Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

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How the Health Care Law Will Impact Your Taxes

There has been a great deal of media coverage, mostly political, related to the US Supreme Court upholding the Affordable Care Act, also known as the Health Care Law. The intent of this article is to explain how the Affordable Care Act will impact your pocketbook in 2013, when the health care taxes kick in, and in 2014, when the mandatory insurance requirement becomes effective. Here are the details for 2013:

Increased Hospital Insurance Tax – Part of the taxes withheld on employees' wages cover the Hospital Insurance (HI) portion of their contribution to Medicare; self-employed individuals pay the HI tax as part of the self-employment tax that is included in their tax return. The HI tax rate will increase by 0.9 percentage points on individual taxpayer earnings (wages and self-employment income) in excess of compensation thresholds for the taxpayer's filing status. The income threshold at which this increase begins is $250,000 for married taxpayers filing jointly, $125,000 for married taxpayers filing separately, and $200,000 for all other taxpayers. ***Impact: Higher income working families.***

For married taxpayers, this additional tax is based upon their joint income. However, if both spouses work, their employers will only base the withholding on the employee's individual earnings. Thus, married taxpayers who both work may find themselves under-withheld on HI taxes and will be required to pay the uncollected HI tax on their income tax return when it is filed. They may need to compensate by taking steps to increase income tax withholding or pay or increase estimated taxes.

Surtax on Unearned Income – A new surtax called the Unearned Income Medicare Contribution Tax is imposed on the unearned income of individuals, estates, and trusts. For individuals, the surtax is 3.8% of the lesser of:

1. The taxpayer's net investment income or

2. The excess of modified adjusted gross income (MAGI) over the threshold amount ($250,000 for a joint return or surviving spouse, $125,000 for a married individual filing a separate return, and $200,000 for all others).

"Net" investment income is investment income reduced by allowable investment expenses. Investment income includes: interest, dividends, annuities, royalties, passives rents, non-business capital gains and trade or business income that is a passive activity of the taxpayer. For surtax purposes, MAGI does not include excluded items, such as interest on tax-exempt bonds, veterans' benefits, and excluded gains from the sale of a principal residence. ***Impact: Higher income families.***

In order to avoid or minimize this new tax, higher income taxpayers may wish to alter their investment portfolios to include more of the non-taxable investments mentioned above.

Homeowners should be aware that the gain from the sale of their primary home in excess of the homeowner's gain exclusion or gain from selling a second home is treated as investment income and would be subject to this new tax.

Deductible Medical Expenses Threshold Increases – Beginning in 2013, for taxpayers under the age of 65, the AGI threshold percentage for claiming medical expenses on a taxpayer's Schedule A will increase from 7.5% to 10%. Individuals age 65 and older will continue to use the 7.5% rate through 2016. Thus, it may be appropriate to pay outstanding medical bills or pre-pay such things as orthodontics for a child before the AGI threshold increases to 10%. In addition, if you are considering elective deductible medical procedures, such as laser eye surgery, it may be beneficial to have the procedure and pay for it in 2012. ***Impact: All taxpayers (except seniors for now) who itemize their medical expenses.***

Employer Health FLEX-Spending Account (FSA) – To be a qualified benefit under a cafeteria plan, the maximum amount available for the reimbursement of incurred medical expenses of an employee, the employee's dependents, and

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(How the Health Care Law Will Impact Your Taxes Cont'd…)

any other eligible beneficiaries with respect to the employee under the health FSA for a plan year (or other 12-month coverage period) cannot exceed $2,500. ***Impact: All taxpayers participating in health FSAs.***

Some taxpayers or employers may wish to compensate by establishing Health Savings Accounts or Medical Expense Reimbursement Plans to write off newly-disallowed medical expenses.

Beginning in 2014, all U.S. citizens and legal residents, except for those who are exempt from the requirement, will have to maintain minimum essential health insurance coverage or pay a penalty. Generally, individuals who are covered by health insurance through their employers will have met the mandate. ***Impact: Lower income individuals and families not exempt from the requirement.***

Those exempt from this requirement include low income individuals and families (for whom the cost of minimum required coverage exceeds 8% of their annual income), those not required to file a Federal tax return because their income is below the filing threshold, those unlawfully present in the U.S., incarcerated individuals, Indian tribal members, religious objectors, and those with hardship waivers.

Minimum essential coverage generally includes:

- Private market plans
- Government sponsored programs (e.g., Medicare, Medicaid, VA, etc.)
- Eligible employer-sponsored plans
- American Health Exchange "bronze" coverage

By 2014, each state must establish an Exchange to help individuals and small employers obtain coverage. Benefit options will be in a standard format, and a single enrollment form will be used for all policies. Plans must provide essential health benefits, limit cost sharing, and provide for a specific percentage amount paid the insurer. Out-of-pocket deductibles are limited to the same amounts as the caps for Health Savings Accounts and are further limited to $2,000 ($4,000 for families) in the small group market. Plans in the individual and small group markets use a metallic designation for the accrual benefits provided:

- Bronze 60%
- Silver 70%
- Gold 80%
- Platinum 90%

The law provides a premium assistance credit for low-income families whose household income is at least 100%, but not more than 400% of the federal poverty line, and who do not receive health insurance under an employer plan, Medicaid, or other acceptable coverage. Based upon the 2012 poverty levels, the credit would phase out at $44,680 for individuals and $92,200 for a family of four. Eligibility for the premium assistance credit will be based on the individual's income for the tax year ending two years prior to the enrollment period.

The credit is based on the taxpayer's household income level relative to the federal poverty line. The calculation is computed on a sliding scale starting at 2.0% of income for taxpayers at or above 100% of the poverty line and phasing out to 9.5% of income for those at 400% of the poverty line.

The penalty for individuals required to purchase insurance who fail to do so will be phased in beginning in 2014 and will be fully implemented in 2016. The penalty for noncompliance is the greater of the sum of the monthly penalty amounts for months in the taxable year during which 1 or more such failures occurred, or the average cost of the Bronze coverage.

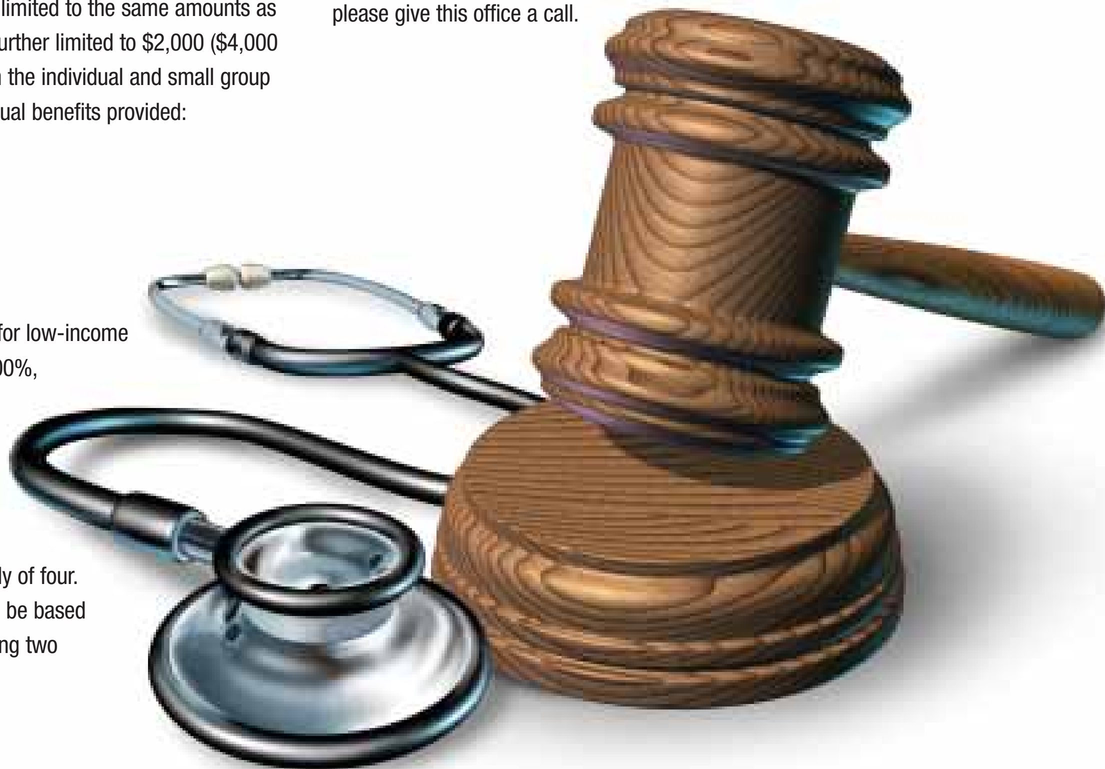
The monthly penalty amounts are based upon a complex formula and is equal to the greater of an inflation adjusted flat dollar amount, which is $95 for 2014 and increases to $625 in 2016, or 1% of income increasing to 2.5% in 2016. However, the annual family penalty cannot exceed 300% of the individual maximum penalty for the year ($1,875 in 2016).

Household income refers to the sum of the incomes of the taxpayer and all individuals accounted for in the family size required to file a tax return for that year. Income includes all tax-exempt interest, Social Security benefits and foreign earned income.

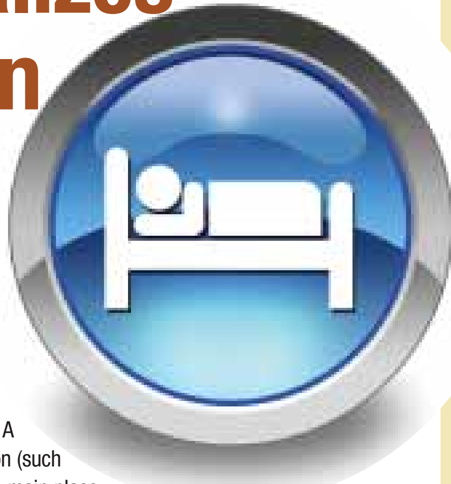
The penalty will be included on the taxpayer's Form 1040 for each year the individual has not complied with the insurance coverage requirement. Although the IRS is responsible for collecting the penalty, the law prohibits the IRS from jailing taxpayers or seizing their property if they fail to pay it.

The foregoing is a very brief overview of the health care provisions for individuals and how your pocketbook may be impacted beginning in 2013. However, the health care provisions are not yet cast in stone. In fact, this is a hot political issue, so be sure to watch for further developments.

If you have questions or would like to schedule a tax planning appointment, please give this office a call.



IRS Liberalizes Position on Local Lodging



In the past, a business deduction was allowed only for lodging when a taxpayer traveled away from his or her "tax home." A taxpayer's tax home is generally the location (such as city or metropolitan area) of a taxpayer's main place of business (not necessarily the place where he/she lives).

This has long created problems for individuals attending conferences and training sessions within their tax homes that include extended-hour events that preclude traveling back home between days of the events. In 2007, the IRS announced that it would amend the regulations to allow certain temporary local lodging expenses to be treated as business expenses; now, five years later, the proposed regulation changes have recently been announced.

Proposed Changes – The IRS has issued proposed reliance regulations permitting certain non-away-from-home lodging expenses to be treated as deductible business expenses by employers and tax-free working condition fringe benefits or accountable-plan reimbursements to employees. The proposed regulations provide a safe harbor; local lodging expenses are treated as ordinary and necessary business expenses if all of these conditions are met:

(1) The lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function.

(2) The lodging is for a period that does not exceed five calendar days and does not recur more frequently than once per calendar quarter.

(3) If the individual is an employee, his or her employer requires him or her to remain at the activity or function overnight.

(4) The lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit.

Example: A business conducts business-related sales training sessions at a hotel and conference center near its main office. The employer requires both its field and in-house sales force to attend the training and stay at the hotel overnight for the bona fide purpose of facilitating the training. If the company pays the lodging costs directly to the hotel, the stay is a working condition fringe benefit to all attendees (even to employees who live in the area who are not on travel status) and the company may deduct the cost as an ordinary and necessary business expense. If the employees pay for the lodging costs and are reimbursed by the company, the reimbursement is of the accountable plan variety and is tax-free to the employees and deductible by the company as an ordinary and necessary business expense.

Example: If a locally-based self-employed consultant were required by a company to attend the sessions and stay at the hotel, he or she could deduct the expense if he or she paid for it himself or herself or exclude the expense if he or she were reimbursed by the company after accounting for it in full for his or her costs.

The new rules apply to expenses paid in prior years in cases in which the statute of limitations for claiming refunds is still open (generally, after 2008). Thus, returns can be amended for refund where a lodging deduction would have been allowed.

If you have questions related to how this change affects prior filed returns or how it will affect your business deductions going forward, please give this office a call.

SE Health Insurance Deduction: Has the IRS Finally Gotten It Right?

It seems the IRS cannot make up their minds related to the self-employed health insurance deduction. Although it made sense that the Medicare premiums paid by a self-employed individual should be allowed as part of the self-employed health insurance deduction, the IRS said no in their 1040 instructions through 2009. Then for 2010 returns, without any fanfare, they quietly modified the instructions, allowing the self-employed individual to include his or her premium in the computation of the self-employed health insurance deduction and suggested prior year returns where the 3-year statute of limitations had not expired could be amended.

However, the IRS failed to address the issue of whether the spouse's Medicare-B premiums could be included in the deduction. The wording in the 2011 publication was changed by inserting the wording shown in bold below, making it seem that the spouse's Medicare premiums would not be deductible.

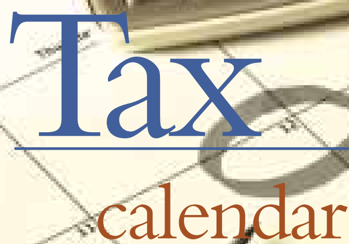
"Medicare premiums you voluntarily pay to obtain insurance ***in your name*** *that is similar to qualifying private health insurance can be used to figure the deduction."*

This month, the IRS legal department (Office of the Chief Council) issued an advisory letter announcing that both the self-employed individual's and the self-employed individual's spouse's Medicare premiums can be included when computing the self-employed health insurance deduction. The Council's analysis of the law is as follows (bold emphasis added):

"Medicare is insurance that constitutes medical care under section 162(l). Therefore, ***all Medicare premiums*** *are similar to other health insurance premiums and can be used to compute the deduction under section 162(l).* ***This rule also extends to Medicare premiums for coverage of a self-employed individual's spouse,*** *dependent, or child (as defined in section 152(f)(1) who as of the end of the taxable year has not attained age 27)."*

So in addition to stating that a spouse's Medicare premiums are eligible for the self-employed individual's health insurance deduction (if all other requirements are met), the Chief Council Advisory also clarifies that all Medicare premiums (B, C and D) are eligible.

If you are self-employed and did not claim your or your spouse's Medicare premiums as part of the SE health insurance deduction in prior years, 2009 through 2011, this office can amend those returns so you can claim a refund. Please call for additional information.



Tax calendar

Sept. – Dec. 2012

September – December:
- Time for your 2012 fall and 2013 Tax Planning. Contact this office to schedule a consultation appointment.

September 17, 2012:
- The third installment of 2012 individual estimated taxes is due.
- This is the FINAL extended filing due date for your 2011 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

October 15, 2012:
- This is the FINAL extended filing due date for your 2011 individual income tax return.

December 31, 2012:
- Last day for taxpayers who began their minimum IRA distributions in a year before 2012 to make their required withdrawals for 2012. However, to allow IRA trustees/custodians ample time to process distribution payments, taxpayers should request distributions well ahead of this date.
- This is generally the LAST day that you can pay tax-deductible expenses for the year. IRA contributions and some self-employed retirement plan contributions can be made after the close of the year.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

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Since You Asked...

You Asked: Someone told me if I had a substantial increase in investment income this year, I could be subject to a penalty. Can you explain?

Answer: Generally, if a taxpayer has not paid by withholding and estimated taxes during the year an amount equal to 90% of their current year's tax liability, they are subject to underpayment penalties. However, there are exceptions if the withholdings and estimates equal 100% (110% for higher income taxpayers) of your prior year tax liability. However, when figuring the penalty, the estimated tax payment must be made evenly or front-loaded to avoid the penalty, and withholdings, even if made late in the year, are considered paid evenly throughout the year.

You Asked: I provide document delivery services and use my motorcycle to make the pick-ups and deliveries. Can I use the IRS standard mileage rate as a business deduction for using the motorcycle?

Answer: I am afraid not. The IRS has never established an optional mileage rate for motorcycles. Although it was the subject of an IRS Chief Council memorandum in 2009, no further action was taken. So you are stuck with the actual expense method for deducting the motorcycle's use.

You Asked: My son is attending college and will begin his third year in 2013. I have heard tuition credit may be reduced next year. Is that correct?

Answer: As it stands right now, the American Opportunity Credit will expire at the end of 2012. And if Congress does not extend it, the credit will be replaced by the Hope Credit, which only covers the first two years of post secondary education. The credit is less and none of it is refundable (can only reduce your tax to zero). But since your child will be in his or her 3rd year of post-secondary education, the Hope Credit would not apply. There is the Lifetime Learning Credit with a family limit that your child may qualify for if your income does not exceed the limits for the credit.