

FRANZEN & FRANZEN, LLP

CERTIFIED PUBLIC ACCOUNTANTS

January 21, 2014 – 2013 Fourth Quarter Federal Tax Developments

During the fourth quarter of 2013, there were many important federal tax developments. This letter highlights some of the more significant developments for you. As always, contact our office if you have any questions.

IRS temporary shutdown

On October 1, the IRS furloughed approximately 90 percent of its employees after a lapse in appropriations. The IRS resumed operations in mid-October after Congress passed a stop-gap funding bill. During the shutdown, many functions were halted.

2014 filing season

The 2014 filing season is scheduled to begin on January 31, 2014, the IRS announced. The 10-day delay is due to the government shutdown in October. The IRS needed more time to reprogram its return processing systems. The risk of an IRS shutdown during the 2014 filing season has been removed by passage of the Bipartisan Budget Act of 2013. Our office will keep you posted of developments as the filing season unfolds.

Tax extenders

More than 50 popular but temporary tax incentives expired after December 31, 2013. These incentives, known as tax extenders, include the higher education tuition deduction, teachers' classroom expense deduction, research credit, and transit benefits parity. In December, some lawmakers tried to move bills to extend these incentives through 2014 or 2015 but Congress recessed for the holidays without taking any action. Congress may take up the extenders in 2014, either as part of comprehensive tax reform or as stand-alone legislation.

Tax reform

In November, one of the chief proponents of tax reform unveiled a number of proposals in Congress. Sen. Max Baucus, D-Mont., who chairs the Senate Finance Committee proposed, among other things, simplifying tax administration, reducing the number of depreciation rates, repealing the last-in, first-out (LIFO) method of accounting, and overhauling the international taxation rules. However, the fate of his proposals in 2014 is uncertain as Baucus is retiring from Congress and has been nominated by President Obama to serve as U.S. ambassador to China.

Net investment income tax

The IRS released much-anticipated final regulations on the 3.8 percent Net Investment Income tax (NII tax) under the Affordable Care Act. At the same time, the IRS issued proposed reliance regulations

intended to provide, among other things, simplified methods to compute NII vulnerable gain or loss on the sale of pass through entities. The final regulations, the IRS explained, aim to answer many questions about application of the NII tax. However, the IRS declined suggestions to adopt bright-line tests.

Additional Medicare Tax

The IRS issued final regulations on the Additional Medicare Tax under the Affordable Care Act (TD 9645). The tax applies to wages above certain thresholds and also to self-employment income above those thresholds.

Mileage rates

For 2014, the optional business mileage rate is 56 cents-per-mile, the IRS announced. The optional business mileage rate for 2013 was 56.5 cents-per-mile. The 2014 rate for qualified medical/moving expenses is 23.5 cents-per-mile. The 2014 rate for charitable miles driven is 14 cents-per-mile. Additionally, the depreciation component of the business standard mileage rate for 2014 is 22 cents-per mile, which reflects a decrease of one cent from the depreciation component for the 2013 business standard mileage rate.

Affordable Care Act

The Obama administration announced in December a delay in health insurance Marketplaces for small businesses until November 2014. The Small Business Health Options Program (SHOP) was created to give employers with fewer than 50 full-time equivalent employees a new way to shop for coverage. Small businesses that want to buy Marketplace plans for their workers now will need to go through an agent, broker or insurance company to buy coverage for 2014. Employers would be able to determine their eligibility for tax credits.

In October, the IRS reminded individuals who obtain health insurance through an Affordable Care Act Marketplace may be eligible for the Code Sec. 36B premium assistance tax credit. The Marketplace will estimate the amount of the credit, if any, when individuals apply for coverage. Individuals may elect to opt for advance payment of the credit.

The IRS issued final regulations and guidance on annual fees imposed on health insurance providers. The Affordable Care Act generally imposes an annual fee (Code Sec. 9010 fee) for calendar years beginning after 2013 on covered entities engaged in the business of providing health insurance. The aggregate fee imposed on all covered entities is \$8 billion for 2014.

Health FSAs

In November, the IRS announced relief from the “use-or-lose” rule for health flexible spending arrangements (health FSAs) by allowing a new up-to-\$500 carryover option for year-end balances.

Effective for plan years starting in 2013, employers may amend their cafeteria plan documents to provide for this new option. Any unused amount above \$500 will be forfeited.

Inflation adjustments

Some key Tax Code provisions will increase for 2014 because of inflation, the IRS announced in November. Personal and dependency exemptions will increase from \$3,900 in 2013 to \$3,950 for 2014.

Standard deductions will increase for 2014 to \$12,400 for married joint filers (up from \$12,200 for 2013) and \$6,200 for single filers and married separate filers (up from \$6,100 for 2013). For heads of household, the standard deduction will be \$9,100 (up from \$8,950 for 2013).

For 2014, the alternative minimum tax (AMT) exemption for married joint filers and surviving spouses will be \$82,100 (up from \$80,800 for 2013). For heads of household and unmarried single filers, the exemption will be \$52,800 (up from \$51,900 for 2013). For married separate filers, the amount will be \$41,050 (up from \$40,400 for 2013).

The gift tax annual exemption will remain the same for 2014, at \$14,000. However, the estate and gift tax applicable exclusion will increase from \$5,250,000 for 2013 to \$5,340,000 for 2014.

In related news, the Social Security Administration announced that the taxable wage base would increase for 2014. The maximum amount of earnings subject to Social Security will be \$117,000 for 2014, up from \$113,700 for 2013.

Code Sec. 199 deduction

In October, the Tax Court denied the domestic production activities deduction (DPAD) under Code Sec. 199 to a direct mail advertising company that contracted with third-party printers to produce its print ad material (*ADVO, Inc.*, 141 TC No. 9). According to the Tax Court, the taxpayer was not entitled to the deduction because it did not have the benefits and burdens of ownership of the printed material. Instead, the printers would have been entitled to the DPAD.

Employment taxes

In October, the U.S. Supreme Court announced that it will resolve a split among the circuit courts of appeal on the FICA tax treatment of severance pay. The Supreme Court will review a decision by the Sixth Circuit, which held that supplemental unemployment benefits (SUB) payments are not wages for purposes of FICA taxation (*In re Quality Stores*, 2012-2 *ustc* ¶150,551).

The government, which asked the Supreme Court to review the case, predicted that there are thousands of refund cases potentially reaching \$1 billion.

Partnerships

In December, the IRS issued proposed regulations to clarify the rules on a partner's share of recourse liabilities. The proposed regulations would determine the amount of a partnership liability allocated to multiple partners who bear the economic risk of loss for the same liability (overlapping economic risk of loss). The proposed regulations also address the treatment of nonrecourse partnership liabilities when related partners are involved.

FATCA

Despite requests by financial institutions and others, the IRS indicated in December that it will not change the July 1, 2014, effective date for reporting and withholding under the Foreign Account Tax Compliance Act (FATCA). The IRS had previously delayed the effective date (which had been January 1, 2014). Withholding agents generally will be required to begin withholding on withholdable payments made after June 30, 2014.

IRS commissioner

The IRS has a new leader: John Koskinen. President Obama nominated Koskinen to serve as Commissioner of Internal Revenue and the Senate approved his nomination in December. Koskinen told lawmakers that he will aim to improve customer service in a challenging budgetary environment.

If you have any questions about these or other federal tax developments that may impact you or your business, please contact our office.