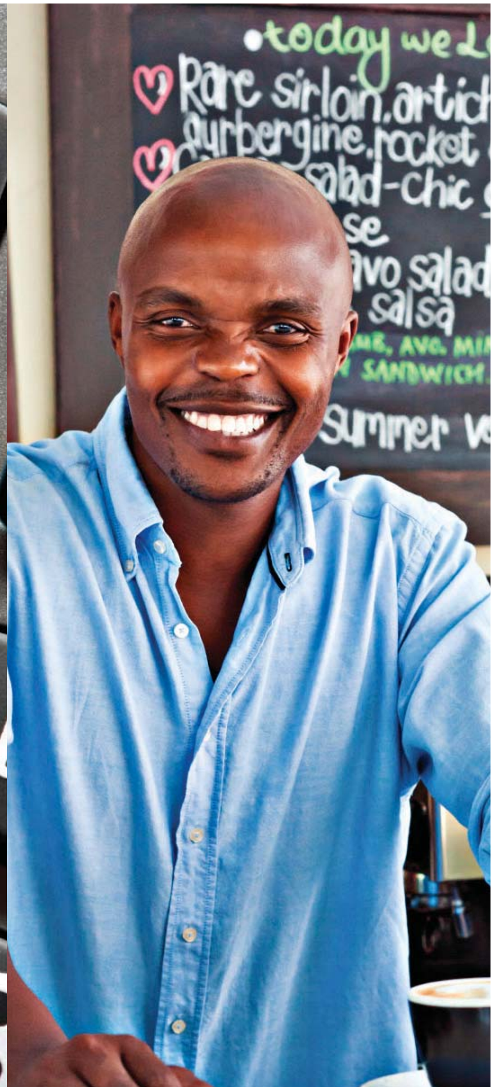


Tax Law Snapshot

for the 2013 Filing Season

Kiefer | Bonfanti & Co. LLP
Certified Public Accountants & Business Advisors

Building Relationships | Building Businesses | Making a Difference

The combination of an unpredictable tax and political environment and the passing of the American Taxpayer Relief Act of 2012 ("the Act") created additional complexities to making financial decisions and determining tax liability. These complexities will grow as more provisions, such as new rates and capped deductions, take effect.

Tax Law Snapshot for the 2013 Filing Season provides an overview of key tax law provisions that may affect your return. Information is current as of Feb. 6, 2013. The *Tax Law Snapshot* features separate sections devoted to tax issues affecting individuals and small business owners. Many of the tax laws that pertain to individuals will also affect small business owners, particularly those who are set up as a pass-through entity such as an S corporation.

Important tax law changes that temporarily extended a number of tax provisions, and made permanent others that had lapsed or were set to expire, affect millions of taxpayers, individuals and business owners alike.

As a trusted business advisor, your CPA can answer your questions, address your concerns and design strategies you can follow throughout the year to reduce your tax liability. He or she also can identify the long- and short-term tax consequences of your spending, investment and other financial decisions, and advise you on the steps you can take to save money and meet your financial goals.

Table of Contents

INDIVIDUAL

Core Provisions . . . 2

Health Care . . . 3

Home Ownership . . . 4

Family . . . 6

Education . . . 7

Investments . . . 8

Retirement . . . 8

Obtain Professional Advice . . . 9

SMALL BUSINESS

Expenses . . . 10

Health Care . . . 11

Employees . . . 12

Value of Professional Advice . . . 12

KEY PLANNING ISSUE

CAPPED DEDUCTIONS AND HIGHER RATES FOR HIGHER-INCOME TAXPAYERS

Starting in 2013, the American Taxpayer Relief Act imposes limits on the amount of itemized deductions and the personal exemption that upper income taxpayers can claim. For example, joint filers with taxable income of more than $450,000 will owe $125,846, plus 39.6% of the excess over $450,000. Talk to your CPA about how you can minimize your liability on next year's return.

INDIVIDUAL

Tax law changes for individuals following the Act affect Americans across age groups, industries and life stages — from family finances and health care to home ownership and retirement planning. The Act also brings a long sought-after degree of certainty to many tax areas by creating permanent tax rates on ordinary income, estate tax, dividends and capital gains. Other changes include a highly anticipated permanent "patch" to the Alternative Minimum Tax (AMT) and the extension of education and child credits.

The following provisions address select tax areas that are top priorities for individuals and reflect the diverse range of issues that will arise in the preparation of your tax return.

Core Provisions

FILING STATUS AND TAX RATES

You can file as single, married filing jointly, married filing separately, head of household or qualifying widow(er)/ surviving spouse. If more than one filing status applies to you, choose the one that results in the lowest tax obligation.

If you are married, you should generally take advantage of the joint tax return rates as they will be the most favorable, especially now that the Act has eliminated the "marriage penalty" for joint filers in the 15% tax bracket. However, there are circumstances in which a married couple might choose the married filing separately option.

Unmarried taxpayers may file as single or, if they qualify, as head of household or surviving spouse, which have more favorable tax rates. In most cases, you can file as a head of household if you pay more than 50% of the household costs for a dependent child or relative who lives with you, or for a dependent parent who may or may not live with you.

Generally, you can file as a qualifying widow(er)/surviving spouse if: (1) your spouse passed away in 2010 or 2011, (2) you did not remarry before 2013 and (3) you were financially responsible for more than 50% of the household costs for you and your dependent child in 2012. For 2012, tax rates are 10%, 15%, 25%, 28%, 33% and 35%.

ALTERNATIVE MINIMUM TAX

In addition to the regular income tax, taxpayers are increasingly finding themselves subject to the Alternative Minimum Tax (AMT). The AMT is designed to ensure equitable taxes are paid by higher-income taxpayers, although it also applies to lower income taxpayers with a large number of exemptions or other tax adjustments. For 2012, Congress has resolved some AMT concerns by permanently indexing its exemption amounts for inflation. There also is relief from AMT for nonrefundable credits.

2012 EXEMPTION THRESHOLDS FOR ALTERNATIVE MINIMUM TAX

Filing Status	Amount
Joint Returns or Surviving Spouses	$78,750
Unmarried Individuals (other than Surviving Spouses)	$50,600
Married Individuals Filing Separate Returns	$39,375
Estates and Trusts	$22,500

STATE, LOCAL AND SALES TAXES

State and local income taxes withheld from your pay, estimated 2012 payments and the balance of 2011 state and local taxes you paid in 2012 are all deductible. However, you may derive a greater tax benefit by deducting state and local general sales tax rather than state and local income tax. In most cases, sales taxes can only be deducted up to the general sales tax rate or you can use the table included in Form 1040 instructions. Since each state is different, your CPA can evaluate the best approach for your situation.

Health Care

The tax benefits of health care plans can vary depending on your employer, as well as your medical situation and financial management strategy. Your CPA can advise you not only on health care changes that were made for 2012 but also on selecting a plan that will minimize your taxes while meeting your health care needs.

ITEMIZED MEDICAL EXPENSES

Taxpayers who itemize their deductions can write off qualified medical costs not covered by insurance or other sources. However, the costs must exceed 7.5% of adjusted gross income (AGI) and, in 2013, must exceed 10% of AGI. Deductible expenses include those for you as well as for a spouse or dependent(s). Once the threshold is passed, there is no dollar limit on the deduction amount.

HEALTH FLEXIBLE SPENDING ARRANGEMENTS

Amounts you contribute for medical expenses to accounts under your employer's Flexible Spending Arrangements (FSAs) are not taxed in 2012. Funds contributed as salary reductions can be accessed any time during the year to pay for health insurance premiums as well as medical costs and other qualifying expenses not covered by insurance. Funds not used during the year, or by the end of any grace period the plan may offer, are lost.

DID YOU HAVE A DEBT CANCELED OR FORGIVEN?

When debt is canceled, the forgiven amount is treated as taxable gross income. However, exceptions apply to many qualified S corporation, partnership and real property business debts, as well as to certain debts canceled in bankruptcy.

Keep in mind that if a debt you owe of $600 or more is canceled or forgiven by a bank, credit union or federal government agency, you and the IRS will each receive a Form 1099-C that will include the amount of the canceled debt. Carefully review these forms for accuracy. Even though the bank has officially forgiven the debt, that does not mean it will not attempt to collect these funds later through debt-collection efforts or deny future credit requests.

If, as part of a mortgage restructuring or foreclosure, qualified principal residence indebtedness is forgiven, up to $2 million of the discharge is excluded from gross income so long as the discharge occurred before 2013.

HEALTH SAVINGS ACCOUNTS

Health Savings Accounts (HSAs) are designed for individuals covered by a high-deductible health insurance policy and are not covered by Medicare or, with a few exceptions, other health coverage. HSAs offer a number of tax advantages. Contributions within certain limits are tax deductible and earnings that accumulate within the account are not taxed until withdrawn, and even under those circumstances, withdrawals to pay for qualified medical expenses are tax free. However, withdrawals you may make for nonmedical costs and medical expenses that are not qualified are both taxable and subject to a 10% penalty unless you are age 65 or older or disabled, or the account owner dies.

You and your employer can make contributions, with the total maximum contribution ranging from $3,100 for self-only coverage to $6,250 for family coverage. Higher amounts can be contributed for those age 55 or older.

HEALTH REIMBURSEMENT ARRANGEMENTS

Under a Health Reimbursement Arrangement (HRA), companies deposit funds in an account for each employee from which the employee can draw to pay for unreimbursed medical expenses. The company determines HRA features and requirements.

Among the benefits of HRAs are that they are a cost-free employee benefit, deposits and withdrawals for qualified medical expenses are not taxed and have no dollar limit, and unused funds from one year can be carried over to the next.

Home Ownership

Traditional tax benefits of home ownership — capital gains exclusion and mortgage interest deduction — are unchanged from last year, and for those making home energy improvements or were affected by a disaster or other catastrophe, tax breaks may be available.

MORTGAGE INTEREST

Home mortgage interest on up to $1 million ($500,000 if married filing separately) of home-acquisition loans secured by your principal residence and/or second home is fully deductible. Mortgage interest on a home equity loan up to $100,000 ($50,000 if married filing separately) also can be deducted. Therefore, interest can be deducted on total home debt of up to $1.1 million ($550,000 if married filing separately). You can use the loan proceeds to buy, build or significantly renovate your home.

TAX EXCLUSION OF THE SALE OF A PRINCIPAL RESIDENCE

When you sell your home (principal residence), you can exclude from income up to $250,000 in gains ($500,000 if married filing jointly or surviving spouse in certain circumstances).

To qualify, you must have owned and occupied the home as your principal residence for at least two years (aggregate) during the five-year period ending on the date of sale and you did not claim an exclusion on another sale within the previous two years. Special rules are provided for a sale of the home due to certain health issues, employment reasons or unforeseen circumstances.

ENERGY IMPROVEMENTS

In 2012, homeowners can again claim the Residential Energy Efficient Property Credit for making certain energy-saving improvements to their residence in the United States. They also can claim the Nonbusiness Energy Property Credit, which applies to less expensive upgrades and was set to expire after the 2011 tax year but has been extended through 2013.

The 30% Residential Energy Efficient Property Credit applies to costs for qualified residential solar panels, geothermal heat pumps, solar water-heating equipment, solar electric property costs and small wind-energy property. This credit has no dollar limit or principal-residence requirement.

Under the Nonbusiness Energy Property Credit, homeowners can receive a credit of 10% of the costs of qualified energy-efficient improvements and 100% of the costs of certain energy property expenditures, although dollar limitations may apply to specific types of property, including a maximum lifetime credit of $500. Energy efficient improvements range from insulated walls or ceilings and energy-efficient exterior doors and windows to specially treated metal or asphalt roofs, and a high-efficiency furnace, water heater or central air conditioning system.

CASUALTY LOSSES

Although property damage or destruction caused by a catastrophe often is not fully covered by insurance or other reimbursement, you can deduct certain non-covered casualty losses as itemized deductions if your total losses for the year are greater than 10% of your adjusted gross income. The deduction typically is taken in the year of the casualty.

Your deduction is not limited to any dollar amount. However, the amount of your loss is limited to whichever is smaller: the decrease in the property's value resulting from the casualty or its adjusted basis. In addition, each loss must be reduced by $100 per event.

DISASTER LOSSES

Disaster losses are a type of casualty losses resulting from a disaster or other event declared by the President of the United States to require federal government assistance. The loss can be deducted either in the year that the loss occurred or the previous year. There is no dollar limit on a disaster loss claim.

To claim the deduction, you must not only meet casualty loss requirements but also two additional requirements: the event must have occurred within a federally designated disaster zone and, if you decide to claim the loss on the previous year's tax return, you must do so within a specific time frame.

Family

Family tax benefits were one of the focal points of the Act, with several tax credits extended and estates valued at less than $5.1 million being permanently exempt from the estate tax.

CHILD TAX CREDIT

The Child Tax Credit, which is in addition to the child's dependency exemption, is worth $1,000 for each qualifying child who is under age 17 at the end of the calendar year and who qualifies as a dependent. The credit, which is now permanent, phases out for higher income taxpayers. If you are claiming the credit for three or more children, you can receive an additional child tax credit.

DEPENDENT CARE CREDIT

If you are a parent who must pay for the care of a dependent under age 13 — whom you also claim as a dependent — while you work or look for work, you may be eligible for a tax credit between 20% and 35% of qualifying expenses. You must have earned income to receive the credit.

The credit, which is determined by adjusted gross income, is not restricted to child-related care costs. If you pay someone to look after an incapacitated spouse or dependent of any age, such as a parent or disabled family member, you may also be eligible for this tax break.

The maximum amount of expenses on which the credit can be claimed is $3,000 for the care of one qualified dependent and $6,000 for the care of two or more. Thus, the maximum credit allowed in 2012 is $1,050 if you have one qualified dependent and $2,100 if you have two or more qualified dependents.

The dependent care credit is reduced by the value of qualifying day care provided by your employer under a written, non-discriminatory plan, which generally is not taxable up to $5,000 ($2,500 if married filing separately).

ESTATE TAX

Estate tax is a tax on the transfer of property at the owner's death and it is the responsibility of the estate, and not the beneficiary or beneficiaries, to pay it. In 2012, if an estate is valued at $5 million or less and death occurs in 2012, the estate is exempt from the tax. Amounts above the exemption are taxed up to a top rate of 35% for 2012 (40% in 2013 and future years). Also, the estate tax exemption is portable between married couples. This allows any estate tax exemption that was not used by a deceased spouse to be transferred to a surviving spouse, provided a required election is made.

Education

Students fared well under the Act as certain tax benefits were extended, including the student loan interest deduction that had expired in 2011.

AMERICAN OPPORTUNITY TAX CREDIT

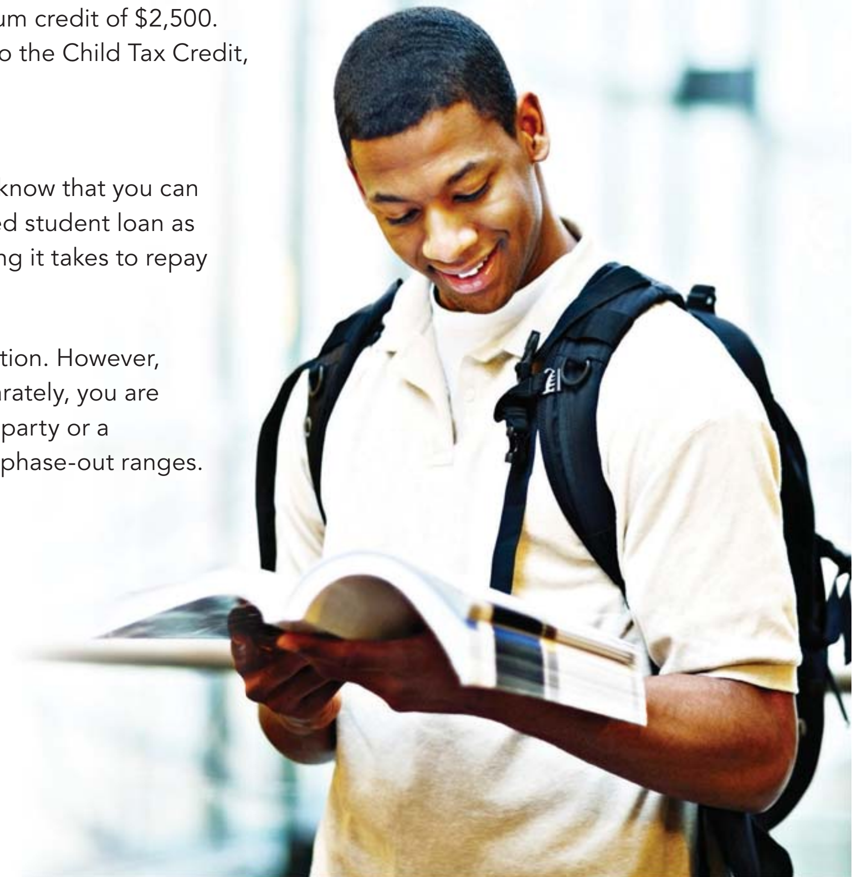
The American Opportunity Tax Credit, which is effective through 2017, is available to each eligible student and for the first four years of college or other postsecondary school that leads to a degree, certificate or other recognized educational credential. The maximum credit is $2,500 per student for each year and 40% of the credit is refundable — that is, it can reduce the taxpayer's liability below zero.

The credit, which also is allowed against the AMT, applies to 100% of the first $2,000 of costs and 25% of the next $2,000 of costs. This means you must spend at least $4,000 to obtain the maximum credit of $2,500. Approved costs are tuition and related fees. Similar to the Child Tax Credit, this credit phases out for higher income taxpayers.

STUDENT LOAN INTEREST

If you're paying off student loans, you'll be happy to know that you can deduct up to $2,500 of the interest paid on a qualified student loan as an adjustment to gross income, regardless of how long it takes to repay the loan.

You don't need to itemize in order to take this deduction. However, there is no deduction if you file as married filing separately, you are claimed as a dependent or the loan is from a related party or a qualified employer plan. The deduction is subject to phase-out ranges.



Investments

The Act's impact on individual investments varies by income. Taxpayers in middle- and low-income tax brackets will see no rate change, while those in the new top income bracket will pay more taxes on the net capital gain exceeding the income thresholds for that bracket.

LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS

A 20% tax rate applies to capital gains and dividends for individuals above the top income tax bracket threshold, with a 15% rate for taxpayers in the middle brackets. However, for taxpayers in the 10% or 15% income tax bracket, the tax rate is zero. Capital gains on investments held for one year or less are taxed at regular income tax rates.

OFFSET CAPITAL GAINS WITH LOSSES

Capital losses are netted against capital gains. If your capital losses are greater than your capital gains, you can deduct up to $3,000 of your combined long-term and short-term capital losses against ordinary income ($1,500 if married filing separately). Any remaining net capital losses may be carried over to future years.

Retirement

While there are no significant changes that affect tax treatment of your retirement plan for 2012, there are options that can minimize your taxes. The Act allows employer-sponsored 401(k) participants to transfer any amount to a Roth 401(k). The funds will be taxed when converted and the employer plan must be set up for a Roth. Your CPA can help you determine which plan is best for you.

TRADITIONAL AND ROTH IRAS

You may contribute up to $5,000 to fund a traditional or Roth Individual Retirement Account (IRA) in 2012. For individuals age 50 or older by the end of 2012, the contribution limit is $6,000.

You cannot contribute more than your qualifying income for the year, but if your spouse has little or no income, you can contribute to either a traditional IRA or Roth IRA for your spouse based on your earnings.

Traditional IRA contributions may be deductible depending on your modified AGI and whether you or your spouse (if filing jointly) is covered by an employer-sponsored retirement plan. For 2012, if you are age 70½ or older and had the trustee of your traditional IRA make a direct transfer to an eligible charity from your account, up to $100,000 of the transfer is not taxable. Also, you must begin to take minimum required distributions from the IRA once you reach age 70½, but this does not apply to Roth IRAs.

Roth IRA contributions are not deductible, but you can withdraw them at any time tax free. You also can withdraw earnings on contributions tax free after five years if you are age 59½ or older, disabled or paying qualifying first-time homebuyer expenses. Eligibility to contribute to a Roth IRA is subject to phaseout thresholds.

Earnings on both types of IRAs accumulate tax free until distributions are made.

You have until the filing deadline of April 15, 2013, to open and contribute to an IRA for 2012.

EMPLOYER-SPONSORED 401(K)

Pre-tax contributions to your employer-sponsored retirement plan reduce your taxable wages. Matching contributions and income earned within your plan also are tax deferred. Your dollar-limit contribution for 2012 is $17,000. If you are age 50 or older by the end of 2012, you may make an additional catch-up contribution of $5,500 to reach $22,500.

Obtain Professional Advice

The rigorous qualifications required to become a certified public accountant makes your CPA a trusted professional who is uniquely and highly qualified to meet all your financial management needs year-round. Speak to your CPA about sound tax planning decisions you can make in 2013.

SELECT TAX PLANNING ISSUES FOR 2013

Speak to your CPA about key upcoming tax changes such as:

- Imposition of surtax on investment income (e.g., long-term capital gains and qualified dividends)
- Limit to Health Flexible Spending Arrangement's salary reduction contribution
- Increase in the top estate tax rate from 35% to 40%, and creation of a 5% surtax on estates valued at more than $10 million
- Change in deduction for student loan interest
- Reduction in the maximum value of the tax benefits for charitable contributions

SMALL BUSINESS

Few groups embody today's entrepreneurial spirit, drive for innovation and unwavering perseverance more than the small business community. Featured below are highlights of select tax legislation that may affect your business. Your CPA can advise you on these and other laws, as well as provide the best strategies for minimizing your tax liability for this filing season and offer year-round, tax-planning services.

Expenses

For 2012 tax returns, small business owners will not see much change in what they can deduct as the new law extended two key rules for personal business property and leasehold improvements. One exception comes from new IRS rules affecting tangible business property and when they can be expensed or capitalized; see Key Tax Planning Issue (left). These new rules will take effect in 2014 but can be used now — your CPA will have more information.

SECTION 179 EXPENSE

Rather than capitalizing and depreciating the cost of property purchased for use in a business, you can immediately deduct it as a Section 179 expense in the first year. The deduction applies to most tangible personal business property (new and used) placed in service during the tax year, including computers, office furniture, vehicles and machinery.

The Act allows business owners to use this deduction to write off up to $500,000 of the cost of business property, with a $2 million investment limit. Also, the Section 179 expense deduction cannot be greater than the business's taxable income, although any unused depreciation can be carried forward.

BONUS DEPRECIATION

If the cost of business property cannot immediately be deducted as a Section 179 expense in 2012, you could use the 50% bonus depreciation rules. They allow you to write off 50% of certain types of investments in the first year, with the remaining cost depreciated over the asset's useful life. The allowance, which the Act extends through 2013, generally applies to tangible personal property with a recovery period of 20 years or fewer, as well as to certain buildings and leasehold improvements, office equipment and purchased computer software. The property must be new and in original-use condition (refurbished and reconditioned property is not eligible).

KEY TAX PLANNING ISSUE

TANGIBLE PROPERTY

The IRS issued regulations (to be finalized and take effect in 2014) to provide further guidance for business owners who are planning to deduct or capitalize an expenditure for tangible property. Under the regulations, if you make repairs to your business property, your costs can be deducted immediately. However, if the costs are capital expenditures, they typically can only be deducted or depreciated over the property's useful life.

An expense generally is considered a repair if it keeps the property in working order and allows the property to continue its intended purpose (such as resurfacing floors in the lobby).

In contrast, a capital expenditure typically involves betterment, restoration and adaptation, such as building an addition or installing a security system. Unlike a repair, the usual result of a capital expenditure is a significant increase in the property's value. While these regulations will not affect your 2012 tax return, you will need to start planning now, as the IRS is expected to issue final guidance in 2013.

START-UP AND ORGANIZATIONAL COSTS

You may deduct up to $5,000 of eligible start-up expenses incurred during the tax year. The balance must be amortized over 180 months, beginning in the month the business was launched. However, the deduction phases out dollar-for-dollar if costs are greater than $50,000, with no immediate deduction available when costs are greater than $55,000. All costs then must be amortized over 180 months. Different rules and dollar limits apply to start-up costs paid or incurred during other time periods.

Certain organizational costs incurred in the setup of a C or S corporation or a partnership can be deducted under the same rules for business start-up costs.

MILEAGE

You can use a standard mileage allowance in place of keeping a record of all related expenses and calculating depreciation to determine your deduction for the business use of your automobile. The standard allowance for 2012 increased to 55.5 cents per mile. Although less detailed than the actual expense method, records still need to be kept and maintained by the employee and especially the small business owner, when the standard allowance is used.

Health Care

During a time of increasing insurance costs, medical coverage has emerged as both a valued employee benefit and top financial concern for small business owners. Tax benefits in this area did not change significantly; however, your CPA can advise you of the options that best meet your needs and also explain the impact of the Affordable Care Act on your business strategies.

DEDUCTIONS, CREDITS AND TAX ADVANTAGES

The health care options below, as well as those featured in the individual taxpayer section, are among the many that will continue to have an impact on your benefits decisions and undergo significant change as health care reform legislation continues to roll out.

Medical insurance premiums that you pay for employee health coverage are deductible. However, different rules apply to S corporations and partnerships.

Small business health insurance credit is available to the small business owners who pay at least half of their employees' health insurance coverage. The credit can reach 35% of the employer's contribution; however, it is subject to certain criteria, including employee number, average wages, premium amounts paid and average premiums by the state for certain coverage.

RESEARCH AND DEVELOPMENT CREDIT

DID YOU KNOW?

You can claim a tax credit for expenses incurred in the development of new, improved and more reliable products, processes and formulas. The credit, which was set to expire at the end of 2011, now is available through 2013. This often overlooked incentive is available to new and long-established businesses, and for new and expanding research and development with new simplifications and benefits.

The credit is equal to 20% of eligible expenditures in excess of a base amount and has been increased for businesses that acquire other companies. For businesses with little or no research and development spending, there is a 14% Alternative Simplified Credit.

OTHER SMALL BUSINESS TAX BENEFITS

The American Taxpayer Relief Act of 2012 extends through 2013 a number of additional credits that were set to expire after 2011 and 2012. Among these credits are the following:

- Exclusion of gain on sale of qualified small business stock
- S corporation charitable donations of property
- Reduced recognition period for built-in gains tax for S corporations
- Work Opportunity Tax Credit
- Tax incentives for empowerment zones

Cafeteria Plans are maintained by an employer for employees and they provide plan participants with certain benefits on a pre-tax basis. Participants choose among two or more benefits, including at least one taxable benefit, such as cash, and one nontaxable qualified benefit, such as accident and health benefits. Plan contributions are made by employers, usually by salary-reduction agreements between the employer and employee.

Section 125 Premium-only Plan, which is a type of cafeteria plan, allows employees to pay for their own group health coverage on a pre-tax basis. Coverage is paid by payroll deduction.

Employees

Good news for employers — the tax credit for providing child care services was made permanent in January. And through 2013, employers who provide qualified public transit benefits (including vanpools) can deduct as much as those who provide parking benefits. Other employer-provided benefit issues are highlighted below.

PENSION PLAN CONTRIBUTION AND BENEFIT LIMITS

For a defined contribution plan, annual contributions and other additions (excluding earnings) to a participant's account cannot exceed the lesser of 100% of the participant's compensation or $50,000. For a defined benefit plan, the annual participant benefit cannot exceed the lesser of 100% of the participant's average compensation for his/her highest three consecutive calendar years or $200,000. These contribution and benefit limits increased from 2011 levels.

PENSION PLAN DEDUCTION LIMITS

The deduction for your contributions to a defined contribution plan cannot exceed 25% of the compensation paid (or accrued) during the year to your eligible employee plan participants. The maximum compensation that can be taken into account for each employee increased to $250,000 for 2012. Deduction limits for contributions to a defined benefit plan need to be determined by an actuary because they are based on actuarial assumptions and computations.

Value of Professional Advice

You work hard to make your business thrive. You need a tax professional who understands how these provisions affect you, and can provide trusted advice and services during the tax season and throughout the calendar year.

For tax and financial advice based on unmatched knowledge, experience and education, ask a CPA.

Information is current as of **Feb. 6, 2013**.

Kiefer | Bonfanti & Co. LLP
Certified Public Accountants & Business Advisors

701 Emerson Road, Suite 201
St. Louis MO 63141-6741

www.kieferbonfanti.com
314.812.1100

Copyright © 2013 American Institute of CPAs

12889-312

Building Relationships | Building Businesses | Making a Difference