January 27, 2014 – 2013 Federal Tax Year-In-Review

As 2014 begins, it is a valuable time to look back at some of the important federal tax developments in 2013 and their impact on the new year and beyond. Some of these developments were anticipated; others were surprises. In nearly all cases, the developments open tax planning opportunities.

Tax legislation. 2014 has commenced in a very different budgetary and fiscal climate in Washington compared to the same time last year. At the end of 2012, lawmakers were in tough negotiations over the fiscal cliff. The result was the American Taxpayer Relief Act of 2012 (ATRA), which finally passed Congress on January 1, 2013. The new law extended permanently the Bush-era tax cuts for lower and moderate income taxpayers, including reduced income tax brackets, marriage penalty relief, some education incentives, and much more. ATRA also increased taxes on higher income individuals by restoring the 39.6 percent tax bracket and revising other provisions. These and other changes made by ATRA are reflected on 2013 returns filed in 2014.

Extenders. Although ATRA resolved uncertainty about the Bush-era tax cuts, it did not make permanent many other temporary incentives. After 2013, a host of temporary incentives, known as tax extenders, expired. In some cases, for example transit benefits, taxpayers feel the effects immediately. In other cases, the impact of the expiration of these incentives will not be felt until taxpayers file 2014 returns in 2015. That effectively gives Congress time to extend the expired incentives, including the state and local sales tax deduction, research tax credit, higher education tuition deduction, and many more.

Tax reform. Action on the extenders could be linked to tax reform. During 2013, the leaders of the House and Senate tax writing committees undertook a nationwide campaign to drum up support for tax reform. The lawmakers visited a number of cities and highlighted proposals to simplify the Tax Code. Late in 2013, the Senate Finance Committee released legislative language proposing changes in depreciation, the international tax rules and tax administration. However, it is unclear if the Senate, or the House, will give these proposals serious consideration in 2014. Their chief proponent, SFC Chair Max Baucus, D-Montana, is retiring from Congress.

Affordable Care Act. The Affordable Care Act continued to generate new rules, regulations and controversies in 2013. The Obama administration surprised many observers with a one-year delay in the so-called employer mandate. However, the individual mandate, which generally requires individuals to carry minimum essential health coverage or pay a penalty unless exempt, took effect as scheduled on January 1, 2014. Some individuals whose existing policies were cancelled because they did not meet new standards under the Affordable Care Act may be eligible for a hardship exemption to the penalty. The Affordable Care Act's Marketplaces experienced a rocky opening but as of early 2014, the White House reported that enrollment numbers were climbing.

New Medicare taxes. The IRS released final regulations on two new Medicare taxes imposed by the Affordable Care Act: the Net Investment Income (NII) tax and the Additional Medicare Tax. These two taxes generally impact higher income taxpayers (individuals with incomes over $200,000 and married couples with incomes over $250,000) but they have some especially complex features that complicate tax planning. The NII final regulations are intended to shed light on the many types of income that could be subject to the tax.

Health FSAs. The IRS announced in late 2013 a decidedly pro-taxpayer change to a popular health care benefit. At the plan sponsor's option, employees participating in health flexible spending arrangements (health FSAs) will be allowed to carry over, instead of forfeiting, up to $500 of unused amounts remaining at year-end. Plan sponsors now have the choice of either allowing employees a carryover of up to $500 or giving employees a grace period of up to 2 ½ months. However, plan sponsors cannot offer both.

Same sex marriage and domestic partners. On June 26, 2013, the U.S. Supreme Court struck down as unconstitutional Section 3 of the Defense of Marriage Act. The IRS announced that same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married for federal tax purposes. This impacts not only a taxpayer's filing status. It also applies to all federal tax provisions where marriage is a factor, including claiming personal and dependency exemptions, taking the standard deduction, employee benefits, contributing to an IRA and claiming the earned income tax credit or child tax credit. The IRS also reminded domestic partners and individuals in civil unions that they are not married for federal tax purposes.

Repair regulations. In September, the IRS issued final regulations on the treatment of amounts paid to acquire, produce, or improve tangible property. The complex regulations reach nearly every type of taxpayer. Their complexity should not be a barrier to taking advantage of some of the taxpayer-friendly provisions. For example, the final regulations include a de minimis safe harbor, a safe harbor for small taxpayers to assist them in applying the general rules for improvements to buildings, and more.

Foreign compliance activities. In 2014, foreign financial institutions will have new reporting obligations under the Foreign Account Tax Compliance Act (FATCA). FATCA, its supporters argue, will significantly boost taxpayer compliance. Its detractors counter that the law is too complex and sweeps in its reach taxpayers who have no intention to purposefully evade U.S. taxation. Along with FATCA, the U.S. has been expanding its tax treaties and information agreements with foreign jurisdictions to encourage greater transparency. This trend is likely to continue in 2014.

Mileage rates. The optional business standard mileage rate drops slightly for 2014 to 56 cents-per-mile (compared to 56.5 cents-per-mile for 2013). The IRS attributed the reduction to generally lower vehicle maintenance costs, including the price of fuel. For 2014, the depreciation component of the business standard mileage rate is 22 cents-per mile. This represents a one-cent decrease from the depreciation component for the 2013 business standard mileage rate. Similarly, the optional standard mileage rate for qualified medical and moving expenses will also decrease from 24 cents-per-mile for 2013 to 23.5 cents-per-mile for 2014. However, the 14 cents-per-mile rate for charitable miles driven is set by statute and is unchanged for 2014.

IRS operations. The IRS experienced a turbulent year in 2013 with reports of improper oversight of some organizations, leadership changes and a 16-day shutdown in October. In December, the Senate approved the nomination of John Koskinen to be the new Commissioner of Internal Revenue. One of Koskinen's first tasks will be to oversee the smooth processing of returns and refunds during the 2014 filing season. Koskinen will also have to prioritize IRS activities in a challenging budgetary environment.

If you have any questions about these or any developments in 2013 and their impact on 2014, please contact our office.