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2013 1st Quarter Federal Tax Developments

April 15 has come and gone but it's not time to stop thinking about taxes and strategic tax planning opportunities. Since the start of 2013, there have been many new federal tax developments, which will impact tax planning for this year and beyond. As 2013 unfolds, many changes made to the Tax Code by the *American Taxpayer Relief Act of 2012* (ATRA) take effect. Additionally, there are new taxes to take into account because of the health care reform package, along with enhancements to many tax credits and deductions. Now is a good time to revisit these developments and explore how they will affect your strategic tax plans. Planning today can help maximize your tax savings going forward. As always, please give our office a call or email if you have any questions.

Tax planning and ATRA

Returns just filed (or that will be filed under extension by October 15, 2013) reflect the tax laws as they existed in 2012 (with some expired provisions renewed retroactively for 2012 by ATRA). Looking ahead, your 2013 return to be filed in 2014 will reflect the many changes to the Tax Code made by ATRA. Because the new law was passed at the beginning of the year, it was overshadowed by the filing season. However, its provisions impact every taxpayer and it's vital to take time to gauge how they will affect you. The list of changes made by ATRA is long: many generous tax incentives, such as the $1,000 child tax credit, enhanced adoption credit, and enhanced earned income credit, are made permanent. ATRA also permanently "patches" the alternative minimum tax (AMT), which definitely will impact planning for taxpayers liable for the AMT. The new law also extends permanently the Bush-era tax rate cuts for individuals except taxpayers with taxable income above $400,000 ($450,000 for married couples filing a joint return). Income above these levels is taxed at 39.6 percent effective January 1, 2013. ATRA also increased the tax rates on qualified capital gains and dividends for higher income taxpayers. All these changes and more are set in motion by ATRA. *CCH Federal Tax Weekly No. 2, January 10, 2013.*

New proposals to consider

Looking ahead, some new proposals could impact tax planning in 2013 and beyond. President Obama has proposed to reduce the value to 28 percent of certain deductions and exclusions that would otherwise reduce taxable income in the 33, 35 or 39.6 percent tax brackets. The President also re-proposed the so-called Buffett Rule, now referred to as the "Fair Share Tax" for taxpayers with incomes above $1 million (with full phase-in above $2 million). Moreover, the President has proposed to limit contributions and accruals on tax-favored retirement benefits, including IRAs, qualified plans, tax-sheltered annuities, and deferred compensation plans. The limit generally would apply when a taxpayer accumulates total retirement amounts that exceed the amount necessary to provide the maximum annuity permitted for a defined benefit plan. The President's proposals are expected to be debated in Congress as lawmakers and the White House try to reach an agreement on tax reform and deficit deduction. President Obama has said he wants an agreement before August, which could significantly change your tax planning for 2013 and beyond. Our office will keep you posted of developments. *CCH Federal Tax Weekly No. 16, April 18, 2013.*

NII surtax takes effect

The 3.8 percent Medicare surtax on net investment income (NII) became effective January 1, 2013. The NII surtax on individuals equals 3.8 percent of the lesser of: Net investment income for the tax year, or the excess, if any of the individual's modified adjusted gross income (MAGI) for the tax year, over the threshold amount. The threshold amount in turn is equal to $250,000 in the case of a taxpayer making a joint return or a surviving spouse, $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in any other case.

The IRS issued proposed regulations in 2012 intending them to be "reliance regulations." Nonetheless, taxpayers continue to be confused over certain sections. Although final regulations are promised "within 2013" so they would be available for the 2013 tax year and 2014 filing season, current misinterpretation of the proposed regulations can impact on tax strategies now being put into motion in 2013. Any misinterpretation can also bear on 2013 estimated tax that may be due to cover any 3.8 percent NII surtax liability. Our office will keep you posted of developments. *CCH Federal Tax Weekly No. 14, April 4, 2013.*

Vehicle depreciation limits increase for 2013

Tax planning for 2013 is helped by the IRS's release of inflation-adjusted limitations on depreciation deductions for business-use of passenger automobiles, light trucks, and vans first placed in service during calendar year 2013. Some of the depreciation limits are identical to the limits for 2012; other ceilings have increased by $100. The 2013 dollar limits reflect the inflation adjustments both with the extension of bonus depreciation by ATRA and without. If bonus depreciation is allowed to lapse after 2013, as President Obama has proposed, the dollar limits for 2014 would be lower but would still be adjusted for inflation. The maximum depreciation limits under Code Sec. 280F for passenger automobiles first placed in service during the 2013 calendar year are: $11,160 for the first tax year ($3,160 if bonus depreciation does not apply); $5,100 for the second tax year; $3,050 for the third tax year; and $1,875 for each succeeding tax year. The maximum depreciation limits under Code Sec. 280F for trucks and vans first placed in service during the 2013 calendar year are slightly higher. Keep in mind that SUVs and pickup trucks with a gross vehicle weight rating (GVWR) in excess of 6,000 pounds continue to be exempt from the luxury vehicle depreciation caps based on a loophole in the operative definition. *CCH Federal Tax Weekly No. 9, February 28, 2013.*

IRS audits of business property write-offs on "stand-down"

The IRS announced in March that it had updated its 2012 directive that generally instructs employees to discontinue audits of costs to maintain, replace or improve tangible property. The updated directive tells employees not to begin examining those issues for tax years beginning on or after January 1, 2012 and before January 1, 2014. The directive retains the "stand-down" of audit activity in this area beginning in 2012. The IRS also advised that it intends to make changes to temporary regulations regarding certain de minimis rules, routine maintenance and more. *CCH Federal Tax Weekly No. 14, April 4, 2013.*

Prepare for employer and individual mandates under PPACA

The IRS issued long-awaited proposed reliance regulations on the employer mandate under the *Patient Protection and Affordable Care Act* (PPACA). An applicable large employer is an employer that employed an average of at least 50 full-time employees during the preceding calendar year, including full-time equivalent (FTE) employees. The statute defines a full-time employee as an employee who on average was employed for at least 30 hours of service per week. *CCH Federal Tax Weekly No. 2, January 10, 2013.*

The PPACA also generally requires individuals, unless exempt, to carry minimum essential health insurance coverage after 2013 or make a shared responsibility payment. The IRS has issued proposed regulations on the individual mandate. The proposed regulations, the IRS explained, are intended to mitigate the affordability test for related individuals. *CCH Federal Tax Weekly No. 6, February 7, 2013.*

IRS ramps up oversight of foreign accounts

The *Foreign Account Tax Compliance Act* (FATCA) gives the agency new tools to discover tax evasion. In January, Treasury and the IRS issued final regulations under FATCA that describe the requirements for foreign financial institutions (FFIs), nonfinancial foreign entities (NFFEs), and other taxpayers to comply with FATCA’s reporting and withholding regimes on U.S. and foreign account holders. The 544-page regulation package seeks to harmonize the United States’ regulatory requirements with the use of intergovernmental agreements (IGAs) to implement FATCA. *CCH Federal Tax Weekly No. 4, January 24, 2013.*

Simplified safe harbor for claiming home office deduction

The home office deduction is one of the most complex in the Tax Code. In response, the IRS announced a simplified safe harbor method for claiming the home office deduction for tax years beginning on or after January 1, 2013. Under the safe harbor, taxpayers determine the amount of deductible expenses for qualified business use of the home for the tax year by multiplying the allowable square footage by the prescribed rate. The allowable square footage cannot exceed 300 square feet and the prescribed rate is $5.00, which provides a maximum deduction under the safe harbor of $1,500. The IRS indicated it may revisit the prescribed rate amount in the future. *CCH Federal Tax Weekly No. 4, January 24, 2013.*

If you have any questions about these or any other federal tax developments and their impact on tax planning, please contact our office.

During the fourth quarter of 2012, there were many important federal tax developments. This letter highlights some of the more significant developments for you. As always, give our office a call or email if you have any questions.

Tax legislation

On January 1, 2013, Congress passed the American Taxpayer Relief Act (ATRA). After months of negotiations an agreement between Congressional leaders and the Obama administration finally culminated early on New Year's day. The new law extends permanently the Bush-era tax rates for individuals except for taxpayers with taxable income above $400,000 ($450,000 for married couples filing a joint return and $425,000 for heads of households). Income above these thresholds will be taxed at 39.6 percent, effective January 1, 2013. ATRA also increases the maximum tax rate for qualified capital gains and dividends from the Bush-era rate of 15 percent to 20 percent for higher income taxpayers. The 20 percent rate will apply to the extent that an individual's income exceeds the thresholds for the 39.6 percent rate ($400,000 for single individuals, $450,000 for married couples filing jointly and $425,000 for heads of household). Additionally, ATRA permanently "patches" the alternative minimum tax (AMT), among its many other changes to the Tax Code. *CCH Federal Tax Weekly No. 2, January 10, 2013.*

Payroll tax holiday expires

In 2011 and 2012, wage earners and self-employed individuals paid less in Social Security tax because of a temporary payroll tax cut. The payroll tax holiday reduced the employee-share of Social Security taxes from 6.2 percent to 4.2 percent (with a comparable benefit for self-employed individuals) up to the Social Security wage base for 2012 ($110,100). According to the Treasury Department, an individual earning $50,000 annually received a benefit of approximately $1,000. The maximum benefit was $2,202 for 2012. ATRA did not extend the payroll tax holiday. Consequently, the employee-share of Social Security taxes reverts to 6.2 percent effective January 1, 2013. *CCH Federal Tax Weekly No. 43, October 25, 2012; Issue No. 2, January 10, 2013.*

New Medicare taxes

The IRS issued proposed reliance regulations on the new 3.8 percent Net Investment Income (NII) surtax and the 0.9 percent Additional Medicare Tax. Both taxes were created by the 2010 health care reform legislation and are effective for tax years beginning after December 31, 2012. *CCH Federal Tax Weekly No. 49, December 6, 2012; CCH Federal Tax Weekly No. 50, December 13, 2012.*

NII surtax. NII, the IRS explained, includes interest, dividends, capital gains, passive trade or business income, rents, and royalties, among other items. The IRS also explained some exceptions. The NII surtax generally applies to the lesser of NII or the amount of modified adjusted gross income above a threshold amount ($200,000 for single taxpayers, $250,000 for married couples filing a joint return, and $125,000 for married couples filing separate returns).

Additional Medicare Tax. The 2010 health care reform legislation increased the employee-share of Medicare tax for wages received above certain threshold amounts in any tax year after December 31, 2012 by 0.9 percent. The threshold amounts are $200,000 for single taxpayers, $250,000 for married couples filing a joint return, and $125,000 for married couples filing separate returns. An employer's withholding obligation applies only to the extent that the wages the employee receives from the employer exceed $200,000 in a calendar year.

Foreign accounts

The Treasury Department unveiled its second model agreement (Model Agreement II) to implement the Foreign Account Tax Compliance Act (FATCA). Under Model II, foreign financial institutions will report directly to the IRS about U.S.-owned accounts, supplemented by the exchange of information between the foreign government and the U.S. The first model agreement (Model Agreement I) generally establishes a framework for reporting by foreign financial institutions to their respective governments, followed by the exchange of information under a tax treaty or other agreement. *CCH Federal Tax Weekly No. 47, November 21, 2012.*

In related news, the Treasury Department reported that the United States is negotiating FATCA agreements with more than 50 countries. The U.S. has entered into FATCA agreements with Mexico, Denmark and the United Kingdom, among other countries. *CCH Federal Tax Weekly No. 46, November 15, 2012.*

Repair regulations

In November, the IRS announced that it would delay to tax years beginning after 2013 the application of temporary regulations on the capitalization of expenditures relating to tangible property. Nevertheless, businesses may elect to come under the new rules immediately if they find them more favorable in certain circumstances. The IRS and Treasury expect to issue final "repair" regulations in 2013, also with an effective date of 2014. The repair regulations not only explain how to distinguish a currently deductible repair from a capital expense, but also include some important guidance relating to depreciation under the Modified Accelerated Cost Recovery System (MACRS). *CCH Federal Tax Weekly No. 48, November 29, 2012.*

2013 COLAs

The IRS announced in October that many retirement plan contribution and benefit limits will increase slightly in 2013 because of cost of living adjustments (COLAs). The limits on elective deferrals for employees who participate in 401(k), 403(b) and certain 467 plans increase from $17,000 for 2012 to $17,500 for 2013, and the annual benefit limit under a defined benefit plan increases from $200,000 for 2012 to $205,000 for 2013, among other changes. *CCH Federal Tax Weekly No. 43, October 25, 2012.*

Employer health care mandate

The IRS issued proposed reliance regulations on the Code Sec. 4980H employer shared responsibility provisions ("employer mandate") under the Patient Protection and Affordable Care Act (PPACA). Under the employer mandate starting in 2014, any business classified as a "large employer" will be subject to a shared responsibility payment (an assessable penalty) if, in effect, it offers no insurance or insurance that is not of a specified minimum value that is affordable to one or more lower-income full-time employees.

An applicable large employer is an employer that employed an average of at least 50 full-time (or full-time equivalent) employees during the preceding calendar year. The new regulations fine-tune definitions; rules for determining status as an applicable large employer; rules for determining full-time employees; rules for determining assessable payments; rules for determining whether an employer is subject to assessable payments; and rules on the administration and assessment of assessable payments. *CCH Federal Tax Weekly No. 2, January 10, 2013.*

Disaster relief

The IRS quickly announced a number of relief measures to help taxpayers recover from Hurricane Sandy. It postponed various tax filing and payment deadlines that occurred starting in late October 2012. It reminded taxpayers about special casualty loss deduction rules that allow for an accelerated tax refund. It also temporarily relaxed the rules for retirement plan loans and hardship distributions. *CCH Federal Tax Weekly No. 45, November 8, 2012; No. 47, November 21, 2012.*

Many areas of the United States experienced severe drought conditions in 2012 and the IRS updated its livestock replacement guidance in October. Taxpayers in over 40 states may be eligible for relief under the guidance. *CCH Federal Tax Weekly No. 40, October 4, 2012.*

DOMA

The U.S. Supreme Court announced in December that it will take up a challenge to the federal Defense of Marriage Act (DOMA). The Supreme Court will review an estate tax case (*Windsor, CA-2, October 18, 2012*), in which the Second Circuit held that a surviving same-sex spouse was entitled to the estate tax marital deduction. The IRS previously reiterated on its website in October that it must follow DOMA until the law is repealed or is struck down. *CCH Federal Tax Weekly No. 42, October 18, 2012; CCH Federal Tax Weekly No. 50, December 13, 2012.*

Whistleblowers

The IRS awarded $2 million to a Wall Street whistleblower who exposed a corporation's multi-million dollar tax evasion scheme. The Tax Code authorizes the IRS to reward individuals—whether employees, contractors or others—who provide information about tax evasion. The IRS is expecting the uptick in recent claims to continue. *CCH Federal Tax Weekly No. 41, October 11, 2012.*

Identity theft

The Treasury Inspector General for Tax Administration (TIGTA) cautioned in November that tax-related identity theft is a growing problem. TIGTA also reported that the IRS is using new tools to combat identity theft, such as filters to detect returns that have been filed with stolen identities. According to TIGTA, the IRS prevented the issuance of over $6 billion in fraudulent refunds in 2012. *CCH Federal Tax Weekly No. 46, November 16, 2012.*

IRS administration

IRS Commissioner Douglas Shulman completed his five-year term on November 9, 2012. Shulman, who was appointed by President Bush, was responsible for guiding a number of initiatives at the IRS, including offshore voluntary disclosure programs, the return preparer oversight program and the agency's continuing business systems modernization activities. Until President Obama nominates a new Commissioner, and the Senate approves him or her, IRS Deputy Commissioner Steven Miller is serving as Acting Commissioner. *CCH Federal Tax Weekly No. 42, October 18, 2012; CCH Federal Tax Weekly No. 46, November 15, 2012.*

If you have any questions about these or any other federal tax developments, please contact our office.