REINHARD
KOPKO
KELLER &
MCDONNELL, INC.

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To our Clients and Friends,

Many changes have been seen as the year 2013 comes to an end. Our firm entered into the social media market in 2013 by creating Facebook and LinkedIn pages and also created a new e-mail mailing list so that we may update our clients electronically as new tax law changes become effective. Please follow the web addresses provided at the end of this letter if you would like to interact with us electronically. With the addition of these electronic options, we will continue to provide you with a copy of our year end letter which explains various tax law changes that may affect you. This year's letter comes to you with a little more certainty about what to expect for 2013 and 2014 as the various provisions of the American Taxpayer Relief Act of 2012 (ATRA) and the Patient Protection and Affordable Care Act of 2010 (ACA) become effective. The following highlights the major tax provisions we feel will affect our clients.

The following will affect individuals in 2013:

- New income tax rate: Individuals may find themselves in higher tax brackets than they have been in the past. The ATRA continued the rates under the "Bush-era" tax cuts but added a new 39.6 percent rate as the highest tax bracket. Individuals with taxable income of $400,000 ($450,000 for married couples) will be taxed at the new 39.6 percent rate instead of the previous top rate of 35 percent.
- New capital gains and dividends rate: The zero percent rate for taxpayers in the 10 and 15 percent tax brackets and the 15 percent rate for other taxpayers will continue as a result of the ATRA but an additional 20 percent rate has been added for individuals falling in the new 39.6 percent tax bracket.
- New 3.8 percent surtax on net investment income (NII): The 3.8 percent NII surtax is imposed on the lesser of an individual's net investment income for the tax year or modified adjusted gross income in excess of $200,000 ($250,000 for married couples filing a joint return and $125,000 for married couples filing separate returns). Net investment income includes interest, dividends, annuities, royalties, certain rents, certain other passive business income, as well as certain capital gains.
    - Home sales - A taxable capital gain may arise from the sale of a taxpayer's personal residence. Current tax law allows a taxpayer to exclude up to $250,000 ($500,000 for married couples) of a gain resulting from the sale of one's residence if certain conditions are met. Only a capital gain on a home sale that exceeds these exclusions is includible in net investment income.
- New additional 0.9 percent Medicare tax: An additional 0.9 percent Medicare tax will be imposed on wages and self-employment income of individuals with applicable income in excess of $200,000 ($250,000 for married couples filing a joint return and $125,000 for married couples filing separate returns). An employer is required to start collecting the additional Medicare tax when an employee's wages become greater than $200,000.
    - For married couples, the tax is computed by combining each spouse's wages and then applying the applicable threshold. Each spouse may earn under the $200,000 limit that requires their employer to withhold the additional Medicare tax but when their wages are combined on their joint return, they may be subject to the additional Medicare tax because their combined wages are greater than the $250,000 threshold applicable to married couples.
- A similar situation could arise for married couples that file separately. One spouse's wages may be greater than the $125,000 married filing separate threshold that would cause that spouse to be subject to the

additional tax without having had any additional Medicare tax withheld from their wages by their employer.

- Alternative Minimum Tax (AMT) indexed to inflation: The ATRA set 2013 AMT exemption amounts and indexed future exemption amounts to inflation. Individuals with taxable income of $51,900 ($80,800 for married couples filing a joint return) will be subject to AMT of 26 percent for the first $175,000 of alternative minimum taxable income and 28 percent on amounts above $175,000.

- Revived itemized deduction phase-out: The revived and modified "Pease" limitation on higher income taxpayers reduces an individual taxpayer's itemized deductions by 3 percent of the amount the taxpayer's adjusted gross income (AGI) exceeds $250,000 ($300,000 for married couples filing a joint return). The Pease limitation cannot reduce a taxpayer's itemized deductions by more than 80 percent.

- Revived personal exemption phase-out: The revived and modified personal exemption phase-out causes total exemptions for an individual taxpayer to be reduced by 2 percent for every $2,500 that the taxpayer's AGI exceeds $250,000 ($300,000 for married couples filing a joint return).

- Simplified home office deduction: If you plan to take the home office deduction, there is a new optional safe-harbor method that allows taxpayers to deduct $5 per square foot of home office space (up to 300 square feet). The simplified option does not change the criteria for who may claim the home office deduction; it merely simplifies the calculation and recordkeeping requirements of the allowable deduction.
  - When using the simplified option, allowable home-related itemized deductions (for example, mortgage interest and real estate taxes) are claimed in full on Schedule A.

- Child tax credit: The child tax credit is permanently set at $1,000 per eligible child.

- Increased medical deduction threshold: The threshold to claim an itemized deduction for unreimbursed medical expenses increases to 10 percent of adjusted gross income (AGI) (up from 7.5 percent of AGI in 2012).
  - Taxpayers (or their spouses) who are age 65 and older before the close of the tax year are exempt from the increased threshold; the 7.5 percent threshold continues to apply for them until after 2016.

- Health FSAs offered in cafeteria plans: Salary reduction contributions to health flexible spending arrangements (health FSAs) are limited to $2,500 and will be adjusted annually for inflation.

- Same-sex marriage: Due to the U.S. Supreme Court's ruling to overturn portions of the Defense of Marriage Act (DOMA), the IRS is recognizing all same-sex marriages for federal tax purposes regardless of whether the couple resides in a jurisdiction that recognizes same-sex marriages. All legally married same-sex couples must file using a married filing joint or married filing separate tax status beginning with the 2013 tax year. Individuals in a domestic partnership or civil union are not considered legally married.
  - Same-sex couples filing original returns on or after September 16, 2013 (the effective date of IRS Revenue Ruling 2013-17) must file using a married filing joint or married filing separate tax status.
  - Same-sex couples have the option of amending prior year returns in order to file using a married filing joint or married filing separate tax status as long as the statute of limitations for amending returns has not passed.
  - The State of Ohio (a jurisdiction that does not recognize same-sex marriages) has issued guidance stating that same-sex couples who will be filing jointly at the federal level will be required to supplement their Ohio returns with an Ohio Schedule IT S that will be used to reconcile federal joint adjusted gross income to an Ohio adjusted gross income amount for single taxpayers.

Barring Congressional action, the following may affect individual taxpayers in 2014:

- Individual health insurance mandate: The individual health insurance mandate is scheduled to be effective January 1, 2014 and requires individuals to carry minimum essential coverage, unless they qualify for an exemption, in order to avoid paying a penalty when filing their 2014 income tax return in 2015.
  - Minimum essential coverage is employer-sponsored coverage, coverage through a state or federal Marketplace, Medicare, Medicaid and other qualifying plans.
  - Among others, individuals exempt from the mandate include those whose income is below the minimum threshold for filing a return, members of a health care sharing ministry and individuals unlawfully present in the United States. Individuals other than those not required to file a return must obtain an exemption certificate from a Marketplace.

- Nonbusiness energy property credit: The residential energy property credit available for certain improvements including qualified windows, skylights, doors, building insulation systems, certain roofing materials, central air conditioning systems and certain waters heaters is set to expire at the end of 2013.
  - Residential energy efficient property credit - The credit available for qualified solar electric property, solar water heating property, fuel cell property, small wind energy property and qualified geothermal heat pump property installed at the taxpayer's principal residence continues to be available through 2016.
- State and local sales tax deduction: The option to deduct state and local general sales taxes in lieu of deducting state and local income taxes is set to expire at the end of 2013.
- Teacher's classroom expense deduction: The $250 above-the-line deduction for qualified unreimbursed educator expenses is set to expire at the end of 2013.
- Exclusion of discharge of indebtedness income: The provision excluding discharge of indebtedness income from gross income if the discharged debt is qualified principal residence indebtedness is set to expire at the end of 2013.
- Mortgage insurance premiums: The ability to treat premiums paid for qualified mortgage insurance as qualified residence interest and deduct them as an itemized deduction is set to expire at the end of 2013.
- Charitable distributions from IRAs: The incentive for individuals age 70½ and older to exclude from gross income up to $100,000 of qualified charitable distributions from individual retirement accounts (IRAs) is set to expire at the end of 2013. A taxpayer may still make a gift from their IRA to a charity in 2014 and beyond, however, the distribution will not be excluded from income. The taxpayer would then claim an itemized deduction for the charitable contribution.

Barring Congressional action, the following may affect business taxpayers in 2014:

- Reduction in code section 179 expensing: The ATRA set the dollar limitation for code section 179 expensing to $250,000 with a $2 million investment ceiling for 2013.
  - The limitation is scheduled to drop to $25,000 for 2014 with a $200,000 investment ceiling.
- Bonus depreciation: The special 50 percent first year bonus depreciation allowance on qualified new property with recovery periods of 20 years or less is set to expire at the end of 2013.
- 15-year recovery for leasehold/retail improvements and restaurant property: The 15-year recovery period for qualified leasehold improvements, qualified retail improvements and qualified restaurant property is set to expire at the end of 2013.
- Work Opportunity Tax Credit (WOTC): The WOTC for unemployed veterans and unemployed veterans with service connected disabilities is set to expire at the end of 2013.
- Research tax credit: The Code Section 41 research tax credit is set to expire at the end of 2013.
- 5-year recognition period for S corporation built-in gains: The reduced 5-year recognition period is set to expire at the end of 2013. The general 10-year period will apply again beginning in 2014.
- Employer health insurance mandate: Reporting requirements under the ACA and the employer mandate requiring certain employers to provide minimum essential health insurance coverage to its employees have been delayed until 2015. Although not required for 2014, employers falling under this mandate must make plans during 2014 to make sure appropriate coverage is provided to employees as of January 1, 2015.
- Credit for small employer health insurance premiums: Can help offset the cost of coverage for many companies by providing a credit against taxes, but there will be changes beginning in 2014. The credit rises to 50% for premiums paid (35% for small tax-exempt employers), but it only applies to small businesses that participate in the Small Business Health Options Program (SHOP) Marketplace.
- Repair/capitalization regulations: The IRS released final "repair" regulations that explain when taxpayers must capitalize costs and when they can deduct expenses for acquiring, maintaining, repairing and replacing tangible property used in a business. The regulations apply for tax years beginning on or after January 1, 2014 and allow the following de minimus expensing alternatives:
  - For businesses with an Applicable Financial Statement (AFS), or audit, that have a written accounting procedure for expensing amounts paid or incurred for such property under a certain

dollar amount, and treats such amounts as an expense on its AFS in accordance with its written accounting procedure, the IRS allows up to $5,000 to be deducted per invoice.

  - For small business that do not have an AFS, IRS has created a safe harbor that allows up to $500 to be deducted per invoice.

The following is a listing of key amounts and thresholds that may affect you for the 2014 tax year:

- The optional mileage rates for 2014 are as follows:
  - 56 cents per mile for business travel (down from 56.5 cents per mile in 2013)
  - 23.5 cents per mile for medical or moving purposes (down from 24 cents per mile in 2013)
  - 14 cents per mile for charitable purposes (remains unchanged because it is based on statute)
- The wage base for federal unemployment remains at $7,000 and the wage base for Ohio unemployment remains at $9,000
- The maximum salary or wage deferral in a 401(k), a 403(b) or a 457 plan remains $17,500 for calendar year 2014, plus an additional $5,500 catch up contribution for those ages 50 or older.
- For a SIMPLE IRA, the maximum deferral remains $12,000 for calendar year 2014, plus an additional $2,500 catch up contribution for those ages 50 or older.
- The maximum contribution limit for Individual Retirement Accounts, including ROTH accounts remains $5,500 for 2014, plus an additional $1,000 catch up contribution for those over the age of 50.
- Social Security earners who turn age 66 in 2014 (full retirement age for those born 1943-1954) can earn up to $41,400 in 2014 prior to turning age 66 without losing any benefits. Social Security recipients who have not reached age 66 by the end of 2014 can earn up to $15,480 before they will lose any benefits. Once an individual turns 66, there is no earnings limit.
- The annual gift tax exclusion remains at $14,000.
- The standard deduction increases to $6,200 for singles and $12,400 for married couples filing a joint return for 2014 (up from $6,100 and $12,200, respectively, in 2013). The standard deduction for head of household filers increases to $9,100 for 2014 (up from $8,950 in 2013).
- The personal exemption increases to $3,950 in 2014 (up from $3,900 in 2013). However, the exemption is subject to a phase-out that begins with AGI of $254,200 ($305,050 for married couples filing a joint return). The exemption phases out completely when AGI reaches $376,700 ($427,550 for married couples filing a joint return).
- The maximum Earned Income Credit amount is $6,143 in 2014 for taxpayers filing a joint return who have 3 or more qualifying children (up from a total of $6,044 for tax year 2013). The revenue procedure has a table providing maximum credit amounts for other categories, income thresholds and phase-outs.
- The annual dollar limit on employee contributions to employer-sponsored healthcare flexible spending arrangements (FSAs) remains at $2,500.

Although new and ever-changing tax laws seem to increase complexity, they also often open up new opportunities to minimize your tax bill. We can help you analyze your tax situation and determine the best steps to address your tax challenges and any other financial concerns. We are also available after tax season to advise on strategies and planning decisions that will help you minimize taxes and meet your business and financial goals going forward. Please do not hesitate to contact us today to schedule an appointment to begin discussing your options.

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