclusion for employer-provided educational assistance
- The $2,500 deduction per return for student loan interest (without a 5-year limitation)
- The $2,000 maximum contribution for education savings accounts, which allow expenditures for elementary, secondary and post-secondary education

Planning for college is critical as tuition costs continue to rise. Your CPA can develop a plan to help you save for your children's tuition or, if they are in college now, make sure you maximize the tax benefits available.

8. DONATIONS AND OTHER EXPENSES — WHAT CAN YOU DEDUCT?

Charity: Charitable contributions may provide generous tax benefits for taxpayers. However, the law requires significant documentation in order to claim those benefits, especially in the case of donated property. Deductible contributions are subject to limits based on:

- The type of property donated
- The type of charity
- Taxpayer's adjusted gross income

The ATRA reinstated the popular provision allowing taxpayers age 70½ and older to make up to $100,000 of tax-free distributions from individual retirement accounts (IRAs) directly to qualified charities.

Sales Taxes & Mortgage Insurance Premiums: The law also extended a number of popular tax breaks, including the deduction for state and local sales taxes in lieu of a deduction for state and local income taxes. This provision is particularly important for taxpayers living in states without income taxes and for retirees who may not pay significant state income taxes. The law also extends the treatment of mortgage insurance premiums as interest expense.

Medical: As in past years, taxpayers who itemize their deductions can write off qualified medical costs not covered by insurance. However, for taxpayers under age 65, the costs must exceed 10% of adjusted gross income in 2013, up from 7.5% in previous years. Once the threshold is passed, there is no dollar limit on the deduction amount.

PROTECT YOUR IDENTITY

Tax-related identify theft is on the rise. In addition to other fraudulent activities, criminals are using stolen Social Security numbers and other information to file fake returns requesting fraudulent tax refunds. While the IRS is taking aggressive steps to combat the problem, the best defense is to safeguard your personal information at all times. Your CPA can provide you with tips to help you prevent becoming a victim.

MAJOR LIFE EVENTS

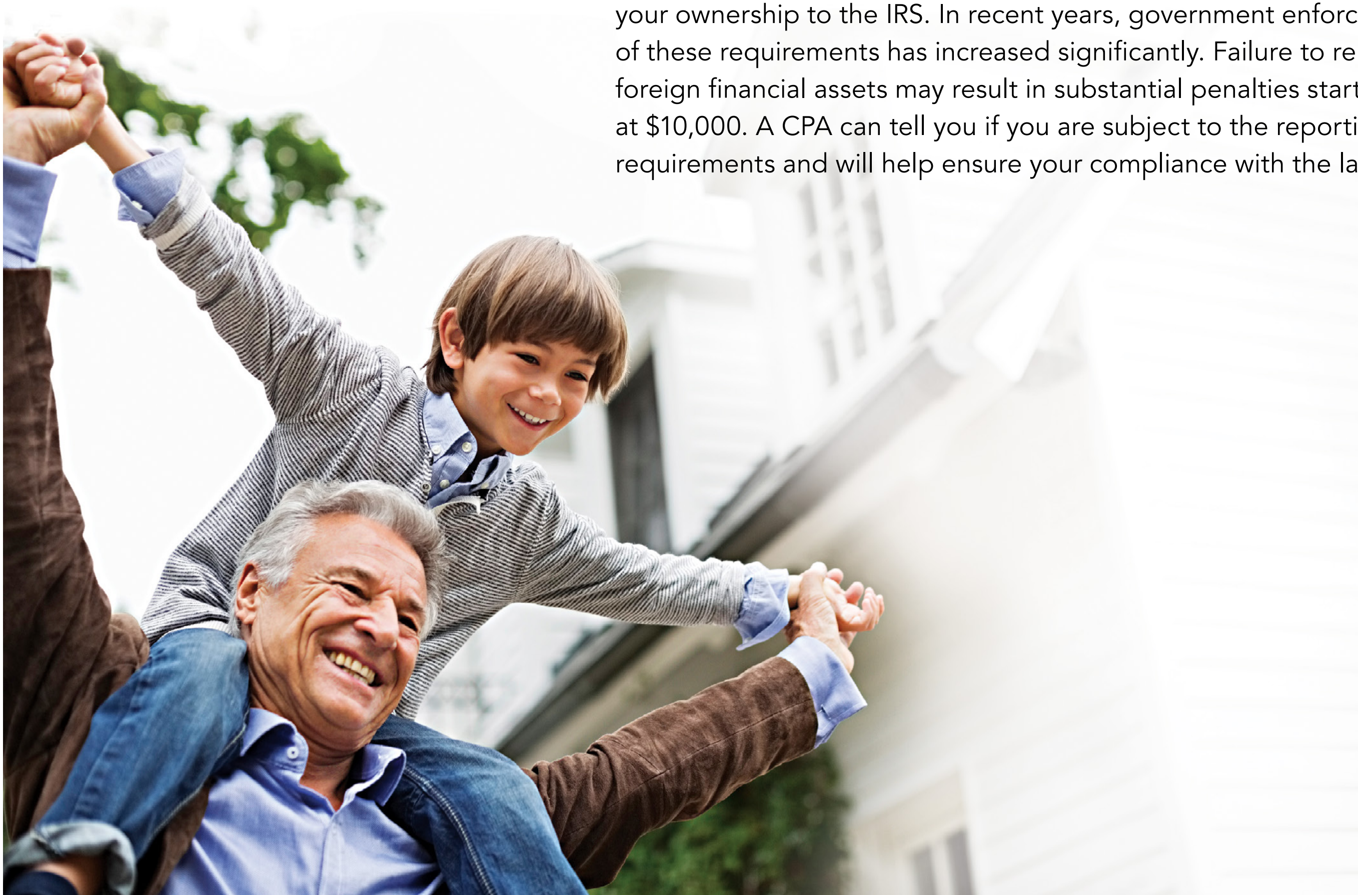
Did you marry or divorce during the year or suffer the loss of a spouse? Make sure you talk to your CPA about the change in your tax filing status. Did you start a new job or begin a new business? Relocation expenses and start-up costs for the new business may be deductible. Did your child start college? These and other major life events may affect your tax liability and provide new tax planning opportunities. Your CPA can help explain what these changes mean to you and your tax situation.

9. ESTATE AND GIFT TAX

The good news is that Congress made several estate and gift tax provisions permanent. For decedents dying in 2013, the estate tax exclusion (the amount that a decedent can leave to heirs without owing estate tax) permanently increased to $5 million and will be indexed for inflation. The exclusion is $5.25 million for 2013 deaths. Among the taxpayer-friendly provisions, Congress made permanent the portability of a deceased spouse's unused exclusion to a surviving spouse. However, it also increased the estate tax rate to 40%. Effective estate tax planning must include a consideration of income tax as well as estate and gift tax consequences and must start before a taxpayer's death. Even if your estate does not reach the $5 million threshold today, talk to your CPA about ways to ensure that your estate passes to your heirs without being subject to estate tax.

10. REPORTING OF FOREIGN BANK AND FINANCIAL ASSETS

If you own a bank account or other financial assets located in a foreign country, you may have a responsibility under the Foreign Account Tax Compliance Act (FATCA) or the Bank Secrecy Act to disclose your ownership to the IRS. In recent years, government enforcement of these requirements has increased significantly. Failure to report foreign financial assets may result in substantial penalties starting at $10,000. A CPA can tell you if you are subject to the reporting requirements and will help ensure your compliance with the law.



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