FRANZEN & FRANZEN, LLP
CERTIFIED PUBLIC ACCOUNTANTS

May 14, 2014 – Post-Filing Season Federal Tax Developments

Over the past few months, our focus has been on the federal income tax return filing season, preparing your individual return, and filing your return. The end of the filing season (except for taxpayers on extension) is an excellent time to turn your attention to next year's deadline for filing your 2014 return. That refocus requires among other things an awareness of the direct impact that many "ordinary," as well as one-time, transactions and events will have on the tax you will eventually be obligated to pay April 15, 2015. To gain this forward-looking perspective, however, taking a moment to look back … at the filing season that has just ended, is particularly worthwhile. This generally involves a two-step process: (1) a look-back at your 2013 tax return to pinpoint new opportunities as well as "lessons learned;" and (2) a look-back at what has happened in the tax world since January 1st that may indicate new challenges to be faced for the first time on your 2014 return.

2013 Form 1040

Examining your 2013 Form 1040 individual tax return can help you identify certain changes that you might want to consider this year, as well encourage you to continue what you're doing right. These "key ingredients" to your 2014 return may include, among many others considerations, a fresh look at:

Your refund or balance due. While it is nice to get a big refund check from the IRS, it often indicates unnecessary overpayments over the course of the year that has provided the federal government with an interest-free loan in the form of your money. Now is the time to investigate the reasons behind a refund and whether you need to take steps to lower wage withholding and/or quarterly estimated tax payments.

If on the other hand you had to pay the IRS when filing your return (or requesting an extension), you should consider whether it was due to a sudden windfall of income that will not repeat itself; or because you no longer have the same itemized deductions, you had a change in marital status, or you claimed a one-time tax credit such as for energy savings or education. Likewise, examining anticipated changes between your 2013 and 2014 tax years — marriage, the birth of a child, becoming a homeowner, retiring, etc.— can help warn you whether your headed for an underpayment or overpayment of your 2014 tax liability.

Investment income. One area that blindsided many taxpayers on their 2013 returns was the increased tax bill applicable to investment income. Because of the "great recession," many investors had carryforward losses that could offset gains realized for a number of years as markets gradually improved. For many, however, 2013 saw not only a significant rise in investment income but also a rise in realized taxable investment gains that were no longer covered by carryforward losses used up during the 2010-2012 period.

Furthermore, dividends and long-term capital gains for the first time in 2013 were taxed at a new, higher 20 percent rate for higher income taxpayers and an additional 3.8 percent net investment income tax surtax for those in the higher income brackets. Short-term capital gains saw the highest rate jump, from 35 percent to 43.4 percent rate, which reflected a new 39.6 percent regular rate and the new 3.8 percent net investment income tax rate. This tax structure remains in place for 2014.

Personal exemption/itemized deductions. Effective January 1, 2013, the *American Taxpayer Relief Act* (ATRA) revived the personal exemption phaseout (PEP). The applicable threshold levels are $250,000 for unmarried taxpayers; $275,000 for heads of households; $300,000 for married couples filing a joint return (and surviving spouses); and $150,000 for married couples filing separate returns (adjusted for inflation after 2013). Likewise, it revived the limitation on itemized deductions (known as the "Pease" limitation after the member of Congress who sponsored the original legislation) for those same taxpayers.

Medical and dental expenses. Starting in 2013, the *Affordable Care Act* (ACA) increased the threshold to claim an itemized deduction for unreimbursed medical expenses from 7.5 percent of adjusted gross income (AGI) to 10 percent of AGI. However, there is a temporary exemption for individuals age 65 and older until December 31, 2016. Qualified individuals may continue to deduct total medical expenses that exceed 7.5 percent of adjusted gross income through 2016. If the qualified individual is married and only one spouse is age 65 or older, the taxpayer may still deduct total medical expenses that exceed 7.5 percent of adjusted gross income.

Recordkeeping. If you cannot find the paperwork necessary to prove your right to a deduction or credit, you cannot claim it. An organized tax recordkeeping system — whether on paper or computerized — therefore is an essential component to maximizing tax savings.

Filing season developments

So far this year, the IRS, other federal agencies and the courts have issued guidance on individual and business taxation, retirement savings, foreign accounts, the *Affordable Care Act*, and much more. Congress has also been busy working up a tax extenders bill as well as tax reform proposals. All these developments can impact how you plan to maximize benefits on your 2014 income tax return.

Tax reform. President Obama, the chairs of the House and Senate tax writing committees, and individual lawmakers all made tax reform proposals in early 2014. The proposals range from comprehensive tax reform to more piecemeal approaches. Although only small, piecemeal proposals have the most promising chances for passage this year, taxpayers should not ignore the broader push toward tax reform that will be taking shape in 2015 and 2016.

Tax extenders. The Senate Finance Committee (SFC) approved legislation (EXPIRE Act) in April that would extend nearly all of the tax extenders that expired after 2013. Included in the EXPIRE Act are individual incentives such as the state and local sales tax deduction, the higher education tuition deduction, transit benefits parity, and the classroom teacher’s deduction; along with business incentives such as enhanced Code Sec. 179 small business expensing, bonus depreciation, the research tax credit, and more. Congress may now move quickly on an extenders bill or it may not come up with a compromise until after the November mid-term elections. Many of these tax benefits are significant and will directly impact the 2014 tax that taxpayers will pay.

Individual mandate. The *Affordable Care Act's* individual mandate took effect January 1, 2014. Individuals failing to carry minimum essential coverage after January 1, 2014 and who are not exempt from the requirement will make an individual shared responsibility payment when they file their 2014 federal income tax returns in 2015. There are some exemptions, including a hardship exemption if the taxpayer experienced problems in signing up with a Health Insurance Marketplace before March 31, 2014. Further guidance is expected before 2014 returns need to be filed, especially on how to calculate the payment and how to report to the IRS that an individual has minimum essential coverage.

Employer mandate. The *Affordable Care Act's* shared responsibility provision for employers (also known as the "employer mandate") will generally apply to large employers starting in 2015, rather than the original 2014 launch date. Transition relief provided in February final regulations provides additional time to mid-size employers with 50 or more but fewer than 100 employees, generally delaying implementation until 2016. Employers that employ fewer than 50 full-time or full time equivalent employees are permanently exempt from the employer mandate. The final regulations do not change this treatment under the statute.

Other recent tax developments to be aware of for 2014 planning purposes include:

- **IRA rollovers.** The IRS announced that, starting in 2015, it intends to follow a one-rollover-per-year limitation on Individual Retirement Account (IRA) rollovers as an aggregate limit.
- **myRA.** In January, President Obama directed the Treasury Department to create a new retirement savings vehicle, "myRA," to be rolled out before 2015.
- **Same-sex married couples.** In April, the IRS released guidance on how the Supreme Court's *Windsor* decision, which struck down Section 3 of the *Defense of Marriage Act (DOMA)*, applies to qualified retirement plans, opting not to require recognition before June 26, 2013.
- **Passive activity losses.** The Tax Court found in March that a trust owning rental real estate could qualify for the rental real estate exception to passive activity loss treatment.
- **FATCA deadline.** The IRS has indicated that it is holding firm on the July 1, 2014, deadline for foreign financial institutions (FFIs) to comply with the FATCA information reporting requirements or withhold 30 percent from payments of U.S.-source income to their U.S. account holders.
- **Vehicle depreciation.** The IRS announced that inflation-adjusted limitations on depreciation deductions for business use passenger autos, light trucks and vans first placed in service during calendar year 2014 are relatively unchanged from 2013 (except for first year $8,000 bonus depreciation that may be removed if Congress does not act in time.
- **Severance payments.** In March, the U.S. Supreme Court held that supplemental unemployment benefits (SUB) payments made to terminated employees and not tied to the receipt of state unemployment benefits are wages for FICA tax purposes (*U.S. v. Quality Stores, Inc.*).
- **Virtual currency.** The IRS announced that convertible virtual currencies, such as Bitcoin, would be treated as property and not as currency, thus creating immediate tax consequences for those using Bitcoins to pay for goods and services.

These and other developments may impact your tax planning moving forward. For more details about these and other developments, and to review your current tax strategy planning and make any updates, please contact our office.

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