

2013 Tax Update

Estate Planning Council of Southeast Denver (EPCSED)

February 11, 2014

By

Fran Coet, CPA/CFF, CVA, CFP, MFFA

Introduction:

Numerous tax law changes and developments occurred in 2013 that impact virtually every individual and business taxpayer. For a “do-nothing” Congress and a 16-day government shutdown, it’s been a busy year, tax-wise.

Legislation:

- **Affordable Care Act (ACA, aka ObamaCare)**
 - 3.8% Surtax on Net Investment Income of Higher Income Taxpayers (IRC §1411)
 - Gross Income from
 - Interest
 - Dividends
 - Sales of property held for investment
 - Rents
 - Royalties
 - Annuities
 - Passive Income
 - Business income from trading in financial securities and commodities
 - Deductions allowed
 - Investment Interest
 - Investment Expenses
 - State and Local Income Taxes allocable to the Investment Income
 - Expenses associated with rental properties
 - Expenses associated with royalty properties

- Business expenses associated with trading in financial securities and commodities
 - Passive Losses (to the extent allowed under IRC §469 marrying PIGs with PALs)
- Not Investment Income
 - Wages
 - Self-Employment Income
 - Rental Activities of Real Estate Professionals
 - Unemployment Compensation
 - Alimony
 - Distributions from Qualified Plans/IRAs
 - Tax Exempt Interest/Other Items that are Tax-Exempt
 - Alaska Permanent Fund Dividends
 - Operating income from a non-passive business
- Triggered at Adjusted Gross Income (AGI) Levels
 - Married Filing Jointly/QW \$250,000
 - Single/Head of Household \$200,000
 - Married Filing Separately \$125,000
 - ***Not Adjusted for Inflation***
- Reported on Form 8960
- Problem Areas:
 - Trusts are subject to 3.8% NIIT at top bracket of \$11,950 taxable income
 - Kiddie Tax attributed income is subject to NIIT
 - Capital losses are really of no consequence for purposes of the NIIT, and in some cases will be wasted for its purposes
 - Although Distributions from Qualified Plans and IRAs and not subject to NIIT, such distributions can serve to lift the AGI and “buoy” other investment income above the AGI levels enumerated above
- Examples
- **.9% Additional Medicare Tax on Earned Income of Higher Income Individuals**
 - Triggered at AGI Thresholds
 - Married Filing Jointly/QW \$250,000
 - Single/Head of Household \$200,000
 - Married Filing Separately \$125,000
 - ***Not Adjusted for Inflation***
 - Reported on Form 8959

- 2014 Excise Taxes and Tax Credits
 - “Individual Mandate”
 - Requires individuals to maintain qualified health insurance coverage, or pay an excise tax with their 2014 1040s
 - The law exempts individuals who are in the US illegally; members of certain religious sects; members of Federally-recognized Indian tribes; incarcerated individuals; certain US citizens living abroad; individuals with household income below the threshold for filing an income tax return; individuals who failed to have “qualified health plan coverage” for less than 3 months during a year; individuals for whom health insurance is “unaffordable” based on the individual’s household income; and, individuals who obtain an economic “hardship exemption certificate” from a state exchange.
 - The excise tax is the *greater* of:
 - \$95 per uninsured adult member of the household, plus \$47.50 per uninsured member of the household under 18, not to exceed \$285 **OR**
 - 1% of “household income” in excess of the income threshold required for filing a Form 1040 return
 - “Household income” is modified AGI (add tax-exempt interest and Form 2555) **plus** the modified AGI of any person you claim as a dependent
 - In no event can the penalty exceed the national average premium for “bronze” level health insurance
 - “Premium Assistance Credit” (PAC)
 - Subsidizes the premiums costs for certain low-and-middle income individuals, or allows a refundable credit (which will be tested on the Form 1040 if the subsidy has been claimed as an offset against the monthly premium)
 - So, if the taxpayer applied for coverage and over-estimated income, there was no subsidy. Then the 1040 is prepared, and the taxpayer would have qualified for subsidy, the PAC would be claimed as a refundable credit on the 2014 1040.
 - “Employer Mandate”
 - Requires employers that employ at least 50 employees to offer qualified health care coverage to employees or pay an excise tax **if at least one full-time employee receives** the PAC

- This provision was postponed in July, 2013. IRS will not enforce this excise tax until 2015.
- **American Taxpayer Relief Act (ATRA) of 2012**
 - Income Tax Rates Increased for Certain Higher-Income Taxpayers
 - Made permanent the “Bush Tax Cuts”
 - Added new “Tax Bracket” at top end – 39.6% beginning
 - Married Filing Jointly/QW \$450,000
 - Head of Household \$425,000
 - Single \$400,000
 - Married Filing Separately \$225,000
 - ***Adjusted for Inflation***
 - Estates and Trusts subject to the new top end bracket of 39.6% (for 2013, at incomes in excess of \$11,950)
 - If taxpayers otherwise in the 39.6% bracket, long-term capital gains and qualifying dividends taxed at 20%; otherwise, the 0%/15% brackets stay in place for other taxpayers
 - PEP and Pease are resurrected
 - Personal Exemptions and Itemized Deductions are once again subject to disallowance and restrictions based upon AGI sensitivities:
 - Married Filing Jointly/QW \$300,000
 - Head of Household \$275,000
 - Single \$250,000
 - Married Filing Separately \$150,000
 - ***Adjusted for Inflation***
 - Alternative Minimum Patch (AMT) Patch made Permanent
 - Certain Temporary Changes to the Estate and Gift Tax Rules Made Permanent
 - ATRA permanently unifies the gift, GST and estate “Exclusion Amounts”
 - “Portability” of deceased spouse’s unused exclusion amount made permanent
 - Selected Tax Extenders
 - Some for 2012 and 2013
 - Some for 2012 through 2014
 - Some for 2012 through 2016
 - Some for 2012 through 2017
 - Allowed in-plan 401(k) conversions to Roth 401(k)s
 - Applies also to 403(b)s

- Effective 01/01/13
- Once converted, there is no recharacterization

Court Decisions

- **United States v. Windsor, S.Ct. 12-307, (06/26/2013).** Edith Windsor had married Thea Spyer in Ontario, Canada in 2007. When Spyer died in 2009, she left her entire estate to Windsor. Windsor sought to claim the exemption on the estate return for surviving spouse, but was barred from doing so by §3 of the federal Defense of Marriage Act (DOMA). Windsor paid \$363,053 in estate taxes, and filed a claim for refund with the Internal Revenue Service contending that DOMA violated the principles of equal protection incorporated in the Fifth Amendment of the US Constitution. The US Supreme Court agreed, struck down DOMA, and the IRS has issued guidance subsequent to the ruling that same-sex couples must file federal returns if they have married in a state that recognizes same-sex marriage (state of celebration) filing as either married filing separate or, at their election, married filing joint. As the ruling serves to amend the Dictionary Act – a law providing rules of construction for over 1,000 federal laws and the whole realm of federal regulations – this decision has far-reaching consequences for pension rights, Social Security, medical information, etc., etc.
- **Terry Ellis, TC Memo 2013-245.** Ellis rolls over \$319,706 from 401(k) to self-directed IRA account. Goes to Law Firm in KC area, sets up LLC to operate used car lot. Operates used car lot for three years – gets salary for the 3 years of +/- \$40k for all 3 years. Ellis reports gross F1099R on his 2005 1040, but reflects that zero of the distribution is taxable. Court said the fact that Ellis took salary from the entity and was the general manager were prohibited transactions. Ellis owed income tax of \$135,936, plus 10% premature distribution penalty, **PLUS** 20% accuracy-related penalty = >\$200k!!!!
- **Mohammad Hassanipour, TC Memo 2013-88.** Taxpayer claimed that he qualified as a “Real Estate Professional” – meaning he devoted more than 750 hours and more than 50% of his time to working on his 28 rental apartments, in spite of his full-time job as a research associate. The Tax Court held that his work timesheets were more reliable than his “post event ballpark guestimates” of the time he spent on his rental properties. See also **Guillermo Merimo, Jr. et ux., TC Memo 2013-167** and **Gary L. Hoskins, et ux., TC Memo 2013-36**.
- **Kayln M. Carpenter, et al v. Commissioner, TC Memo 2013-172.** This was a case for reconsideration for charitable deduction for conservation easements (a Colorado case) which consolidated **Scott A Van Wyhe (15590-10)** and **John C. and Sharon L. Mc Sween (15591-10)**. Decision was against taxpayers. The additional arguments were based on subsequent cases in this area (that even though the

conservation easement in question contained language that allowed the possibility of extinguishment by mutual extinguishment, that language should be ignored under the “so-remote-as-to-be-negligible” standard in determining whether the conservation easement was enforceable into perpetuity). This was one of several cases in this area, and the conservation easement donation has become a new battleground in Tax Court.

- **Erwin v. U.S., 111 AFTR 2d 2013-748.** In 1998, William Pintner hired Buddy Light Accounting & Tax Services (Buddy Light Accounting), and thereby, the Light Brothers (two CPAs) to perform certain duties for GC Affordable Dining, Inc. (GCAD). The duties ultimately included managing payroll and accounts payable, calculating employee withholding tax liability, preparing Form 941 federal withholding reports, and making federal withholding deposits. As time went on, Buddy Light Accounting became more and more involved in the managerial decisions of the business, and cut checks to the owners, not paying the payrolls taxes. Each of the Light Brothers was assessed the Trust Fund Recovery Penalty, along with the business owners, in the amount of \$325,000.

IRS Rulings, Pronouncements, Letter Rulings, etc.:

- December 23, 2014, John Koskinen was sworn in as the 48th Commissioner of the Internal Revenue Service. Prior to his appointment, he served as the non-executive chairman of Freddie Mac from 2008 to 2012 and its acting chief executive in 2009. He has also served as the President of the US Soccer Foundation, Deputy Mayor and City Administrator of Washington, DC, Assistant to the President and Chair of the President’s Council on Year 2000 Conversion and Deputy Director for Management at the Office of Management and Budget.
- **IR News Release 2013-5, Revenue Procedure 2013-13.** IRS announces simplified option for claiming home office deduction starting in 2013. Eligible home-based businesses may deduct up to \$1,500. The \$1,500 is based on \$5 per square feet for up to 300 square feet; if this option is used, there is no reduction of home mortgage interest or real estate taxes for Schedule A purposes.
- **IRS issues Final Regs on Repairs vs. Capitalization.** Because IRS had issued the temporary Regs in December of 2011, and announced in November of 2012 that it planned to issued final Regs in 2013, IRS gives the option of applying either the “final” regulations, the “temporary” regulations (released in 2011), or the older p-re-2011 regulations for the tax years beginning in 2012 and 2013. Further, the final Regs contain provisions that may make it advantageous for taxpayers to:
 - Have written “expensing” policies in place as early as January 1, 2014
 - Amend your 2012 return to retroactively “elect one or more of the safe harbors allowed under the final Regs, or

- Apply for an accounting method change to apply the final Regs to prior years
- **Revenue Procedure 2013-31.** IRS releases new expanded procedure for obtaining automatic relief (without IRS user fee) for certain “late” elections applicable to “S” corporations. This Revenue Procedure supercedes and consolidates several others.
- **IRS Announces That January 31, 2014 will be the first day of the 2013 filing season.**
- The business mileage rate reduces to \$.56 on January 1, 2014; medical and moving mileage reduces to \$.235 on the same date.
- Maximum contributions to traditional and Roth IRAs will remain at \$5,500 for 2014, with \$1,000 catch-up contributions for those 50 and over. Contributions to Simple IRAs will be maximum deferral of \$12,000 for 2014, with catch for those 50 and older of \$2,500; 401(k) and 457 maximum deferrals will be \$17,500 with catch-up of \$5,500 for those age 50 and above; Defined Contribution Limit is \$52,000 on Compensation of \$210,000.
- Social Security wage maximum for 2014 will be \$117,000; earnings limit for those drawing SSA benefits prior to FRA in 2014 - \$15,480; earnings limit for those becoming FRA in 2014 - \$41,400, or \$3,450 per month.
- IRS trains over 35,000 employees on identity theft issues; IRS assigns over 3,000 employees to work identity theft cases. According to TIGTA, there were more than 1.2 million taxpayers affected by identity theft in 2012, and 1.6 million taxpayers affected in 2013 through 06/29/2013. The IRS has developed a PIN system to allow the legitimate taxpayer to file.
- IRS announced in May of 2013 that it is in the process of replacing SSNs with two-dimensional bar codes on most notices.
- In August of 2013, IRS began contacting taxpayers concerning the Forms 1099-Ks. Sent out 20,000 letters – 5035, 5036, 5039 and 5043
- Homeland Security issued revised and updated Form I-9 March 8, 2013.
- IRS issued proposed Reg 1.469-5(e) after losing several cases involving LLC members and passive activity rules of IRC §469. At issue is whether or not LLC members were properly treated as limited partners for purposes of passing the material participation tests. The courts ruled an LLC member is not the same as a limited partner and may in some cases be a general partner when applying the passive activity rules. The new proposed regulations would treat a member as a limited partner (more likely to be passive) if:
 - The entity is classified as a partnership for tax purposes and
 - The member does not have rights to manage the entity at all times during the tax year.
-

