

# TAX TIDBITS

By Paul E. Hornbuckle, CPA  
Vice President of Tax and Business Services

## Post-Election Expectations

Since early this year, major news sources have been discussing the pending “Bush Tax Cuts” and “Fiscal Cliff” concerns. The focus has been on the election as the threshold to dealing with the economy and the impending tax issues. President Obama’s re-election will now initiate an effort of difficult negotiations between Republicans and Democrats. Taxpayers’ year end tax strategies will require more attention, especially for higher income taxpayers. Besides the Bush-era tax cuts, Congress needs to deal with nearly \$100 billion in



automatic spending cuts and the more than 50 expiring tax extenders, among them the alternative minimum tax (AMT). In an effort to be prepared for quick action, the House of Representatives and the Senate have each passed tax legislation that deals with an AMT patch, as well as other popular expiring extenders. Another important item is that the IRS must issue approved tax forms around this time of year so as not to delay the start of the 2013 tax filing season. There is some speculation that Congress may negotiate some time by enacting a three month extension of the Bush-era tax cuts, perhaps even prorating them over 2013. Some kind of

extension may be necessary. Without any extension, wage withholding at higher tax rates would become mandatory for all taxpayers at all income levels. In addition, the payroll tax holiday (2% tax reduction of the employee share of Social Security) is scheduled to end on December 31, 2012. If Congress does not extend the payroll tax cut, this could result in a hit to the economy as consumer spending may be curtailed. People opposing the temporary tax relief say that the nation can no longer afford this.

Since March 23, 2010, a sweeping new health reform law was put into place. The legislation was in two parts consisting of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act. The primary purpose of this legislation is to mandate that all U.S. residents obtain health insurance coverage at the risk of imposing penalties on employers and taxpayers that fail to do so. Additionally, there are several new sections of the law that were enacted to raise the necessary money to fund this reform.

One thing is for sure, there will be changes to the tax laws for the 2012 tax year. The Tax & Business Services department will be ready to advise our clients and to keep them in compliance and be positioned for current and future tax challenges.

Volume 14, Issue 2  
November 2012



*With Offices at:*

400 East Water Street  
Elmira, NY 14901  
(607) 734-2665  
(866) 734-2665

24 West Market Street  
Corning, NY 14830  
(607) 936-1203

350 West Church Street  
Elmira, NY 14901  
(607) 733-9022

*For a full list of  
services our firm  
provides, please call  
607-734-2665 or visit  
us at*

[www.valicenti.com](http://www.valicenti.com).

“Isn’t it appropriate that the month of the tax begins with April Fool’s Day and ends with cries of ‘May Day!’?” – Rob Knauerhase

## **Inflation Adjustments**

The IRS announced on Thursday, October 18, 2012, its annual revenue procedure (Rev. Proc. 2012-41), making inflation adjustments to the gift tax annual exclusion and other items for tax years beginning in 2013. Our clients will be interested to know that the gift tax annual exclusion will increase from \$13,000 to \$14,000 in 2013. This is where the giver of a gift has no gift tax liability exposure for the first \$14,000 given to donees in 2013. Another point of interest is the income exclusion provision for taxpayers who receive U.S. savings bond interest and pay qualified higher education expenses. The provision states that the income exclusion begins to phase out for modified adjusted gross income above \$112,050 for joint filers and \$74,700 for other returns. The exclusion is completely phased out for modified adjusted gross income of \$142,050 or more for joint returns and \$89,000 or more for other returns. There were many other adjustments in very specialized areas of the tax code, such as excise taxes on certain items, foreign earned income exclusions, expatriation issues and other limits and caps. The revenue procedure does not include the inflation adjustments for the tax table amounts, adoption credit, child tax credits, Hope Scholarship and lifetime learning credits, earned income tax credits, the standard deduction, personal exemption, Sec 179 expense election, interest on education loans, overall limitations on itemized deductions, qualified transportation fringe benefits, adoption-assistance exclusions or the unified estate credit. All of the excluded items from this provision will be addressed in separate guidance from the IRS.

## **Medical Expense Deduction**

As many of you may have experienced when you are sitting with your tax preparer and the question is asked –“So, do you have any medical expenses that were incurred for the year?”, inevitably, the response is “yes, but I probably cannot deduct them”. This response is due to the 7.5% deduction floor that has been in place for years. The 7.5% floor is really an amount equal to 7.5% of the taxpayer’s adjusted gross income (AGI). In most instances, this threshold severely curtails or eliminates the

ability for the taxpayer to get an itemized deduction for medical expenses. Well, thanks to the 2010 healthcare reform package, this deduction floor has been raised to 10% of AGI. This change is effective for the tax years beginning after December 31, 2012. This law change only affects those taxpayers who have not attained the age of 65 by the end of the year. For those that have reached the age of 65 by the end of the year, the effective date of this provision is delayed until January 1, 2017.

## **Medicare Contribution Tax on Unearned Income**

An additional tax that is law and was enacted as part of the 2010 healthcare reform package will take effect for tax years beginning after December 31, 2012. That tax is a Medicare contribution tax on unearned income. The tax is imposed on individuals, estates and trusts. For an individual, the tax is 3.8% of the lesser of either:

- Net investment income, or,
- The excess of modified adjustment gross income over the threshold amount.

The threshold amount is \$250,000 for a joint return or surviving spouse, \$125,000 for a married individual filing a separate return, and \$200,000 for all others.

It should be noted that this tax will be applied to some or all of the investment income, including capital gains. This tax can also apply to the gain on the sale of a personal principal residence, subject to the rules under certain sections of the Internal Revenue Code. For an estate or trust, the tax is 3.8% of the lesser of either:

- Undistributed net investment income, or,
- The excess of adjusted gross income (as defined for estates and trusts) over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins.

## **New Limits for Retirement Plan Contributions**

The IRS announced in October 2012, the 2013 contribution limits for pension plans and other retirement related items. The elective deferral (contribution) limit for employees who

participate in Sec.401(k), 403(b) or 457 plans and the federal governments Thrift Savings Plan increases from \$17,000 to \$17,500. The catch-up contribution limit under those plans for those ages 50 and over is unchanged at \$5,500.

---

### **Social Security Wage Base Change**

**T**he IRS recently announced the Social Security wage base for 2013 will be \$113,700, an increase from \$110,100 in 2012. It must be noted that under the two enacted 2010 healthcare reform packages, several income tax increases will take effect in 2013. One is the additional 0.9% Hospital Insurance (HI) tax that will be imposed on individual taxpayers on wages and self-employment income received with respect to employment in excess of:

- \$250,000 for joint returns
- \$125,000 for married filing a separate return, and
- \$200,000 in all other cases.

It should be noted that an employee will be liable for the additional HI tax to the extent that it is not deducted by the employer.

Also, the employer will not be liable for any additional 0.9% HI tax that it fails to withhold and that the employee later pays, however, the employer will be subject to penalties for failure to withhold the tax.

The income tax deduction for self-employment taxes will not take into account the 0.9% of self-employment tax when developing the number to be used in the adjustments in calculating adjusted gross income.

This 0.9% HI could pose some issues for employees that have multiple employers to those whose income exceeds the stated income thresholds.

---

### **Credit Bureaus & the IRS**

**W**ith taxpayers owing approximately \$400 billion to the government, it might make sense to use some leverage to collect the amount owed. Those responsible for writing tax law have asked the Government Accountability Office to determine the feasibility of reporting late payments to the credit bureau agencies. Current law prohibits such reporting. Lawmakers are

thinking people maybe more willing to make payments on their balance due if their credit score is at risk. If you fall into this category, you may want to seriously consider keeping your tax payments current or, if there is a balance due, finding alternate financing if this ever becomes law.

---

### **Itemized Deduction Limitation**

**T**his limitation, known as the "Pease" limitation, (named after the member of Congress who sponsored the original provision) was originally designed to reduce the total allowable itemized deductions of higher income taxpayers by a formula. This limitation was eliminated in 2001 with the enacting of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and was extended by the 2010 Tax Relief Act, which is scheduled to be brought back to life after 2012. The calculation results in a 3% "haircut" or a reduction equal to 3% of the adjusted gross income which exceeds an applicable threshold. The reduction cannot exceed 80%. If the Pease limitation was in effect in 2012, the threshold would have been \$173,650. At the time of this article, President Obama was just re-elected President. The President would like to reinstitute the Pease limitation; however, he would like to use the thresholds that are more in line with his higher income limits - \$250,000 for married joint and \$200,000 for all others.

---

### **Personal Exemption Phaseout (PEP)**

**A**nother tax benefit that is subject to possible reduction or elimination is the personal dependency exemption. This phaseout was eliminated by EGTRRA in 2001. The phaseout was aimed at higher income taxpayers to reduce the benefit of the reduction of their taxable income by the dependency exemption amounts. This elimination was extended for 2010 and 2011 by the 2010 Tax Relief Act. The phaseout is calculated as a reduction equaling two percent for each \$2,500 or portion thereof, by which the taxpayer's AGI exceeds the applicable threshold. If the PEP was in effect in 2012, the thresholds would be \$260,500 for MFJ and \$173,650 for single taxpayers.

## Social Security Benefit Update

It has been announced that in 2013, Social Security benefits will increase 1.7%. This rate increase is less than half of the 2012 increase. Additionally, earnings limits will increase as well. People reaching 66 years of age next year will not lose any benefits if they earn \$40,080 or less before they reach that age. Individuals between ages 62 and 66 by the end of 2013 can earn up to \$15,120 before any benefits will be lost. Once an individual turns 66, there is no earnings cap.

## Education Corner

**Roth IRA** – an individual retirement account subject to the same rules as a traditional IRA except you cannot deduct contributions made into the plan; however, qualified distributions from the plan are tax free.

**Tax Deduction** – an allowable amount used to reduce taxable income, the value of which equates to your tax rate applied to the deduction amount.

**Tax Credit** – an amount used to directly reduce tax liability on a dollar-for-dollar basis.

## Help Us Help Someone You Know...

We work hard to ensure the satisfaction of our clients. We would appreciate your referral of friends and family to us, so that we may deliver the same level of service to them that we provide to you.



Our location at 350 West Church Street, the northwest corner of West Church and Columbia Streets, has become familiar to our clients. With adequate parking in the back, it is convenient to meet with one of our tax specialists to discuss tax questions and solutions.

*This document was not intended or written to be used and it cannot be used for the purpose of avoiding tax penalties that may be imposed on the taxpayer.*

## SELECTED CHANGES IN FEDERAL TAXES: 2012-2013 IF CONGRESS FAILS TO ACT

	2012	2013
<b>Top individual tax rate</b>	35%	39.6%
<b>Capital Gains</b>	15%	20%
<b>Dividends</b>	15%*	Taxed at ordinary income rates
<b>Top estate tax rate</b>	35%	55%
<b>Child tax credit</b>	\$1,000	\$500
<b>American Opportunity Credit</b>	Up to \$2,500	Unavailable
<b>Code Sec. 179 dollar limit</b>	\$139,000**	\$25,000
<b>WOTC for veterans</b>	Up to \$9,600	Unavailable
<b>*Zero percent for taxpayer in the 10 and 15 percent brackets</b>		
<b>**As adjusted for inflation</b>		

*A Semi-Annual Publication by the Tax and Business Services Department*