

**THE UNIVERSITY OF TENNESSEE
2013 SINGLETON B. WOLFE
MEMORIAL TAX CONFERENCE
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**2013 Federal Income Tax Update with
The American Taxpayer Relief Act of 2012 ©**



JOHN D. HOUSTON, CPA

Certified Public Accountant

TAX CONSULTING & CPA SERVICES

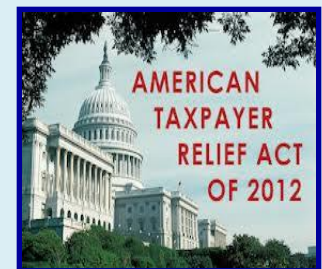
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2013 Federal Income Tax Update with the American Taxpayer Relief Act of 2012 © “ATRA 2012”

A. ATRA 2012 Legislative Summary and Transition

B. Individual and fiduciary taxpayers

- 1. Ordinary income tax rates and brackets**
- 2. Capital gain and dividend tax rates**
- 3. Medicare 0.9% surtax on earned income**
- 4. Medicare 3.8% surtax on net investment income (NII)**
- 5. Individual Alternative Minimum Tax (AMT)**
- 6. Individual tax deductions and exemptions**
- 7. Individual deduction inflation adjusted amounts**
- 8. FICA and SECA inflation adjusted amounts**
- 9. Retirement plan inflation adjusted amounts**



2013 Federal Income Tax Update with the American Taxpayer Relief Act of 2012 © “ATRA 2012”

C. Business taxpayers

- 1. Corporate income tax rates and brackets**
- 2. Tax Depreciation and expense election provisions**
- 3. Business tax credits**

D. Federal income tax update – Cases and IRS rulings

- 1. Selected Federal Court tax related cases**
- 2. Internal Revenue Service regulations, rulings and releases**

E. Tax planning considerations



A - 1 ATRA 2012 Legislative Summary & Transition from 2012 to 2013

- A. Act Section 101 – Permanently extend and modify The Economic Growth and Tax Relief Act of 2001 and the Tax Relief and Job Creation Act of 2010**
- B. Act Section 102 – Permanently extend and modify The Jobs and Growth Tax Relief Act of 2003**
- C. Act Section 103 – Five year extension through 2017 of 2009 tax relief legislation for the American Opportunity, Child, and Earned Income tax credits**
- D. Act Section 104 – Permanently extend Alternative Minimum Tax (AMT) exemption amount inflation adjustments and AMT allowance of NR tax credits**

A - 2 ATRA 2012 Legislative Summary & Transition from 2012 to 2013

- E. Act Sections 201 – 209 – Individual Tax Extensions**
- F. Act Sections 301 – 331 – Business Tax Extensions**
- G. Act Sections 401 – 412 – Energy Tax Extensions**
- H. Act Sections 501 – 504 – Unemployment Benefits**
- G. Act Sections 601 – 610 – Medicare Extensions**
- H. Act Sections 621 – 625 – Other Health Extensions**
- I. Act Sections 631 – 644 – Other Health Provisions**
- J. Act Sections 701 – 702 – Agricultural Extensions**
- K. Act Sections 801 – 802 – Miscellaneous Provisions**

B - 1 Ordinary Income Tax Rates for Individuals – 2013 Tax Year

2013 Tax Rate Schedule – Single

- 10% Bracket \$ -0- to \$ 8,925
- 15% Bracket \$ 8,925 to \$ 36,250
- 25% Bracket \$ 36,250 to \$ 87,850
- 28% Bracket \$ 87,850 to \$ 183,250
- 33% Bracket \$ 183,250 to \$ 398,350
- 35% Bracket \$ 398,350 to \$ 400,000
- 39.6% Bracket \$ 400,000 and up

Tax on \$398,350 = \$ 115,586.25 (29.02%)



B - 1 Ordinary Income Tax Rates for Individuals – 2013 Tax Year

2013 Tax Rate Schedule – Married Filing Joint

• 10% Bracket	\$ -0-	to	\$ 17,850
• 15% Bracket	\$ 17,850	to	\$ 72,500
• 25% Bracket	\$ 72,500	to	\$ 146,400
• 28% Bracket	\$ 146,400	to	\$ 223,050
• 33% Bracket	\$ 223,050	to	\$ 398,350
• 35% Bracket	\$ 398,350	to	\$ 450,000
• 39.6% Bracket	\$ 450,000	and up	

Tax on \$398,350 = \$107,768.50 (27.05%)

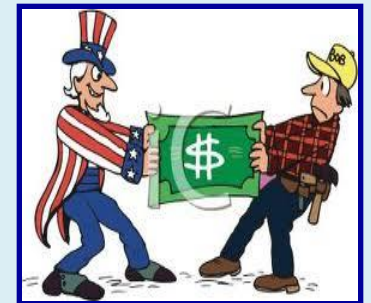
Marriage Tax Penalty = \$7,817.75



B - 1 Ordinary Income Tax Rates for Estates and Trusts – 2013 Tax Year

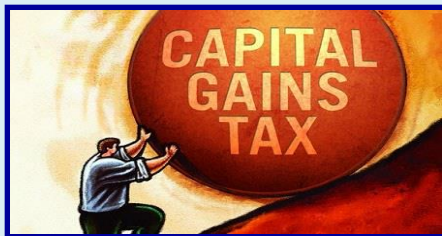
2013 Tax Rate Schedule – Trusts & Estates

- 15% Bracket \$ -0- to \$ 2,450
- 25% Bracket \$ 2,450 to \$ 5,700
- 28% Bracket \$ 5,700 to \$ 8,750
- 33% Bracket \$ 8,750 to \$ 11,950
- 39.6% Bracket \$ 11,950 and up



B - 2 Individual LT Capital Gain and Qualified Dividend Tax Rates – 2013

<u>Modified Taxpayer AGI</u>	<u>Sch D Rate</u>	<u>w/ Medicare</u>
Taxpayers 10% -15% bracket	0.00%	0.00%
Single < \$200,000	15.00%	15.00%
Single \$200,000 - \$400,000	15.00%	18.80%
Single > \$400,000	20.00%	23.80%
Married < \$250,000	15.00%	15.00%
Married \$250,000 - \$450,000	15.00%	18.80%
Married > \$450,000	20.00%	23.80%



B - 2 Individual LT Capital Gains - 2013 Additional Rates and Considerations

Other Individual Capital Gain (Loss) Provisions

- IRC Section 1250 Depreciation LT Rate 25%
- Art, Coins, and Metals LT Collectible Rate 28%
- Annual Limitation for Net Capital Losses \$ 3,000
- Long term Asset Holding Period > 1 Year
- Net LT Capital Gain Rates Allowed for AMT Tax

Purposes Except 3.8% Medicare Surtax on NII



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B - 2 Individual Qualified Dividends – Definitions and Considerations

- Qualified Dividend Tax Rates = LT Capital Gain Rates
- Qualified Dividends Paid from Accumulated Earnings and Profits by Domestic and Qualified Foreign Corporations
- Non Qualified Dividends - Mutual Funds Holding Bonds and Non Equity Securities and Real Estate Investment Trust (REIT) Corporate Deductible Dividends
- Anti-Churning and Other Restrictions Continue to Apply
- Net Qualified Dividend Rates Allowed for AMT Tax purposes except for 3.8% Medicare Surtax on NII



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B - 3 Individual 0.9% Medicare Earned Income Surtax – 2010 PPACA

- A. Effective January 1, 2013 per 2010 Health Care Act**
 - 0.9% Medicare Earned Income Surtax on HI Taxpayers is Applicable to Aggregate Taxpayer Salaries and Wages and and Self-Employment Income for Higher Income AGI Over:
 - \$200,000 (single)
 - \$250,000 (married filing jointly)
- B. Medicare 0.9% Surtax excluded in 50% SECA Deduction**
- C. Employers Withhold Above \$200,000 in Wages**
- D. Only Medicare Taxable Salaries and Wages and Self-Employment Income is Subject to 0.9% Medicare Surtax**
 - S Corporation and LLC Trade or Business Income not treated as Self-Employment Income not Subject to 0.9% Med Surtax



B - 4 Individual 3.8% Medicare Net Investment Income Surtax – 2010 PPACA

- A. Effective January 1, 2013 per 2010 Health Care Act**
- **3.8% Medicare Investment Income Surtax on HI Taxpayers is Applicable to Taxpayers with Higher Income AGI Over:**
 - \$200,000 (single)
 - \$250,000 (married filing jointly)
- B. Applies to Net Investment Income (NII) as Defined Including Interest, Dividends, NQ Annuities, most Rents, Net Income from Passive Activities, and Non Business Capital Gains**
- C. 3.8% Medicare NII Surtax excluded in 50% SECA Deduction**
- **S Corp and Non SE Trade or Business Income is not NII**
- D. IRS Form 8960 – Net Investment Income Tax (Draft Version)**



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B - 5 Individual Alternative Minimum Tax (AMT) – 2013 Tax Year

- A. Exemption Amounts for Individual AMT are finally Permanent and Indexed for Inflation
- B. Individual AMT Exemption Amounts for 2013:
 - Single and HH - \$51,900
 - Married filing joint - \$80,800
- C. Net LT Capital Gain and Qualified Dividend Regular Tax Rates (excluding 3.8% Medicare NII Surtax) Allowed for AMT Tax
- D. Nonrefundable Individual Tax Credits (e.g., Child, Education, Savers, Energy and Electric Vehicle) Permanently Allowed for AMT Tax Calculation



B - 5 Individual Alternative Minimum Tax (AMT) – 2013 Tax Year

- E. Individual AMT Provision that Adversely Impacts Middle and Upper Income Taxpayers is the AMT Exemption Phase-out Equal to 25% for each Dollar AMTI Exceeds Thresholds of:**
- \$112,500 (Single)
 - \$150,000 (Married Filing Joint)
 - AMTI Income Phase-out Ranges not Inflation Indexed
- F. Principal Itemized Deductions Allowed for AMT include Home Mortgage Acquisition Interest and Charitable Donations**
- Itemized Deductions Not Allowed for AMT include State and Local Taxes and Miscellaneous Itemized Deductions
- G. Individual AMT Tax Preferences include Private Activity Bond Interest, ISO Stock Options, and Regular > AMT Depreciation**

B - 6 Individual Tax Deductions ("Extenders") – 2013 and Beyond?

A. Sales Tax Deduction Extended Through 2013

- **Itemized Deduction for State and Local Sales Tax**
Allowed in lieu of Deduction for Income Taxes
- **IRS Will Update General Sales Tax Tables Based on Taxpayer AGI and State and City of Domicile**
- **Actual Sales Taxes may be used in lieu of Table**
- **IRS Table Amounts may be increased for Tax Paid on "Big Ticket" items (vehicles, boats, etc.)**



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B - 6 Individual Tax Deductions ("Extenders") – 2013 and Beyond?

B. Direct IRA Charity Distribution Extended for 2013

- **Taxpayers > Age 70 ½ may transfer up to \$100,000
From an IRA Directly to a Public Charity as a Tax
Free Distribution from an IRA Account**
- **A Qualified Charitable Donation (QCD) is Excluded
From AGI Versus Claiming Itemized Deduction**
- **QCD Donation Applies Toward RMD Amount**
- **Special Retroactive Rule Allowed January 2013 PY
Change for December 2012 IRA RMD Distributions**

B - 6 Individual Tax Deductions (“Extenders”) – 2013 and Beyond?

C. Individual Tax Provisions Extended for 2013

- Teachers Class Expense Deduction up to \$250
- AGI Qualified Tuition Deduction up to \$4,000
- Exclusion up to \$2,000,000 for Cancellation of Debt (COD) Income on Principal Residence
- Parity in Employee Transit Benefits Tax Free Fringe
- Extension of Mortgage Insurance Premium Treated As Qualified Residence Interest
- Extension of Conservation RE Donation Special Rule

B - 6 Itemized Deduction Phase-out Reinstated for 2013 Tax Year

D. “Pease” Limitation on Itemized Deductions

- Starting in 2013, Taxpayers With AGI Above New Thresholds Subject to 3% Reduction to Extent Taxpayer AGI Exceeds the Following:
 - \$250,000 (single), \$275,000 (HH), \$300,000 (joint)
- Investment Interest, Medical Expenses, & Casualty Losses not Subject to 3% Pease Disallowance
- Itemized Deductions Disallowed Limited to 80% of Total Itemized Deductions

B - 6 Phase-out of Personal Exemptions Reinstated for 2013 Tax Year

E. Phase-out of Personal Exemptions

- **Starting in 2013, the Personal Exemptions for Taxpayers With AGI Above New Thresholds Will Phase-out at a Rate of 2% of each \$2,500 of Taxpayer AGI Exceeding the Following:**
 - **\$250,000 (single)**
 - **\$275,000 (head of household)**
 - **\$300,000 (married filing joint)**



B - 7 Individual Inflation Adjusted Amounts – 2013 Tax Year

Standard Deductions

- **Single Taxpayers – 2013** **\$ 6,100**
- **Head of Household – 2013** **\$ 8,950**
- **Married Filing Joint Return – 2013** **\$ 12,200**

Personal Exemptions – 2013 **\$ 3,900**

“Kiddie” Tax Threshold – 2013 **\$ 2,000**



B - 8 FICA and SECA Inflation Adjusted Amounts – 2013 Tax Year

A. FICA Taxes

- Social Security – 2013 Employee 6.20%
- Social Security – 2013 Employer 6.20%
- Social Security – 2013 Wage Limit \$113,700
- Social Security – 2014 Wage Limit (estimate) \$115,500
- Medicare – 2013 Employee 1.45%
- Medicare – 2013 Employer 1.45%

B. SECA Taxes

- Self Employment Tax – 2013 15.30%



B - 9 Retirement Plan Inflation Adjusted Amounts – 2013 Tax Year

A. Individual Retirement Account (IRA) Limits

- Taxpayers < Age 50 – 2013 \$ 5,500
- Taxpayers Age 50 + Additional \$ 1,000
- Roth IRA Conversion AGI Limit None
- Roth IRA Contribution AGI Phaseout Range -
 - Single and Head of Household \$112,000 - \$127,000
 - Married Filing Joint \$178,000 - \$188,000

B. 401(k) Plan and Simple Plans Elective Limits

- 401(k) Elective Deferrals – 2013 \$17,500
- SIMPLE Plans Elective Deferrals – 2013 \$12,000
- 401(k) Catch up for Ages 50+ \$ 5,500
- SIMPLE Catch up for Ages 50+ \$ 2,500

B - 9 Retirement Plan Inflation Adjusted Amounts – 2013 Tax Year

C. Defined Contribution Plan Annual Limits

- IRC 401 Compensation Limit – 2013 \$255,000
- IRC 415 Max Annual Amount – 2013 \$ 51,000

D. Defined Benefit Plan Annual Limits

- Maximum Annual Benefit – 2013 \$205,000



C - 1 Regular Corporate Income Tax Rates – 2013 Tax Year

2013 Tax Rate Schedule – Corporations

- **15% Bracket** \$ -0- to \$ 50,000
- **25% Bracket** \$ 50,000 to \$ 75,000
- **34% Bracket** \$ 75,000 to \$ 100,000
- **39% Bracket** \$ 100,000 to \$ 335,000
- **34% Bracket (1)** \$ 335,000 to \$10,000,000
- **35% Bracket (2)** over \$10,000,000

(1) Flat 34% Rate on income up to \$10,000,000

(2) Flat 35% Rate on income over \$18,333,333



C - 2 Business Tax Bonus Depreciation - 2013 Tax Year

A. IRC Section 168(k) Bonus Depreciation Extension

- The 50% IRC Special Bonus Depreciation Deduction for Qualified Property in effect for 2012 Tax Year Extended through December 31, 2013
- Special Rules for Federal Long-term Contracts and Election to Accelerate AMT Credit in Lieu of Bonus Depreciation Also Extended



C - 2 Business Tax Bonus Depreciation – 2013 Tax Year

B. IRC Section 168(k) Bonus Depreciation Key Rules

- **Qualifying New Tangible Personal Property 20 Years or Less MACRS Recovery Period**
- **Computer Software and Leasehold Improvement Property (e.g., interior build out) Also Qualifies**
- **Option to Elect out for 100% of Asset Class**
- **Bonus Depreciation Not Accepted in Most States**
- **IRC Section 168(k) 50% Bonus Depreciation Scheduled To Expire on January 1, 2014**

C - 2 IRC Section 179 Expense Election – 2013 Tax Year

C. IRC Section 179 Expense Election Amounts

- IRC Section 179 Small Business Expensing Dollar Limit Increased to \$500,000 for 2012 and 2013
- IRC Section 179 Maximum Annual Investment Limit Increased to \$2,000,000 for 2012 and 2013
- Used Tangible Personal Property Qualifies
- IRC Section 179 Expensing Dollar Limit Scheduled To Decrease to \$25,000 on January 1, 2014



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C - 2 Special 15 Year MACRS Recovery Period – 2013 Tax Year

D. 15 Year MACRS Recovery Period Reinstated

- **Special 15 Year MACRS Recovery Period for Three Property Types was Reinstated for 2012 and 2013:**
 - Qualified Leasehold Improvement Property
 - Qualified Restaurant Property
 - Qualified Retail Property



C - 3 Business Tax Credits – 2013 Tax Year

A. IRC Section 41 Research Tax Credit Reinstated

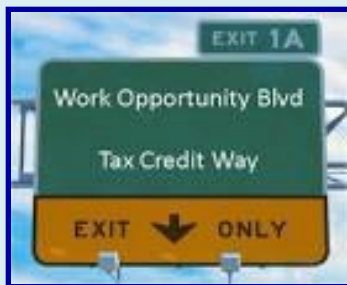
- **IRC Section 41 Credit for Qualifying Research (R&D) Expenditures Reinstated for 2012 and 2013**
- **Reinstated IRC Section 41 R&D Credit Retains the 14% Alternative Research Credit % for Excess of 50% of Average Qualified R&D Expenditures for the Preceding Three Years**



C - 3 Business Tax Credits – 2013 Tax Year

B. Work Opportunity Tax Credit (WOTC) Reinstated

- The Work Opportunity Tax Credit (WOTC) was Reinstated and Includes Eligible Workers Hired from January 1, 2012 through December 31, 2013
- The Reinstatement and Extension of Empowerment Zone Tax Incentives for 2012 and 2013 Also May Expand WOTC Eligibility in Certain Situations



D - 1 Selected Federal Court Tax Decisions Through October 15, 2013

- A. *E.S. Windsor* (U.S. Supreme Court, June 26, 2013)
Removed Section 3 of Defense of Marriage Act (DOMA)
- 2013 + Tax Years – Married Filing Joint or Married Separate
 - 2012 Tax Year – Optional Married Filing Joint or Separate
 - 2011 and Prior Tax Years – May Amend Open Tax Years
- B. *U.S. v Quality Stores* (U.S. Appeals 6th Circuit, 2013-1)
- Appeals Court rules employer supplemental unemployment benefit (SUB) payments do not constitute wages subject to FICA taxation
 - Ruling is in direct conflict with Federal Circuit *CSX* Case



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D - 1 Selected Federal Court Tax Decisions Through October 15, 2013

C. *Vancouver Clinic v U.S.* (WD Washington, 2013-1)

- District Court held that employer advances to newly hired physicians identified as “loans” were in fact compensation for services subject to FICA taxation and withholding

D. *Glass Blocks v Comm* (Tax Court Memo, 2013-180)

- Tax Court ruled that distributions made by an S corporation were wages subject to employment taxes as opposed to S corporation distributions or loan repayments
- Key point in government case was failure of S corporation to pay wages or file Forms W-2 or 1099-MISC



D - 2 Selected IRS Rulings, Regulations, and Releases through October 15, 2013

A. Proposed Regulation NRPM-148873-09

- IRS releases proposed regulations to allow optional truncated taxpayer identification numbers (TTINs) for use on paper or electronic payee statements on Forms 1099 and 1098 but not on Forms W-2

B. IRS Ruling CCA 201310028

- The IRS has determined that heating, ventilation, and air conditioning (HVAC) units located outside a building (either on the roof or on the ground) do not constitute qualified leaseholds and must be depreciated over either a 27.5 year or 39.0 year MACRS recovery period



D - 2 Selected IRS Rulings, Regulations, and Releases through October 15, 2013

C. IRS Website Announcement circa July 2, 2013

- IRS announced that certain corporations and partnerships with assets of \$10,000,000 but less than \$50,000,000 will be permitted to file Schedule M-1 in lieu of Schedules M-3 Parts II and III starting with the 2014 tax year

D. IRS Notice 2013-45 (IRS 2013-31)

- President Obama announced in July 2013 that employer-responsibility payment provisions of the PPACA Act (ObamaCare) are not effective on January 1, 2014 and are deferred by Executive Order until January 1, 2015



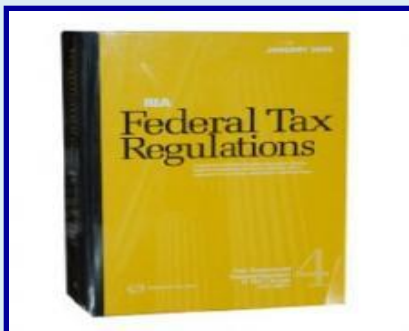
D - 2 Selected IRS Rulings, Regulations, and Releases through October 15, 2013

E. Final Section 5000A Regulations (T.D. 9632)

- IRS issues final regulations on the individual healthcare mandate provisions of the PPACA Act (ObamaCare) that take effect on January 1, 2014. “Minimum essential coverage” will include employer-sponsored coverage, Medicare and Medicaid, and government-provided plans

F. Proposed Regulation NPRM REG-130507-11)

- IRS issues proposed regulations which attempt to sort out and simplify the applicability of the 3.8% Medicare Surtax on Net Investment Income (NII) to rental income



E - 1 Individual Income Tax Planning – Post ATRA 2012

Individual AGI > \$200,000 (single), \$250,000 (married)

- **Higher Income Taxpayer Federal Tax Rates**
 - Ordinary Taxable Investments **31.8% - 43.4%**
 - LT Capital Gains & Qualified Dividends **18.8% - 23.8%**
- **Tax Deferral from Retirement Plan Contributions (< age 50):**
 - Individual Retirement Accounts **\$ 5,500**
 - 401(k) Plan Elective Deferrals **\$ 17,500**
 - Simple Plans **\$ 12,000**
 - Defined Contribution (Profit Sharing) & Simplified Employee Pension (SEP) **\$ 51,000**



E - 2 Business Income Tax Planning – Post ATRA 2012

A. All Business Taxpayers

- **Favorable 50% Bonus Depreciation and \$500,000 Section 179 Expense Elections Available for Calendar 2013**
- **S Corporation Income and Non SE Partnership Business Income Generally Not Subject to new Medicare Surtaxes**
- **Privately Held Companies May Need to Reconsider Their Choice of Business Entity Under Following Scenarios:**
 - **Annual Taxable Income in Excess of \$500,000**
 - **Operating Entity with major Real Estate Holdings**
 - **Near term Potential Sale of Assets or Liquidation**



E - 2 Business Income Tax Planning – Post ATRA 2012

B. C Corporation – Reasons to Consider C Corp

- **Federal Corporate Income Tax Rate of 34% for Taxable up to \$10,000,000 and 35% Rate Thereafter**
- **C Corporations Offer the Maximum Debt and Equity Capital Alternatives (e.g., access to major capital markets)**
- **C Corporations Have Considerable Flexibility in Choice of Tax Accounting Year and Offer Maximum Flexibility in Shareholder Retirement Programs and Fringe Benefits**
- **C Corporation Shareholders Active in Business Classified as Employees for Federal Income Tax Purposes**



E - 2 Business Income Tax Planning – Post ATRA 2012

B. C Corporation – Reasons to Consider C Corp

- **Use of Second Entity for Real Estate and Other Investment Assets in Can Mitigate Potential Double Taxation Issues**
- **C Corporations can pay Qualified Dividends to Individual and Fiduciary Shareholders who Receive Lower Tax Rate**
- **Shareholders Investing in C Corporation Stock That Qualifies as Small Business Stock Under IRC Section 1244 Entitled to Ordinary Loss up to \$50,000 (single) and \$100,000 (joint) on Sale or Abandonment**



E - 2 Business Income Tax Planning – Post ATRA 2012

C. S Corporation – Reasons to Consider S Corp

- Shareholders of S Corporations are Treated as Employees for Federal Employment Tax Purposes
- Assuming Reasonable Shareholder Compensation, S Corp Profits Are Not Subject to SECA or 0.9% Medicare Surtax
- Federal Income Tax on S Corporation Profits is Calculated and Paid at the Shareholder Level (No Double Taxation)
- Shareholders of Large and Highly Profitable S Corporations Will Pay a 39.6% Federal Income Tax Rate which Compares To a 34% Tax Rate for Most C Corporations (15+% more)



E - 2 Business Income Tax Planning – Post ATRA 2012

D. Limited Liability Co – Reasons to Consider LLC

- Limited Liability Companies (LLCs) taxed for Federal Income Tax Purposes as a Partnership Offer Liability Protection With Benefits of Partnership Flow Through Taxation
- LLCs are Preferred Investment Entities for Real Estate, Natural Resource Development, and Many Professionals
- Manager Managed LLC With Operating Agreement Can Protect Limited Members from SECA and Medicare Surtax
- Single Member LLCs can Offer Additional Liability Protection and Be Treated as a Subsidiary for Federal Income Tax Purposes When Owned by Other Limited Liability Entities

