

15 New Tax Rules of 2014

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By Richard J. Koreto

You may struggle with a multitude of new tax rules this season. Some changes took effect in 2013, but are just now coming into play, while others are new for 2014. Here's what you need to know.

It may be time to retire that old saying: Nothing is certain but death and taxes. Actually, only the existence of taxes is certain—each new year brings a wide variety of changes that can affect your take-home pay, savings, and estate plans.

Some changes began in 2013 and may have been forgotten, but will have an impact as you enter numbers in Form 1040. Others changes came into play on January 1 of this year and should figure into your tax and general financial planning going forward. So let's replace the old "nothing is certain..." with "forewarned is forearmed."

1. Bracket changes—Small but noticeable.

The Feds have made some adjustments for inflation, which could be good news if you are right on the edge. For married-filing-jointly, the limit for the 28% bracket goes up more than \$2,000 to \$148,850. At the top end, at 39.6%, the floor has risen some \$7,000 to \$457,600. The standard deductions have also risen across the board, but barely: married-filing-jointly, for example, goes from \$12,200 to \$12,400.

2. AMT—It's a new ballgame. This is what many have been waiting for, and this year it can really affect your tax status. The dreaded alternative minimum tax has been running for 40 years like an old car, fixed with occasional patches. But at the beginning of 2013, American Taxpayer Relief Act of 2012 (ATRA) permanently tied it to the rise in inflation. So this is one surprise that will not be happening. AMT won't be creeping up the way it has been, capturing relatively low-income taxpayers.

3. Medicare surcharges. There's some confusion about this, but the basic message is you'll probably have to pay more. To begin with, the current tax filing season is the first time you have to account for the additional 0.9% Medicare tax. The threshold is \$250,000 for married filing jointly. Plus, there's the 3.8% net investment income tax that's technically a tax on net investment income. It kicks in at the \$250,000 threshold as well.

- 4. Other ACA-related limitations.** In addition to the items noted above, there are other tax provisions, as outlined on the IRS site. Some of these other items include the small business health care tax credit and the medical device excise tax. The medical expense deduction went up to 10% of AGI in 2013, but there are exceptions for senior citizens.
- 5. The Pease limitation.** This is basically a cutoff on deductions for those surpassing certain thresholds. In short, rich people aren't going to get the breaks everyone else gets. In fact, the wealthier you get, the greater the reduction. For joint filers in 2014, the deductions start to phase out at \$305,050.
- 6. The PEP phase-out.** This goes hand-in-hand with the Pease changes, which hit 2013 and continue in 2014 at slightly different levels. Basically, the total amount of personal exemptions is reduced by 2% for each \$2,500 over the established threshold. This phase-out can hit high-end taxpayers hard, but in a way, it can simplify planning—no need to keep track of exemptions you aren't going to get anyway.
- 7. More taxes for the portfolio.** Beginning last year, ATRA raised the top rates for capital gains from 15% to 20%, and this is a change that should affect your investing decisions going forward. That top level corresponds more or less to the same level as the 39.6% income tax.
- 8. Qualified small business stock gain exclusion.** If you invest, you need to take note that such stock acquired during 2013 (and earlier periods) qualified for a 100% gain exclusions if the holding period was met.

However, starting in 2014, there is only a 50% gain exclusion. This is a relatively small change, but for certain investors, it can have a big effect on their portfolio.

- 9. Estate planning: A break if you act fast.** For executors and trustees who wish they had made more tax-advantageous distributions in 2013, all is not lost. The Internal Revenue Code allows you to treat distributions that occur on or before March 6, 2014, as having been made in 2013.
- 10. Retirement plan and income changes.** It's a little harder now to avoid Social Security taxes—the tax cap has gone up from \$113,700 to \$117,000 in the new year. Contribution limits for 401(k) and IRAs are the same as they were in 2013, but there are other changes: if you have a plan at work you can claim a deduction for IRA contributions as well until MAGI falls between \$60,000 and \$70,000.
- 11. Same-sex couples.** The well-publicized U.S. Supreme Court case Windsor made tax filing for same-sex couples both simpler and more confusing. To cut through the misunderstandings: The case did not require any state to grant same-sex marriages, but it did require the federal government to recognize a marriage that a state did. By “federal,” that means IRS. Couples in a state like New York can now file joint returns for both state and federal returns. Such couples may even be able to go back as far as three years and re-file as a married couple.
- 12. Simplified home office deduction.** If you work from home, full-time or part-time, the rules for when you can deduct a home office, and to what extent, have been com-

plex. If you are filing a home office deduction this tax season, the IRS has simplified the process. According to the IRS, you will be able to claim allowable mortgage interest, real estate taxes, and casualty losses on the home as itemized deductions on Schedule A.

13. Tax break on forgiven mortgages has ended. Let's say that for financial reasons you have to walk away from a mortgage—as with a foreclosure or a short sale. The amount of mortgage you don't end up paying is essentially income, and you have to pay tax on that. Of course, most in that situation are usually unable to afford that, so Congress added an escape valve, saying that such unpaid mortgage amounts were exempt from income taxes. But that exemption ended on Dec. 31. Discharge of debt on a mortgage now generates a taxable event.

14. The 179 deduction—a loss for businesses. As a small business owner in 2013, you were able to deduct half a million for key assets you needed for business—but that amount plunged to \$25,000 in 2014. Of course, there's hope Congress will change the law sometime this year, as this was a popular deduction.

15. Don't forget the states! All of the above items are federal, but you should check out what is happening in your state tax department. Are there income tax credits? Sales tax credits? For estate planning, it's especially important to check changes in estate tax. The current federal threshold is over \$5 million. Some states have no estate tax, some have an inheritance tax and some have both—and the limits may be much lower than the feds. Any planning not involving the state is only half-planning.

The new year brings some significant changes to the table such as an adjusted tax bracket and a new Medicare surcharge. Understanding these new rules can help you avoid some unnecessary headaches in 2014.

Of course, the rules included are just the most major changes, and your personal situation may vary. The important thing is to get good advice, especially if complex returns are involved. Before making any financial decisions, please consult with a professional tax advisor.

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