Year-End 2013 Brings New Challenges And Opportunities

HIGHLIGHTS

- Increased tax rates for higher income individuals
- New net investment income surtax
- Many extenders set to expire
- Bonus depreciation may be ending
- IRS recognizes same-sex marriage nationwide
- Health care employer mandate delayed
- Individual mandate effective January 1

INSIDE

Year-end 2013 brings many new planning opportunities along with the traditional year-end tax planning strategies. It also brings challenges - for both individuals and businesses. There is much for taxpayers and their tax advisors to consider in taking action before 2013 ends, including the important changes made by the American Taxpayer Relief Act of 2012 (ATRA) (signed into law on January 2, 2013), the provisions in the Patient Protection and Affordable Care Act) (scheduled to take effect in 2013, 2014) the Supreme Court's decision on same-sex marriage and the release of significant new IRS rules on many pressing issues. There is also the prospect of comprehensive tax reform in 2014, which will require some "crystal ball" forecasting of what Congress may or may not do in the coming year. On top of everything, the IRS shutdown in October could delay the start of the 2014 filing season, although the long-term effects have yet to be determined.

This briefing explores some of the 2013 year-end planning opportunities available to taxpayers, especially as the result of provisions that are new-for-2013 and those that at the moment are scheduled to expire after 2013. Of course, every taxpayer's situation is unique and a year-end planning strategy, whether for an individual, family or business, should be customized in consultation with a tax professional.

STRATEGY *For higher income tax-payers, 2013 also represents a year of increased tax burden in comparison to previous years. Not only did ATRA set the maximum income tax rate at 39.6 percent but the Affordable Care Act's new surtax on net investment income (NII) and Additional Medicare Tax also began to apply as of January 1, 2013. The combination of these and other factors makes year-end planning all that more crucial.*

COMMENT *At the time this Briefing was prepared, the IRS had furloughed nearly 90 percent of its personnel in response to a lapse in appropriations after fiscal year (FY) 2013. The IRS has instructed taxpayers to file returns and pay taxes as normal during the shutdown. Notices and other automated functions are operating. However, the IRS is not responding to taxpayer questions during the shutdown. What long-term effects the shutdown will have, particularly for the 2014 filing season, are uncertain.*

PLANNING FOR INDIVIDUALS

The approach of year-end 2013 brings more certainty to tax planning than in 2012 because of ATRA. In addition to the permanent extension of the Bush-era tax cuts for lower and middle income taxpayers, ATRA also revived the 39.6 percent tax bracket (at new levels) for higher income individuals, revived the personal exemption phase-out (PEP) and limitation on itemized deductions (Pease limitation) (at new levels), increased the maximum tax rate on qualified dividends and capital gains, and made many additional changes. And, as already noted, the Affordable Care Act brings two additional considerations that need to be factored into year-end planning by higher-income taxpayers for the first time in 2013 - the NII surtax and the new Additional Medicare Tax.

Tax Rates

For 2013 and subsequent years, the individual income tax rate schedules reflect a continuation of the rates under the "Bush-era" tax cuts, except for the addition of a new 39.6 percent rate for the highest bracket. Thus, the individual income tax rates for 2013 and future years are 10, 15, 25, 28, 33, 25 and 39.6 percent. As in the past, each taxable income rate bracket is increased slightly each year based upon an inflation factor. The starting points for the 39.6 percent bracket for 2013 and 2014 (as projected for inflation) are:

	2013	2014
Married filing jointly and surviving spouse	$450,000	$457,600
Heads of households	$425,000	$432,200
Unmarried individuals	$400,000	$406,750
Married filing separately	$225,000	$228,800

STRATEGY *Because the highest rate for estates and trusts starts at a relatively low level of taxable income ($11,950 in 2013 and $12,150 in 2014), executors and trustees should consider making distributions to beneficiaries before year end, which generally will pass that amount of taxable income through to those beneficiaries and escape tax at the comparatively high estate/trust level.*

Capital Gains/Dividends

Starting in 2013, ATRA has raised the top rate for capital gains and dividends to 20 percent, up from the Bush-era maximum 15 percent rate. This top rate is generally aligned with the same income levels at which the new 39.6 percent income tax rate bracket starts: long-term capital gains and qualified dividends, to the extent they would be otherwise taxed at the 39.6 percent rate as marginal ordinary income, will be taxed at the 20 percent rate.

IMPACT *Absent ATRA, the maximum tax rate on net capital gain of all non-corporate taxpayers would have reverted to 20 percent (10 percent for taxpayers in the 15 percent bracket) starting January 1, 2013. On the other side of the spectrum, because of ATRA, taxpayers with incomes below the top of the 15 percent income tax bracket for 2013 and in the future will continue to be subject to a zero percent capital gains/dividends rate.*

COMMENT *The 28 and 25 percent tax rates for collectibles and unrecaptured Code Sec. 1250 gain, respectively, continue unchanged after 2012. Also un-changed is the application of ordinary income rates to short-term capital gains, except that now taxpayers may potentially be subject to a higher top rate (39.6 percent instead of 35 percent). This could be even higher (43.4 percent) if the NII surtax applies (see below).*

STRATEGY *Taxpayers may consider using carryforward losses from 2012 by recognizing capital gains to the extent of the available carryforwards, preferably short-term gains if available, since they are taxed at the ordinary-income rates. Carryforward net capital losses from pre-2013 transactions, which would have only offset capital gains at a maximum 15 percent rate, are able to offset capital gains at the new, higher rates without adjustment for the rate change.*

STRATEGY *Holding capital assets for more than 12 months before taxable disposition to avoid short-term capital gain status is usually advisable, unless sufficient loss offsets have been recognized, or market conditions indicate otherwise.*

STRATEGY *Year-end planning should also look to avoiding spikes in income, whether capital gains or other income, which may push capital gains into either the 39.6 percent bracket or the 20 percent capital gains bracket. Spreading the recognition of certain income between 2013 and 2014, rather than reco-nizing it all in either 2013 or 2014, may accomplish this goal.*

Qualified Dividends

Generally, dividends received from a domestic corporation or a qualified foreign corporation, on which the underlying stock is held for at least 61 days within a specified 121-day period, are qualified dividends for purposes of the reduced, capital gains tax rate. Certain dividends do not qualify for the reduced tax rates and are taxed as ordinary income. These include, dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

CAUTION *Installment payments are subject to the tax rates for the year of the payment, not the year of the sale. The capital gains portion of payments made in 2013 ax later in now taxed at the 20 percent rate for higher-income taxpayers.*

Surtax On Net Investment Income (NII)

Starting in 2013, higher-income tax-payers may be liable for a 3.8 percent NII surtax. The NII surtax on individuals equals 3.8 percent of the *lesser* of:

(1) Net investment income for the tax year, or
(2) The excess, if any of:
  (a) the individual's modified adjusted gross income (MAGI) for the tax year, over
  (b) the threshold amount.

The threshold amount is equal to:

- $250,000 in the case of joint returns or a surviving spouse.
- $125,000 in the case of married tax-payer filing a separate return, and
- $200,000 in any other case.

CAUTION *The NII tax threshold amounts are not indexed for inflation. Although both the 39.6 percent ordinary income rate, the 20 percent capital gain/dividend rate, and the 3.8 percent rate are commonly referred to as affecting "higher income" taxpayers, the income threshold for being subject to the 3.8 percent NII tax is significantly lower than the others. Therefore, a greater number of taxpayers will be subject in the 3.8 percent rate for the NII surtax.*

IMPACT *Depending upon the character of the NII income, combined NII tax and regular income tax rates can cause NII be taxed at 23.8 percent if long-term capital gain or qualified dividends, or at 36.8, 38.8, or 43.4 percent if short-term gains or passive activity income is involved. At the 23.8 percent level, the difference in tax paid on net capital gains and dividends between 2012 and 2013 is nearly a 60 percent increase.*

STRATEGY *Taxpayers should consider keeping threshold income below the $250,000/$125,000/$200,000 NII tax threshold levels if possible by spreading income out over a number of years or offsetting the income with above-the-line deductions. In particular, spikes in income should be carefully managed in connection with Roth IRA conversions, taxable sales of large assets (including primary residences, if gain is not fully protected by the Code Sec. 121 primary residence exclusion), and other "one-time" events. Taxpayers should also be aware that the threshold amounts are keyed to all income and not just net investment income.*

STRATEGY *All net investment income should be monitored for exposure to the NII surtax. Net investment income is more than simply capital gain and dividends. Principally, it also includes income from a business in which the taxpayer is a passive participant. Rental income may also be considered NII unless earned by a real estate professional. Taxpayers should also carefully weigh the impact of IRS regulations under Code Sec. 1411 on any year-end maneuvers, including the impact of the self-rental rule as well as pass-through income from an active owner of an S Corporation or partnership.*

STRATEGY *Quarterly estimated tax payments may have required adjustment throughout 2013 because of the increase in rate for capital gains and other net investments income. The run up in the stock markets earlier this year may have contributed to this situation. Although make-up payments for fourth-quarter estimated tax may help lessen any eventual estimated tax penalties, they will not eliminate them. However, directing an employer to increase wage withholding for the balance of 2013 to make up the difference can eliminate any estimated tax penalty entirely and retro-actively with respect to all 2013 quarters.*

COMMENT *At the time this Briefing was prepared, the IRS had not finalized Form 8960, Net Investment Income Tax, nor its instructions, which taxpayers will use to report liability for the NII surtax.*

Additional Medicare Tax

Effective for tax years beginning after December 31, 2012, the Additional Medicare Tax increases the employee-share of Medicare tax by an additional 0.9 percent of covered wages in excess of certain "higher income-level" threshold amounts. Similarly, the Additional Medicare Tax increases Medicare tax on self-employment income for any tax year beginning after December 31, 2012 by an additional 0.9 percent of self-employment income in excess of certain threshold amounts.

Threshold Amounts

The Additional Medicare Tax is not imposed until an individual's covered wages, compensation and/or self-employment income exceed the threshold amount for the taxpayer's filing status. The threshold amounts are: $200,000 for single individuals (and heads of household); $250,000 for married couples filing a joint return; and $125,000 for married individuals filing separate returns.

COMMENT *The threshold amounts are not indexed for inflation and therefore will remain the same for 2014 and subsequent years as for 2013. All wages subject to regular Medicare Tax are subject to the Additional Medicare Tax.*

IMPACT *Single individuals liable for Additional Medicare Tax after 2012 pay 1.45 percent Medicare tax on the first $200,000 of compensation plus 2.35 percent (1.45 percent + 0.9 percent) on compensation in excess of $200,000. Married couples filing a joint return pay 1.45 percent Medicare tax on the first $250,00 of compensation plus 2.35 percent (1.45 percent + 0.9 percent) on compensation in excess of $250,000. Unlike Social Security tax, there is no cap on the amount of compensation subject to Medicare tax.*

COMMENT *The threshold amounts are identical to those set for the NII tax. However, despite some relationship between these two taxes, income that escapes the NII tax does not necessarily get caught by the 0.9 percent Medicare tax, or vice versa.*

STRATEGY. *Taxpayers liable for Additional Medicare Tax will calculate Additional Medicare Tax liability on their individual income tax returns. Taxpayers who anticipate liability for Additional Medicare Tax may request that their employer(s) take out an additional amount of income tax withholding which would be applied against taxes shown on the taxpayer's individual income tax return, including any Additional Medicare Tax liability.*

CAUTION *The IRS has cautioned that if an employee has amounts defined under a nonqualified deferred compensation plan, and the nonqualified deferred compensation is taken into account as wages for FICA (Social Security and Medicare) purposes under a special timing rule, the nonqualified deferred compensation would likewise be taken into account under the special timing rule to determine the employer's obligation to withhold Additional Medicare Tax.*

Withholding

An employer is required to collect Additional Medicare Tax with respect to wages earned for duties performed by the employee for the employer only to the extent the employer pays wages to the employee in excess of $200,000 in a calendar year. This rule applies without regard to the employee's filing status or other wages/compensation.

STRATEGY *The employer's obligation to withhold Additional Medicare Tax starts at $200,000. This is distinct (as explained above) from the threshold amounts for liability for Additional Medicare Tax. Individuals who receive wages from more than one employer, and who expect those wages to exceed the threshold amounts, should consider increasing their withholding or making estimated tax payments. Under proposed IRS regulations, interest-free adjustments of employer under-payments of Additional Medicare Tax generally may be made only if the error is ascertained in the same year the wages or compensation was paid.*

Alternative Minimum Tax

Year-end planning was made more complicated in the past because of uncertainty over the reach of the alternative minimum tax (AMT). Congress had originally intended that the AMT operate so that very wealthy taxpayers could not escape taxation. Because the AMT had not been indexed for inflation, along with other factors, the AMT began to encroach on middle income taxpayers. To prevent this, Congress routinely "patched" the AMT by increasing the exemption amounts and making other changes. ATRA permanently patches the AMT for 2013 and subsequent years.

Under ATRA, the exemption amounts for 2013 are $51,900 for single individuals and heads of household and $80,800 for married couples filing joint return and surviving spouses. ATRA provides that these amounts are indexed for inflation after 2013. Taxable income that exceeds the exemption amount is subject to a 26 percent AMT rate on the first $175,000 of alternative minimum tax income (AMTI) and a 28 percent on any AMTI above this $175,000 amount. ATRA also allows taxpayers to take all of the nonrefundable personal credits against regular and AMT liability.

COMMENT *It's projected that, for 2014, the AMT exemption for married joint filers and surviving spouses will be $82,100 (up from $80,800 in 2013). For heads of household and unmarried single filers, the exemption will be $52,800 (up from $51,900 in 2013).*

STRATEGY *Taxpayers who were accustomed to reviewing their AMT liability versus regular tax liability in years before ATRA permanently patched the AMT should continue their analysis. Some taxpayers may find that their AMT liability and regular tax liability are roughly equal from year to year. Other taxpayers may find that they have had significant fluctuations in income from year to year and could explore the benefit from being able to shift some AMT-triggering items from an AMT year to a non-AMT year.*

STRATEGY *Taxpayers who discover they are not liable for AMT for 2013, but who had been liable for the AMT in a past year, may be eligible to take a mini-mum tax credit against their regular tax this year. This credit cannot, however, be used to reduce AMT liability in a future year. Additionally, the minimum tax credit is allowed only for the AMT caused by deferral items (such as depreciation) and not exclusion items (such as the standard deduction).*

COMMENT *President Obama has proposed to replace the AMT with the so-called "Buffett Rule," which would impose a minimum tax of 30 percent on taxpayers with incomes above $1 million. In April 2013, the Senate rejected the Buffett Rule as proposed in a bill sponsored by Democrats. Senate Democrats could reintroduce the bill in 2014.*

LIFE CYCLE CHANGES IMPORTANT TO YEAR-END STRATEGIES

In addition to changes in the tax law, year-end tax strategies should also consider personal circumstances that changed during 2013 as well as what may change in 2014. These "life cycle" changes include:

- Changes in filing status: marriage, divorce, death or head of household changes
- Birth of a child
- Child no longer young enough for child credit
- Child who has outgrown the "kiddie" tax
- Casualty losses
- Changes in medical expenses
- Moving/relocation
- College and other tuition expenses
- Employment changes
- Retirement
- Personal bankruptcy
- Large inheritance
- Business successes or failures

Pease Limitation

ATRA revived and modified the "Pease" limitation (named for the member of Congress who sponsored the original legislation) on itemized deductions for higher income taxpayers. The Pease limitation had been eliminated as part of the Bush-era tax cuts through 2012. The Pease limitation "applicable threshold" levels under ATRA for 2013 are:

- $300,000 for married couples and surviving spouses;
- $275,000 for heads of households;
- $250,000 for unmarried taxpayers; and
- $150,000 for married taxpayers filing separately.

IMPACT *Without ATRA, the applicable threshold for the Pease limitation for 2013, as adjusted for inflation and as computed under Bush-era sunset rules, would have been $178,150 ($89,075 for individuals married filing separately).*

COMMENT *The dollar amounts are adjusted for inflation for tax years after 2013. For 2014, they are projected to be $305,050 for married couples filing joint returns; $278,650 for heads of house-hold; $254,200 for single taxpayers; and $152,525 for married taxpayers filing separate returns.*

IMPACT *The Pease limitation reduces the total amount of a higher-income taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. However, the amount of itemized deductions is not reduced by more than 80 percent. Certain items, such as medical expenses, investment interest, and casualty, theft or wagering losses, are excluded.*

Personal Exemption Phase-out

ATRA revived and modified the personal exemption phase-out (PEP). The threshold adjusted gross income amounts for the PEP mirror those of the revived Pease limitation:

- $300,000 for married couples and surviving spouses;
- $275,000 for heads of households;
- $250,000 for unmarried taxpayers; and
- $150,000 for married taxpayers filing separately.

IMPACT *Under the phase-out, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500, or portion thereof (two percent for each $1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income exceeds the applicable threshold level.*

Child Tax Credit

For 2013, the child tax credit is $1,000 per qualifying child. Before ATRA, the child tax credit had been scheduled to revert to $500 per qualifying child. ATRA, however, made permanent the $1,000 amount for 2013 and subsequent years.

IMPACT *The child tax credit is not indexed for inflation. As a result, the "real" value of the credit will continue to decline.*

STRATEGY *When claiming the child tax credit, taxpayers should assess other expenses related to children, such as educational and child care costs, which could qualify for special tax breaks, as year-end approaches. In divorce or separation situations, the taxpayer entitled to the child credit is often aligned with the taxpayer who claims the dependency exemption and the child and dependent care credit. Absent an agreement between the parties, it is critical that a determination of the amount of time that a child lives within a certain household be made. It is also essential to determine whether more than half of the child's support is provided by one of the parties. These considerations make year-end assessments, and follow-up contributions or other tweaks to these threshold requirements, important in some cases.*

Medical Expense Deduction

Before 2013, taxpayers who itemized deductions could claim a deduction for qualified nonreimbursed medical expenses to the extent those expenses exceeded 7.5 percent of adjusted gross income (AGI). Effective for tax years beginning after December 31, 2013, the 7.5 percent threshold generally increases to 10 percent. Taxpayers (or their spouses) who are age 65 or older before the close of the tax year, however, may continue to apply the 7.5 percent threshold for tax years through 2016.

STRATEGY *For deductions by cash-basis taxpayers in general, including for purposes of the medical expense deduction, a deduction is permitted only in the year in which payment for services rendered is actually made. Under this general rule, payment by credit card constitutes payment in the year in which the credit card statement is paid. Prepayment of medical expenses prior to the year in which services are rendered, however, generally does not accelerate the deduction, absent some legitimate payment-In-advance requirement of the service provider.*

COMMENT *The AMT threshold for itemized deductions remains unchanged as 10 percent. No exemption for those age 65 or older exists.*

Health Flexible Spending Arrangements

Beginning in 2013, the Affordable Care Act caps annual contributions to health flexible spending arrangement (health FSAs) at $2,500. Any salary reductions in excess of $2,500 will subject an employee to tax on distributions from the health FSA. The $2,500 maximum amount is indexed for inflation after 2013. For 2014, the cap is projected to be $2,500, the same as in 2013.

STRATEGY *Use-it-or-lose-it rules for health FSAs allow cafeteria plans to provide for a 2 ½ month grace period after the current year to incur expenses and request reimbursement. However, plans are not required to offer this grace period so participants should check before year-end whether a grace period applies to them. Also relevant to year-end is the requirement that an election as to the amount contributed to an FSA be made before the tax year to which it will apply.*

Sunsetting "Extenders"

Some people, but temporary, tax incentives known as "extenders" are scheduled to expire after 2013. Whether Congress will extend them again is questionable. While all have their supporters, Congress appears likely to take an extremely budget-conscious approach toward any tax provision it may consider, in addition to being divided on most tax issues in general. Taxpayers should accordingly consider acting upon the benefits provided by these provisions now, before year-end 2013, whenever possible. The extenders provision include:

State and Local Sales Tax
Taxpayers may elect to deduct state and local sales taxes in lieu of state and local income taxes. Although this incentive is scheduled to sunset at the end of 2013, it appears to be the most politically-backed extender and, there-fore, may survive through another extension until tax reform permanently addresses its place.

Teachers' Classroom Expense Deduction
Primary and secondary education professionals may take an above-the-line deduction for qualified nonreimbursed expenses up to $250 paid during the year.

Exclusion of Cancellation of Indebtedness on Principal Residence
This provision allows taxpayers to exclude from income cancellation of mortgage debt of up $2 million on a qualified principal residence, but only through 2013.

Transit Benefits
Parity in the amount of transit fringe benefits that may be enjoyed pre-tax by employees has allowed those using public transportation and van pooling to benefit at the same higher-level as is available to taxpayers receiving qualified parking benefits ($245 for 2013). This parity will expire after 2013 unless extended by Congress, thus reducing the benefit for public transportation and van pooling to $130 per month for 2014 (as projected for inflation).

Mortgage Insurance Premiums
Mortgage insurance premiums have been allowed to be treated as qualified residence interest.

Contribution of Capital Gains Real Property for Conservation
Contributions of capital gain real property for conservation purposes have been allowed to be taken against 50 percent of an individual's charitable contribution base, allowing for a larger charitable contribution amount.

IRA Distributions to Charity
Tax-free distributions, up to a maximum of $100,000 per taxpayer each year, from individual retirement accounts to public charities by individuals age 70 ½ or older, have been allowed as an alternative to taking an itemized deduction.

Same-Sex Marriage

On June 26, 2013, the U.S. Supreme Court struck down Section 3 of the Defense of Marriage Act in *E.S. Window, 2013-1 uste 50,400.* The Court held that Section 3, which had defined marriage for federal purposes as the union of one man and one woman, was unconstitutional. Subsequently, the IRS announced a general rule in Rev. Rul. 2013-17 recognizing same-sex marriages nationwide.

Places of Celebration Approach
All same-sex marriages are recognized for all federal tax purposes, regardless of whether a couple resides in a jurisdiction that recognizes same-sex marriage or in a jurisdiction that does not recognize same-sex marriage. All legally married same-sex couples will be treated as married for all federal tax purposes, including income and gift and estate taxes.

IMPACT *Under the place of celebration approach used by the IRS, a couple that marries in a state that recognizes same-sex marriage and subsequently moves to a state that does not recognize same-sex marriage will continue to be treated as married for all federal tax purposes. The IRS has taken the same approach to common law marriages for over 50 years.*

IMPACT *The Supreme Court did not strike down Section 2 of DOMA, which provides that states do not have to recognize same-sex marriages recognized in other states. The result is a patchwork of laws, with some state recognizing same-sex marriage and others not. As of the time this Briefing was prepared, 13 states and the District of Columbia recognized same-sex marriage.*

Filing Status
The IRS announced different rules for different tax years:

- ***Tax Year 2013 and Subsequent Years*** For tax year 2013 and beyond, same-sex spouses generally must file using a married filing separately or jointly filing status.
- ***Prior Tax Years*** For tax year 2012, and all prior tax years, same-sex spouses who file an original tax return on or after September 16, 2013 (the effective date of Rev. Rul. 2013-17), generally must file using a married filing separately or jointly filing status. For tax years 2011 and earlier, same-sex spouses who filed their tax returns timely may choose, but are not required, to amend their federal tax returns to file using a married filing separately or jointly filing status, provided the period of limitation for amending the return has not expired.

STRATEGY *Married same-sex couples should explore the potential benefits of filing amended returns for open tax years. Generally, the limitations period for filing a refund claim is three years from the date the return was filed or two years from the date the tax was paid, whichever is later. Some taxpayers may have filed protective claims to keep the limitations period open for certain years.*

IMPACT *Along with filing status, IRS recognition of same-sex marriage nationwide allows same-sex couples to take advantage of many tax incentives that include special rules for married filing jointly taxpayers, such as the adoption credit.*

Employee Benefits
As a result of DOMA, taxpayers may have paid taxes on the fair market value of employer-provided health care coverage for their same-sex spouse.

In Notice 2013-61, the IRS announced two optional special administrative procedures for employers to make claims for refunds or adjustments of employment taxes for certain benefits paid to same-sex spouses. Under the first procedure, employers may use the fourth quarter 2013 From 941, Employer's Quarterly Federal Tax Return, to correct any overpayments of employment taxes for the first three quarters of 2013. Under the second procedure, employers may file one Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, for the fourth quarter of 2013 to correct any overpayments of FICA taxes for all quarters 2013.

Domestic Partners

IRS recognition of same-sex marriage does not apply to registered domestic partners, individuals in a civil union, or similar relationships. Taxpayers in these types of relationships must continue to file their federal income tax returns as single individuals, even if they are able to file state returns jointly. Registered domestic partners may not file as married filing jointly or married filing separately, because the individuals are not considered married or spouses for federal tax purposes.

IMPACT *A registered domestic partner can itemize his or her deductions regardless of whether his or her partner itemizes or claims the standard deduction. Although Code Sec. 63(c)(6)(A) prohibits a taxpayer from itemizing deductions if the taxpayer's spouse claims the standard deduction, this provision does not apply to registered domestic partners because they are not considered married for federal tax purposes.*

ESTATE AND GIFT TAXES

After a number of years during which significant uncertainty existed over the federal estate and gift tax system, ATRA finally provided a permanent structure under which planning can now take place. ATRA permanently pro-vides for a maximum federal unified estate and gift tax rate of 40 percent which an inflation-adjusted $5 million exclusion for gifts made and estates of decedents dying after December 31, 2012.

IMPACT *The applicable exclusion amount, as adjusted for inflation, is $5,250,000 for gifts made and estates of decedents dying in 2013. The exclusion is projected to increase to $5,340,000 in 2014.*

ATRA also preserved the annual gift tax exclusion. This exclusion allows tax-payers to give up to an inflation-adjusted $14,000 to any individual, gift tax free and without counting the amount of the gift toward the lifetime $5 million exclusion, adjusted for inflation.

IMPACT *The $14,000 limit applies to 2013 gifts. The same $14,000 limit is projected for 2014.*

There is no limit on the number of individual donees to whom gifts may be made under the $14,000 exclusion. Spouses may "split" their gifts to each donee, effectively raising the per donee annual maximum exclusion to $28,000. Spouses may give an unlimited amount of gifts to one another without any gift tax imposed.

STRATEGY *Maximizing each year's annual gift tax exclusion (now at the $14,000 level) has been a traditional year-end tax strategy that should continue post-ATRA. The annual exclusion cannot be carried over and added onto next year's exclusion; it is a classic use-it-or-lose-it benefit. For example, $14,000 given to Individual X on December 31, 2013, and another $14,000 given to Individual X on January 1, 2014 are both gift tax free. If a split gift election between spouses is made, those gifts may be doubled to a $56,000 maximum given tax free. Funds given to support a dependent do not count toward the $14,000 limit; nor do funds given directly to college to pay tuition or to a medical service provider.*

STRATEGY *Gifts of appreciated property are counted for purposes of the annual exclusion and gift tax, in general, at their market value, rather than the donor's basis. However, the donor's basis must be used in computing any gain on a subsequent sale by the donee. Frequently, a donee may be in a lower tax bracket than the donor, therefore gifting appreciated property potentially saves income tax as well as gift tax. In particular, those donees currently within the 10 or 15 percent rate income tax bracket may realize a zero percent capital gain tax. "Kiddie tax" implications (in which the donee may be taxed at the same rate as the donor), however, must be considered within this strategy.*

PLANNING FOR BUSINESSES

Businesses seeking to maximize tax benefits through 2013 year-end tax planning may want to consider two general strategies:

1) Use of traditional timing techniques for income and deductions; and
2) Special consideration of significant tax incentives (known as tax extenders) scheduled to expire at the end of 2013.

IMPACT *Business incentives scheduled to end with 2013 include bonus depreciation, enhanced Code Sec. 179 expensing, the Work Opportunity Tax Credit, and many other business-friendly provisions. Although Congress has routinely renewed these tax extenders in the past, current politics over budget concerns, and the impression that the economy may no longer need extra-ordinary stimulus measures, may point to 2013 year-end as the last occasion for businesses to take advantage of one or more of these special benefits.*

IMPACT *Ultimately, the fate of many of the tax extenders may be decided when Congress takes up comprehensive tax reform. However, as partisan politics continue in Washington, prospects steadily diminish for a "grand bargain" in which the extenders would carry a January 1, 2014 effective date.*

New for business owners

Businesses should also be aware of those tax rules that are new-for-2013. In particular, increased tax rates on higher-income individuals effective for

2013 may impact business strategies directed toward minimizing taxes for business owners with either pass-through or dividend income. Also important for year-end 2013, are tax strategies in connection with recently-issued final "repair" regulations.

Code Section 179 Expensing

An enhanced Code Sec. 179 expense deduction is available through 2013 to taxpayers (other than estates, trusts or certain non-corporate lessors) that elect to treat the cost of qualifying property (Code Sec. 179 property) as an expense rather than a capital expenditure. The annual dollar limitation on Code Sec. 179 expensing for tax years beginning in 2012 and 2013, as increased by ATRA , is $500,000. Similarly, for tax years be-ginning in 2012 and 2013, an annual $2 million overall investment limitation applies before the maximum $500,000 deduction must be reduced, dollar-for-dollar, for amounts above that $2 million amount.

IMPACT *The Code Sec. 179 deduction phases out completely in a tax year beginning in 2013 if the taxpayer places more than $2.5 million of Code Sec. 179 property in service. In contrast, for tax years beginning after 2013, that dollar limit is scheduled to plummet under current law to $25,000 unless otherwise extended by Congress. The phase-out ceiling is also scheduled to drop to $200,000 in 2014 unless otherwise extended by Congress. As a result, purchases of otherwise qualifying property in excess of only $225,000 in 2014 will reduce the Code Sec. 179 deduction to $0.*

STRATEGY *A business could maximize its benefits under Code Sec. 179 by expensing property that does not qualify for bonus depre-ciation (such as used property) and property with a long modified accelerated cost recovery system (MACRS) depreciation period. For example, given the choice between expensing an item of MACRS five-year property and an item of MACRS 15-year property, the 15-year prop-erty should generally be expensed since it takes 10 additional tax years to recover its cost through annual depreciation deductions as opposed to recovery of the cost of the five-year property.*

Carry forward

The Code Sec. 179 deduction is also limited to the taxpayer's taxable income derived from the active conduct of any trade or business during the tax year, computed without taking into account any Code Sec. 179 deduction, deduction for self-employment taxes, net operating loss carryback or carryover, or deductions suspended under any provision. Any amount disallowed by this limitation may be carried forward and deducted in subsequent tax years, subject to the maximum dollar and investment limitations, or, if lower, the taxable income limitation in effect for the carryover year.

STRATEGY *Since the maximum dollar limit for 2014 is scheduled to fall to $25,000 (unless the $500,000 amount is extended to at least the same degree by Congress), business should not assume that a carryover will be fully absorbed immediately in 2014. Monitoring 2013 taxable income in 2013 for this purpose therefore is important within an overall Code Sec. 179 strategy.*

Qualifying property

Code Sec. 179 property is generally defined as new or used depreciable tangible Code Sec. 1245 property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software is also included for 2013 in the definition of qualifying property as is some real property (discussed below).

STRATEGY *Under current law, off-the-shelf computer software and certain real property will not qualify for Code Sec. 179 expensing after 2013, even at the lower $25,000 ceiling. This makes year-end strategies that take advantage of them in 2013 particularly critical.*

Qualified real property

The Code Sec. 179 expensing allowance for qualified real property, is scheduled to expire for property place in service after 2013. Qualified real property for expensing purposes includes qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

Code Sec. 179 expensing versus bonus depreciation

Unlike Code Sec. 179 expensing, there is no dollar cap on the amount of bonus depreciation that a business may claim (*Bonus depreciation is discussed below*). Additionally, Code Sec. 179 property encompasses used property, while bonus depreciation is limited to first-use by the taxpayer.

COMMENT *Bonus depreciation is keyed to a calendar year and generally ends after December 31, 2013. Rules for 2013 Code Sec. 179 expensing, on the other hand, apply for tax years beginning in 2013.*

Bonus Depreciation

ATRA generally allows for 50 percent bonus depreciation during 2012 and 2013. After 2013, bonus depreciation is scheduled to expire (except for certain noncommercial aircraft and longer production period property which may be eligible for 50 percent bonus depreciation through 2014).

Qualifying property

Qualified property for bonus depre-ciation purposes must be depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. These requirements encompass a wide variety of assets. The property must be new and placed in service (as well as acquired) before January 1, 2014 (placed in service before January 1, 2015 for certain noncommercial aircraft and longer production period property).

STRATEGY *Unlike regular depreciation, under which half or quarter year conventions may be required, a taxpayer is entitled to the full, 50-percent bonus depreciation irrespective of when during the year the asset is purchased. Year-end placed-in-service strategies therefore can provide an almost immediate "cast discount" for qualifying purchases, even when factoring in the cost of business loans to finance a portion of those purchases.*

STRATEGY *Although a bonus-depreciation election should be factoring into a year-end strategy, a* *final decision on making it is not required until a return is filed. Further, bonus depreciation is not mandatory. Certain taxpayers should consider electing out of bonus depreciation to spread depreciation deductions more evenly over future years.*

CAUTION *Bonus depreciation's placed-in-service deadline for certain noncommercial aircraft and property with a longer production period was extended by ATRA for an additional year, but its acquisition date remains at before January 1, 2014, as under the general rule. Property acquired pursuant to a written binding contract entered into before January 1, 2014, is deemed acquired before January 1, 2014.*

Luxury car depreciation caps

Along with the sunset of bonus depreciation, the additional $8,000 first-year depreciation cap for passenger automobiles under Code Sec. 280F to account for bonus depreciation is scheduled to expire after 2013.

STRATEGY *The scheduled sunsetting of the additional $8,000 first-year depreciation amount may give businesses an additional incentive to purchase (and place into service) a vehicle before year-end 2013. The additional $8,000 amount could be extended by Congress as in the past but there is no guarantee that it will do so again.*

Final Repair/Capitalization Regulations

In September 2013, the IRS released much-anticipated final "repair" regulations that explain when taxpayers must capitalize costs and when they can deduct expenses for acquiring, maintaining, repairing and replacing tangible property. The final regulations make many significant taxpayer-friendly changes to temporary regulations issued in 2011. The final regulations are considered to challenge virtually every business because of their broad application.

Compliance timetable

The final regulations apply to tax years beginning on or after January 1, 2014, but provide taxpayers with the option to apply either the final or temporary regulations to tax years beginning after 2011 and before 2014. The IRS has promised critical "transition guidance" later this year to help taxpayers deal with implementation regarding how to apply the regulations for years prior to 2014 as well as what change-of-accounting procedures should be followed.

STRATEGY *As a result of the final regulation's optional retroactive effective date, some taxpayers may be better off putting certain procedures into place before the start of 2014 to maximize benefits; other taxpayers may consider filing amended returns for 2012 and 2013 to take advantage of certain elections provided in the final regulations. Under all circumstances, taxpayers must use only permissible procedures in their tax years beginning in 2014. Because of all these immediate options and requirements, taxpayers should work on integrating a response to the final regulations as part of their 2013 year-end planning, and have a definite plan in place before mandatory rules become effective on January 1, 2014.*

De minimis expensing alternative

The final regulations also include a new *de minimis* expensing rule that allows taxpayers to deduct certain amounts paid or incurred to acquire or produce a unit of tangible property. If the taxpayer has an Applicable Financial Statement (AFS), written accounting procedures for expensing amounts paid or incurred for such property under certain dollar amounts, and treats such amounts as expenses on it AFS in accordance with its written accounting procedures, the final regulations allow up to $5,000 to be deducted per invoice.

STRATEGY *To take advantage of the $5,000 de minimis rule, taxpayers must have written book policies in place at the start of the tax year that specify a per-item dollar amount (up to $5,000) that will be expensed for financial accounting purposes. Calendar-year taxpayers, therefore, should have a policy in place by year-end 2013 to qualify for 2014.*

STRATEGY *For smaller businesses, the final regulations added a safe harbor for taxpayers without an AFS. The per-item or invoice threshold amount in that case is $500.*

15-Year Recovery For Leasehold/Retail Improvements, Restaurant Property

ATRA extended through 2013 the 15-year recovery period for qualified leasehold improvements, qualified retail improvements and qualified restaurant property. To qualify for this accelerated recovery period, the qualifying property must be placed in service before January 1, 2014.

Qualified restaurant property is any Code Sec. 1250 property that is a building or an improvement to a building. More than 50 percent of the building's square footage must be devoted to preparation of meals and seating for on-premise consumption of prepared meals.

Qualified leasehold improvement property is any improvement made by the lessor or lessee under or pursuant to the terms of the a lease to an interior part of a building that is nonresidential real property that is more than three years old.

Qualified retail improvement property is any improvement to an interior portion of nonresidential real property that has been in service for more than three years. The improved interior portion must be open to the general public and used in the retail trade or business of selling tangible personal property.

Work Opportunity Tax Credit

Eligibility for the Work Opportunity Tax Credit (WOTC) ends on December 31, 2013. Among other requirements, an employer must hire members of certain targeted groups and have those individuals start work before January 1, 2014.

Targeted groups

Targeted groups include qualified individuals in families receiving certain government benefits, individuals who receive supplemental Social Security Income or long-term family assistance, and veterans.

Amount
The credit is generally equal to 40 percent of the qualified worker's first-year wages up to $6,000 ($3,000 for summer youths and $12,000, $14,000, or $24,000 for certain qualified veterans). For long-term family aid recipients, the credit is equal to 40 percent of the first $10,000 in qualified first year wages and 50 percent of the first $10,000 of qualified second-year wages.

Advanced certification required
On or before the day the employee begins work, the employer must receive a written certificate from the designated local agency (DLA) indicating that the employee is a member of a specific targeted group. Employers can use Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, to obtain the certification.

Research Tax Credit

ATRA extended the Code Sec. 41 research tax credit through 2013. The research credit may be claimed for increases in business-related qualified research expenditures and for increases in payments to universities and other qualified organizations for basic research. The credit applies to excess of qualified research expenditures for the tax year over the average annual qualified research expenditures measured over the four preceding years.

COMMENT *Although the research tax credit enjoys significant bipartisan support in Congress, the Obama Administration, and the business community, its estimated $14.3 billion 10-year revenue cost of making it permanent will likely persuade Congress once again to enact a one- or two-year extension of the credit, and perhaps waiting to do so retroactively sometime in 2014.*

Small Business Stock

To encourage investment in small businesses and specialized small business investment companies (SSBICs), Code Sec. 1202(a) allows a noncorporate taxpayer to exclude from gross income a specified percent of the gain realized from the sale or exchange of qualified small business stock held for more than five years. As extended by ATRA, a full 100-percent exclusion applies to qualified small business stock that is acquired after September 27, 2010, and before January 1, 2014, and held for more than five years. Under current law, the percentage that is excluded reverts to 50-percent (60-percent for empowerment zone stock) for qualifying stock acquired after December 31, 2013.

COMMENT *Eligible gain from the disposition of qualified stock of any single issuer is subject to a cumulative limit for any given tax year is equal to the greater of: (1) $10 million ($5 million for married tax-payers filing separately), reduced by the total amount of eligible gain taken in prior tax years; or (2) 10 times the taxpayer's adjusted basis in all qualified stock of a corporation disposed of during the tax year.*

STRATEGY *Year-end planning for 2013 that takes advantage of the sunsetting 100 percent exclusion requires attention to two dates: (1) The Code Sec. 1202 stock must be acquired before January 1, 2014, which in turns requires steps taken by the corporation under state law or otherwise to issue such stock; and (2) taxpayers who hold such shares need to wait five-years before disposition; even being a single day short of the five-year period - measured from the acquisition date - eliminates any benefit, with no proration allowed. Certain exchanges of similar stock before the five year period however are permitted.*

Recognition Period for S Built-in Gains

A corporate-level tax, at the highest marginal rate applicable to corporations, is imposed on an S corporation's net recognized built-in gain (for example, gain that arose prior to the conversion of a C corporation to an S corporation that is recognized by the S corporation during the recognition period). That recognition period, specified under Code Sec. 1374, is generally the 10-year period beginning with the first day of the first taxable year for which the corporation becomes an S corporation. ATRA extended a reduced recognition period of give years through 2013.

STRATEGY *The disposition of property with built-in gain before the end of 2013 should be considered for property already held for give years, or more. After December 31, 2013, that property must e held for 10 years unless Congress again changes the rule.*

Other Provisions Sunsetting at Year End

Many more valuable business tax extenders are scheduled to expire after 2013. These tax benefits include:

- New Markets Tax Credits;
- Employer wage credit for activated military reservists;
- Subpart F exceptions for active financing reservists;
- Look through rule for related controlled foreign corporation payments;
- Enhanced deduction for charitable contributions of food inventory;
- Tax incentives for empowerment zones;
- Indian employment credit;
- Low-income tax credits for non-federally subsidized new buildings;
- Low-income housing tax credit treatment of military housing allowances;
- Treatment of dividends of regulated investment companies (RICs);
- Treatment of RICs as qualified investment entities; and
- Adjusted-basis reduction of stock after S corp. charitable donation of property.

COMMENT *Some extenders were not extended by ATRA and have thus expired. Their supporters are likely to fight for renewal in 2014. These include brownfields remediation expensing and tax incentives for the District of Columbia.*

ENERGY INCENTIVES

Energy tax incentives should be considered within a taxpayer's overall year-end tax strategy. ATRA extended a number of energy tax incentives, primarily business-related credits, but also some consumeroriented benefits. With sunset looming, taxpayers should weigh the value of these incentives, and take appropriate action before year-end.

Code Sec. 25C Nonbusiness Energy Property Credit

ATRA extended the Code Sec. 25C non-business energy property credit through December 31, 2013. This nonrefundable credit is available for qualified energy efficiency improvements (building envelope components such as energy efficient doors and windows), and residential energy property expenditures (such as energy efficient heat pumps, furnaces, central air conditioning systems and water heaters). The lifetime aggregate amount of the credit that may be claimed by a taxpayer cannot exceed certain maximum amounts. Among them is an overall $500 lifetime limit for the credit, as well as a $200 cap for exterior windows and doors.

STRATEGY *Proof that installation has occurred on or before January 1, 2014, is essential due to this credit's sunset date. In addition, the qualified energy efficiency improvements and qualified energy property must be installed in or on a United States dwelling unit owned by the taxpayer and used as his or her principal residence. The property must originally be placed in service by the taxpayer, and there must be a reasonable expectation that the qualified energy efficiency improvements will remain in use for at least five years.*

TRADITIONAL INCOME AND DEDUCTIONS DEFERRAL/ACCELERATION STRATEGIES

Year-end 2013 presents unique challenges. Traditional year-end planning techniques nevertheless remain important both to maximize benefits in connection with what's new and to do so within the usual ebb and flow of the taxpayer's personal economy. The following traditional income and deduction acceleration techniques and their reciprocal deferral strategies should be considered:

Income Deferral/Acceleration:

- Enter into/ Sell installment contracts
- Defer/ Receive bonuses before January
- Hold/ Sell appreciated assets
- Hold/ Redeem U.S. Savings Bonds
- Accumulate/ Declare special dividend
- Postpone/ Complete Roth conversions
- Delay/ Accelerate debt forgiveness income
- Minimize/ Maximize retirement distributions
- Delay/ Accelerate billable services
- Structure/ Avoid mandatory like-kind exchange treatment

Deductions and Credits Acceleration/Deferral

- Bunch itemized deductions into 2013 and take standard deduction into 2014/ reverse steps
- Pay bills in 2013/ Postpone payments until 2014
- Pay last state estimated tax installment in 2013/ delay payment until 2014
- Accelerate economic performance/ postpone performance
- Watch AGI limitations on deductions/ credits
- Watch net investment interest restrictions
- Match passive activity income and losses

COMMENT *The Code Sec. 25D residential energy efficient property credit, by contrast, is not scheduled to expire after 2013. The Code Sec. 25D credit rewards taxpayers who make energy efficient improvements, such as installing small wind turbines and other qualified property before 2017.*

Plug-in Elective Drive Motor Vehicle Credit

Code Sec. 30D provides a credit for Qualified Plug-in Electric Drive Motor Vehicles, including passenger vehicles and light trucks. The total amount of the credit allowed for a vehicle is limited to $7,500. For qualified 2- or 3-wheeled plug-in electric drive vehicles, the cap is the lesser of $2,500 or 10 percent of its cost.

COMMENT *The credit begins to phase out for a manufacturer's vehicles when at least 200,000 qualifying vehicles have been sold for use in the United States (determined on a cumulative basis for sales after December 31, 2009). Eligible vehicles include the 2012-2014 Ford Focus Electric; the 2013 Ford Fusion Energi, the 2013 Ford C-MAX Energi, and the 2011-2012 Nissan LEAF.*

STRATEGY *To be entitled to the credit, original use must start with the taxpayer. For a 2013 credit, the vehicle must be acquired by the taxpayer by year-end 2013. The credit for qualified 2- or 3-wheeled vehicles ends after 2013; the four-wheeled vehicle credit continues until manufacturer sales exceed the 200,000 threshold.*

Renewable Resources Credit

ATRA modified the Code Sec. 45 renewable electricity production tax credit for electricity produced from wind and other qualified facilities. ATRA replaced certain placed-in-service deadlines with new deadlines and revised certain definitions, including the term "municipal solid waste." The amount of the credit varies depending on the type of technology.

More Expiring Energy Credits

Other energy tax incentives scheduled to expire after 2013 include:

- Credits for alternative fuel vehicle refueling property;
- Credits for cellulosic biofuel production;

- Credits for biodiesel and renewable diesel:
- Production credits for Indian coal facilities;
- Credit for energy-efficient appliance manufacture;
- Allowance for cellulosic biofuel plant property:
- Special rules for sales of electric transmission property; and
- Tax credits and outlay payments for ethanol.

AFFORDABLE CARE ACT

When Congress passed the Affordable Care Act in 2010, it delayed the effective date of several key provisions until 2014. In July 2013, the Obama administration announced a further delay in the Affordable Care Act's employer shared responsibility payment provision (also known as the employer mandate). The individual shared responsibility provision (known as the individual mandate) has not been delayed and starting in 2014, individuals must carry health insurance or otherwise pay a penalty unless exempt.

Employer Mandate

The Affordable Care Act requires that an applicable large employer pay an assessable payment if either:

- The employer fails to offer to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under a eligible employer-sponsored plan and any full-time employee is certified to the employer as having received a premium assistance tax credit or cost-sharing reductions; or
- The employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan and one or more full-time employees is certified as having received a premium assistance tax credit or cost-sharing reduction.

These two methods of calculating the tax are mutually exclusive for any particular period. The amount of the assessable payment for an employer that does offer coverage to its full-time employees is capped so that it can never exceed the assessable payment if it had not offered coverage. The IRS in proposed regulations has softened the rules somewhat by treating an employer as offering coverage to its full-time employees even if it fails to offer coverage to up to 5 percent of them.

IMPACT *Code Sec. 4980H defines an applicable large employer with respect to a calendar year as an employer that employed an average of at least 50 full-time equivalent employees on business days during the preceding calendar year. Proposed regulations issued by the IRS treat 130 hours of service in a calendar month as the monthly equivalent of 30 hours of service per week. Hours worked by part-time employees (individuals working fewer than 30 hours per week) are converted into FTEs and are included in the calculation used to determine whether a firm is a large employer. Seasonal workers are excluded from this calculation if the number of full-time employees and FTEs exceeds 50 for 120 days or less during the preceding calendar year, and the employees in excess of 50 during those days are seasonable workers.*

> "The testing period for the average 50 full-time employee threshold under the employer mandate is generally the preceding calendar year..."

Delay

In July 2013, the Obama administration announced that employer (and insurer) reporting requirements (discussed below) under the Affordable Care Act will be delayed for an additional year (to 2015). As a result, the administration also delayed the employer mandate for one additional year (to 2015).

STRATEGY *Part-time employees (those working fewer than 30 hours per week) are counted to determine employer size. However, penalties are assessed only with respect to full-time employees that work 30 or more hours per week. The testing period for the average 50 full-time employee threshold under the employer mandate is generally the preceding calendar year with some transition relief available. For the 2015 mandate, therefore, staffing numbers starting January 1, 2014 will be immediately relevant and may call for a taxpayer's review of its workforce as part of 2013 year-end planning.*

Employer and Insurer Reporting

The Affordable Care Act generally requires applicable large employers to file an information return (known as a Code Sec. 6056 return) that reports the terms and conditions of the health care coverage provided to the employer's full-time employees for the year. Health insurance issuers, sponsors of self-insured health plans, government agencies, and other entities that provide minimum essential coverage must file similar information returns (known as Code Sec. 6055 returns). Following the White House's announcement of the delay in employer and insurer reporting, the IRS issued transition relief and proposed regulations.

IMPACT *Under proposed regulations, an applicable large employer would generally report information about coverage (including contact information for the employer and the number of full-time employees) as well as a list of full-time employees and information about coverage offered to each, by month, including the cost of self-only coverage. Applicable large employers also must furnish Code Sec. 6056 statements to qualified employees. The statements would describe, among other things, information about coverage.*

IMPACT *Because of the delay in reporting, Code Sec. 6056 returns must be filed with the IRS no later than February 28 (March 31 if filed electronically) of the year immediately following the calendar year to which the return relates. The IRS explained that the first Code Sec. 6056 returns required to be filed for calendar year 2015 must be filed no late than March 1, 2016 (February 28, 2016 falls on a Sunday) or March 31, 2016, if filed* *electronically. Employee statements must be furnished on or before January 31 of the year immediately following the calendar year to which the employee statement relates. The first Code Sec. 6056 employee statements (statements for 2015) must be furnished no late then February 1, 2016 (January 31, 2016 falls on a Sunday), the IRS explained.*

STRATEGY *The IRS has encouraged voluntary compliance with the employer and insurer information reporting requirements for 2014 and is expected to issue additional guidance before January 1, 2014. Additionally, electronic filing of Code Sec. 6056 returns is required except for an applicable large employer filing fewer than 250 returns during the calendar year. All returns (including Forms W-2) are aggregated for the purpose of applying the 250-return threshold, the IRS explained. Code Sec. 6056 employee statements may be provided electronically if notice, consent and other requirements are met.*

W-2 Reporting

Separate form Code Sec. 6056 reporting (discussed above), the PPACA requires employers that provide applicable employer-sponsored coverage to report the cost of that coverage on the employee's Form W-2, Wage and Tax Statement. Small employers - generally employers filing fewer than 250 Forms W-2 for the previous calendar year- are temporarily exempt from reporting. Other entities, such as multi-employer plans, are also eligible for the temporary relief.

IMPACT *At the time this Briefing was prepared, the IRS had not announced any change in the temporary relief available to small employers and others. The IRS has advised that when the temporary relief is terminated, it will give small employers and others sufficient lead time to plan to meet the reporting requirements.*

Individual Mandate

Beginning January 1, 2014, the Affordable Care Act generally requires individuals to carry minimum essential coverage for each month, qualify for an exemption or make a payment when filing his or her return. Minimum essential coverage for purposes of the individual mandate is employer-sponsored coverage, coverage through a state or federal Marketplace, Medicare, Medicaid, and other plans. Certain individuals may be exempt, including individuals whose income is below the minimum threshold for filing a return, members of a health care sharing ministry, individuals unlawfully present in the U.S., and others.

IMPACT *The individual shared responsibility payment (penalty) is $95 in 2014 or the flat fee of one percent of taxable income, $325 in 2015 or the flat fee of two percent of taxable income, $695 in 2016 or 2.5 percent of taxable income (the $695 amount is indexed for inflation after 2016).*

IMPACT *An individual is treated as having coverage for a month so long as he or she has coverage for any one day of that month.*

IMPACT *Individuals who have short gaps in coverage will not be subject to the individual shared responsibility payment. Gaps of three months or less are generally allowed.*

STRATEGY *Certain individuals must obtain an exemption certificate from a Marketplace to verify their exemption from the individual mandate. However, individuals who are not required to file a return are automatically exempt for that year.*

Premium Assistance Tax Credit

The Affordable Care Act created the Code Sec. 36B premium credit to help offset the cost of health insurance coverage obtained through a Marketplace. Based upon the estimate made by the Marketplace, the individual can decide if he or she wants to have all, some or none of the estimated credit paid in advance directly to the insurance company to be applied to monthly premiums. Taxpayers who do not opt for advance payment may claim the credit when they file their federal income tax return for the year.

IMPACT *The Code Sec. 36B credit is linked to household income in relation to the federal poverty line (FPL). Generally, taxpayers whose household income for the year is between 100 percent and 400 percent of the federal poverty line for their family size may be eligible for credit. The credit for 2014 is based on the 2013 FPL guidelines.*

IMPACT *Eligibility for the Code Sec. 36B credit may be more widespread than initially apparent. For 2013, for residents of one of 48 contiguous states or Washington D.C., the following illustrates when household income would be between 100 percent and 400 percent of the federal poverty line: $11,490 (100%) up to $45,960 (400%) for one individual; $15,510 (100%) up to $62,040 (400%) for a family of two; $23,550 (100%) up to $94,200 (400%) for a family of four.*

IMPACT *The employer mandate penalty is triggered for an applicable large employer if one or more of its full-time employees obtains a premium tax credit. Lower paid employees are likely to qualify for the credit if they are not offered minimum essential coverage from the employer.*

Small Employer Health Insurance Credit

The Affordable Care Act provides a tax credit to encourage eligible small employers to provide health insurance coverage to their employees. Starting in 2014, a taxpayer may claim the Code Sec. 45R credit for two-consecutive tax years, beginning with the first tax year in or after 2014 in which the eligible small employer attaches Form 8941, Credit for Small Employer Health Insurance Premiums, to its income tax return, or in the case of a tax-exempt eligible small employer, attaches Form 8941 to Form 990-T, Exempt Organization Business Income Tax Return. A taxpayer may claim the credit for tax years beginning in 2010 through 2013 without those years counting toward the two-consecutive tax year period.

IMPACT *An eligible small employer for purposes of the Code Sec. 45R credit is an employer that has no* *more than 25 FTEs for the tax year, whose employees have average annual wages of less than $50,000 per FTE (adjusted for inflation after December 31, 2013), and that has a qualified arrangement in effect that requires the employer to pay a uniform percentage (not less than 50 percent) of the premium cost of a qualified health plan offered by the employer to its employees through a SHOP Marketplace.*

IMPACT *For tax years beginning during or after 2014, the maximum Code Sec. 45R credit for an eligible small employer (other than a tax-exempt employer) is 50 percent of the employer's premium payments. The maximum credit for tax-exempt employers for those years is 35 percent. For 2010-2013, the maximum credit has been 35 percent for taxable employers and 25 percent for tax-exempt employers.*

SELECTED AFFORDABLE CARE ACT EFFECTIVE DATES

Provision	**Effective Date**
Employer Mandate	Delayed to 2015
Individual Mandate	2014
Premium Assistance Tax Credit	2014
Employer Code Sec. 6055 Reporting	Delayed to 2015*
W-2 Health Care Reporting	Indefinite for Small Employers

* Voluntary for 2014