YEAR-END 2013

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TAX TIPS & news

This Issue Includes:

Make the Most of Your Deductions

As you plan for your tax year, keep in mind that you benefit from itemizing your tax deductions if they exceed the standard deduction; sometimes when you are subject to the alternative minimum tax (AMT), it is beneficial to itemize even if the result is less than the standard deduction. The following is a run-down on itemizing your deductions.

Bunching Deductions: If your allowed deductions exceed the standard deduction, you will want to itemize them. Itemized deductions consist of five basic categories, each with its own limitations and special considerations. If your deductions only marginally exceed the standard deduction, consider "bunching" your deductions in one year. You can bunch your deductions by pre-paying some of your expenses in one year, such as your church contributions. This allows you to produce higher than normal itemized deductions that year and then take the standard deduction the other year. Also consider pre-paying your state's January estimated tax payment in December, or paying your property tax in full rather than in installments carrying over to the next year.

Medical Expenses: Deductible medical expenses are limited to unreimbursed expenses for you, your spouse if married, and dependents, that exceed 10% (7.5% if age 65 or older) of your adjusted gross income (AGI) for the year. If you are 65 or older, for AMT purposes, your medical deduction will be lower because only the excess of unreimbursed expenses above 10% of your AGI is deductible.

Don't overlook some less common deductions such as:

- The cost of a weight-loss program (not including food) for the treatment of a specific disease or diseases (including obesity) diagnosed by a physician.
- Medicare-B premium payments and Medicare-D premiums for drug coverage.
- Participation in smoking-cessation programs and for prescribed drugs (but not non-prescription items such as gum or patches) designed to alleviate nicotine withdrawal.
- Elder care, generally including the entire cost of nursing homes, homes for the aged, and assisted living facilities.
- Medical dependents: For medical purposes, an individual may be a dependent even if his gross income precludes a dependency exemption, thus enabling you to deduct the individual's medical expenses that you paid.

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Are You Ready For Mandatory Health Insurance in 2014?

Beginning in 2014, the Patient Protection & Affordable Care Act imposes the new requirement that US persons, with certain exceptions, have minimal essential health care insurance. A penalty, payable with the individual's income tax return, may apply to those who don't have the required health care coverage. A minimum essential health care policy is one in which the insurer pays 60% of the average medical expenses incurred by an average person over the course of one year. How this will impact your family will depend upon a number of issues.

Already insured: If you will already be insured through an employer plan, Medicare, Medicaid, the Veterans Administration, or a private plan that provides minimal essential care, then you will not be subject to any penalties under this new law.

Exempt from the mandatory insurance requirement: The following individuals will be exempt from the insurance mandate and will not be subject to a penalty for being uninsured:

- Individuals who have a religious exemption;
- Those not lawfully present in the United States;
- Incarcerated individuals;
- Those who cannot afford coverage based on formulas contained in the law;
- Those who have income below the federal income tax filing threshold;
- Those who are members of Indian tribes;
- Those who were uninsured for short coverage gaps of less than three months; or
- Those who have received a hardship waiver from the Secretary of Health and Human Services, who are residing outside of the United States, or who are bona fide residents of any possession of the United States.

Lower Income Subsidies: Individuals and families whose household income is between 100% and 400% of the federal poverty level will qualify for a varying amount of subsidy to help pay for the insurance in the form of a Premium Assistance Credit. To qualify for that credit, the insurance must be acquired from an insurance exchange operated by the applicant's state or by the Federal Government, and the applicant cannot be eligible for minimal essential coverage through Medicaid, Medicare, employer-sponsored insurance, or other acceptable types of coverage. Exchanges are currently accepting applications for insurance that will become effective January 1, 2014.

It is important to note that the subsidy is really just a tax credit based upon family income. It can be estimated in advance and used to reduce the monthly insurance premiums; it can be claimed as a refundable credit on the tax return for the year; or it can be some combination of both. However, it is based upon the current year's income and must be reconciled on the tax return for the year. If too much was used as a premium subsidy, it must be repaid. If there is excess, it is refundable.

If household income is below 100% of the poverty level, the individual or family qualifies for Medicaid.

Penalty for noncompliance: The penalty for noncompliance will be the greater of either a flat dollar amount or a percentage of income:

- For 2014, $95 per uninsured adult ($47.50 for a child) or 1 percent of household income over the income tax filing threshold.
- For 2015, $325 per uninsured adult ($162.50 for a child) or 2 percent of household income over the income tax filing threshold.
- For 2016 and beyond, $695 per uninsured adult ($347.50 for a child) or 2.5 percent of household income over the income tax filing threshold.

Flat dollar amounts: The flat dollar amount for a family will be capped at 300% of the adult amount. For example, the maximum in 2016 for a family will be $2,085 (300% of $695). The child rate will apply to family members under the age of 18.

Overall penalty cap: The overall penalty will be capped at the national average premium for a minimal essential coverage plan purchased through an exchange. This amount won't be known until a later date.

Avoid Home Cancellation of Debt Income

When a taxpayer settles a debt for less than its full amount, the forgiven amount of the debt is taxable, unless the taxpayer qualifies for one of two currently available exclusions. With the downturn in the economy and the accompanying drop in home prices that occurred in recent years, many taxpayers are unable to keep up the mortgage payments on their home, and unable to sell their homes because they owe more than the market price. As a result, a large number of homeowners have let their homes go back to the lender.

Congress offered help for those in this situation by providing an exclusion from income of the forgiven acquisition debt from a taxpayer's principal residence. If a taxpayer's home is upside down, and they are considering letting it go back to the lender, they should be aware that unless Congress provides a last-minute extension, this Principal Residence Acquisition Debt Relief Exclusion will expire at the end of 2013. The only other exclusion available is the insolvent taxpayer exclusion, which limits the amount that can be excluded to the excess of the taxpayer's total debts over the taxpayer's total assets.

An individual not able to exclude the forgiven debt on their home using the insolvent taxpayer exclusion may wish to act before year's end. The tax implications of forgiven debt are very complicated and not all the details are covered in this article. You are strongly urged to contact this office if you are contemplating letting your home go back to the bank.

(Make the Most of Your Deductions Cont'd...)

- A child of divorced parents is considered a dependent of both parents for medical expenses purposes (so that each parent may deduct the medical expenses he or she pays for the child.)

Generally, travel costs (not including meals) may be a deductible expense if the trip is primarily for medical purposes. Cosmetic surgeries are generally not deductible.

Taxes: Deductible taxes primarily consist of real property taxes, state and local income taxes, and personal property taxes. Planning tip: Because taxes are not deductible for AMT purposes, you should attempt to minimize the payment of taxes in a year you are subject to the AMT if you can avoid late payment penalties for the tax payments. Where property taxes were paid on unimproved and unproductive real estate, you can annually elect to capitalize the taxes in lieu of deducting them (add the amount paid to your cost basis for the property).

For 2013, you have the option of deducting on Schedule A as part of your itemized deductions the LARGER of: (1) state and local income tax paid, or (2) state and local sales tax you paid during the year.

Interest: The only interest expenses that are deductible as itemized deductions are home mortgage interest and investment interest. Although this category does not have an AGI limitation, each interest type has special limitations. Home mortgage interest is limited to the interest paid on acquisition debt that does not exceed $1 million and home equity debt (not exceeding $100,000) on your main home and a designated second home.

Investment interest is interest on debts incurred to acquire investments such as securities or land. The investment interest deduction is limited to net investment income (investment income less investment expenses), and any excess not deductible in the current year is carried over to future years. Interest on debt to acquire tax-free investment income is not deductible.

Charitable Contributions: All cash contributions, regardless of the amount, must be documented with a written verification from the charity or a bank record. Non-receipted cash contributions are not deductible. Non-cash contributions also require an acknowledgement of the contribution from the qualified charitable organization, except for donations of $250 or less left at unmanned drop points.

Vehicle (including boat and plane) contributions are generally limited to $500 and require a Form 1098-C to verify the deduction. A larger amount can be deducted if certain special conditions are met. Call for additional information.

Miscellaneous Deductions: Miscellaneous deductions fall into two basic categories: those that are reduced by 2% of your AGI and those that are not.

- Those Subject to the 2% Reduction: This category generally includes your investment expenses, costs of having your tax return prepared, and employee business expenses.
- Those NOT Subject to the 2% Reduction: This category includes gambling losses, personal casualty losses, repayments of income reported in prior years, and estate tax deductions.

Overall Itemized Deduction Limitation: If your 2013 adjusted gross income exceeds $300,000 for joint filers or a surviving spouse, $275,000 for heads of household, $250,000 for single filers, and $150,000 for married taxpayers filing separately, your total itemized deductions will be limited, adding another factor to consider for planning purposes. If the limitation applies to you, the total amount of your itemized deductions is reduced by 3% of the amount by which your AGI exceeds your threshold amount listed above, with the reduction not to exceed 80% of your otherwise allowable itemized deductions. The threshold amounts are inflation-adjusted for tax years after 2013.

Take Advantage of the IRA-to-Charity Transfer

For 2013, if you are age 70½ and over, you are allowed to make direct distributions (up to $100,000) from your Traditional or Roth IRA account to a charity. The distribution is tax free, but there is no charitable deduction, and the distribution can count toward your required minimum distribution (RMD). This provision can be very beneficial for a taxpayer who is inclined to make substantial charitable contributions for the year and:

- Receives Social Security (SS) benefits, and the taxpayer's required minimum distribution for the year causes an increase in the tax on the SS benefits; or
- Is unable or is marginally able to itemize deductions for the year.

Example: *A 75-year-old married taxpayer's adjusted gross income (AGI) before taking his RMD is $28,000. His RMD for the year is $10,000, and he wishes to contribute $8,000 to the building fund for his house of worship. If he takes his RMD and then contributes the $8,000 to the building fund, his AGI will be $38,000; it will be more, if his income includes SS benefits. On the other hand, if he makes a direct transfer of the $8,000 to his house of worship, his AGI would only be $30,000; some or all of his SS benefits would be tax free, depending how much he receives in SS benefits.*

Arranging a direct transfer may require some extra time, so if you want to donate some of your IRA to a charity, don't wait until the last minute to make arrangements with your IRA trustee to do so.

The higher a taxpayer's income tax bracket, the greater the tax benefits when making a direct IRA-to-charity distribution. Please contact this office if you have questions related to the tax benefits derived from this strategy.

Nov. 2013 - Apr. 2014

Tax Calendar

November-December 2013:
It's time for 2013 year-end and 2014 tax planning. Call now if you have a substantial increase in income or fewer deductions.

December 31, 2013:
- Last day to pay deductible expenses for the 2013 return. IRA, SEP, or Keogh contributions can be made after Dec. 31, 2013.
- Last day to set up a Keogh Retirement Account for 2013.
- Last day for individuals who turned 70½ in 2012 or in a prior year to withdraw their IRA required minimum distribution for 2013.

January 1, 2014:
- Unless exempt, individuals and families must have minimal essential health care insurance or face the possibility of penalties for 2014.

January 15, 2014:
- The fourth-quarter 2013 federal individual estimated tax payment is due, unless the 2013 return is filed by January 31, 2014 and the entire balance due is paid with the return. State due dates may vary.

January 31, 2014:
Deadline for businesses to provide 1099s to contractors and W-2s to employees they paid during 2013. 1099s are required for payments of $600 or more for the services by individuals (other than employees) during the year.

February 28, 2014:
This is the deadline for filing (sending) 2013 Forms 1099 and W-2 to the government.

March 1, 2014:
This is the last day for a farmer or fisherman who owed, but did not pay, estimated tax by January 15, 2014 to file a 2013 calendar-year income tax return to avoid a late payment penalty.

April 1, 2014:
This is the last day for taxpayers who turned 70-1/2 during 2013 to withdraw their IRA required minimum distribution for 2013.

April 15, 2014:
- Deadline for individuals to file a 2013 federal income tax return or request an extension of time to file. State due dates may vary.
- This is the deadline for fiduciaries of estates and trusts to file a 2013 calendar-year income tax return or request an extension.
- The first installment of the 2014 federal individual estimated tax payment is due. Caution: State due dates may vary.
- First contribution of 2014 defined benefit pension plans is due.

TAX TIPS & news

Since You **Asked...**

You Asked: A few years ago, my brother got himself into financial difficulties and I loaned him $10,000. He has been unable to pay me back, and I have decided to forgive the loan and write it off when I file my taxes. How do I report the loss on my tax return?

Answer: Non-business bad debts are reported on Form 8949 (for Schedule D) as a short-term capital loss. The information required includes the name of the debtor. The reason the lender is allowed to claim a loss on such a loan is that a forgiven debt constitutes income to the debtor, thereby balancing the tax scale.

In your case, unfortunately, you cannot write off the $10,000. To be deductible, a non-business bad debt must be an enforceable debt and you, as the lender, must make reasonable efforts to collect on that debt. Such efforts to collect include legal action. If you decide to forgive your brother's debt, the loss is nondeductible, as it is essentially a gift to him.

You Asked: My wife and I are getting a divorce. As part of the property settlement, she will be keeping our home. What are the possible tax consequences that may arise?

Answer: When property is divided in a divorce, there are no immediate tax consequences. Therefore, the transfer of your interest in the home to your spouse will not result in a taxable gain or loss to either you or her. However, tax rules say that she assumes the home at the community basis. Generally, community basis will be what you jointly paid for the home plus the cost of any improvements you've made since. Thus, she would be responsible for reporting any gain in excess of the community basis when and if she chooses to sell the home. If she qualifies, she can exclude the first $250,000 of gain; any portion of the gain in excess of the exclusion will be taxable to her. As part of your divorce tax strategy, and assuming you qualify for the home gain exclusion, you may want to consider selling the home jointly. This will convert the asset to cash, which can then be divided up as part of the settlement. By doing so, you will have a combined $500,000 home gain exclusion and will only be taxed on the amount, if any, in excess of this larger exclusion amount.