Tax Tidbits

Volume 15, Issue 2 November 2013

I am pleased to welcome back two people who previously worked in our Tax and Business Services Department. Evelyn Bristol held the position of tax return reviewer and handled electronic tax payments on behalf of clients. Evelyn is a graduate of Elmira Business Institute with an Associates degree in Accounting. Prior to joining us the first time, Evelyn was employed by a Fortune 500 company for 11 years as a tax preparer.

Evelyn is now back on the staff with payroll and bookkeeping functions, and will also be assisting in the tax preparation functions.

Kathleen M. O'Herron, CPA is also returning to the department. Kathleen last worked with us in September 2005 as a tax preparer. Kathleen is a graduate of St. John Fisher College with a Bachelor's degree in Accounting. She has over six years experience working in public accounting, focusing mainly on tax and small business services. She most recently was employed by the largest public accounting firm in Upstate New York.

Kathleen has the position of staff accountant and will be preparing business tax returns, as well as individual tax returns. Until tax season starts, Kathleen will be working on the bookkeeping and financial statements of the business clients that require this information for their tax returns in January 2014.

Welcome back, ladies.

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

The 2013 Tax Terrain

The following is a list of pertinent tax issues for 2013:

- Net Investment Income Tax
- Tax Bracket and Long-Term Capital Gain Tax Rate
- Medicare Tax
- Alternative Minimum Tax
- Medical Deduction Floor
- Itemized Deduction Limitations
- Personal Exemption Phaseout

Net Investment Income Tax

The additional 3.8% Net Investment Income Tax (NIIT) will apply if your modified adjusted gross income (MAGI) exceeds $200,000 if you file Single, $250,000 if you file Married Filing Joint (MFJ) or $125,000 if you file Married Filing Separate (MFS). The additional 3.8% NIIT will only apply to the lesser of your net investment income, or the amount of MAGI in excess of the applicable threshold. MAGI means regular adjusted gross income plus the amount excluded from gross income under the foreign earned income exclusion.

The net investment income for purposes of the 3.8% NIIT is gross investment income, less allocable deductions. The gross investment income is the total of gross income from interest, dividends, annuities, royalties, and rents, unless those items are earned in the ordinary course of an actively participated business; net taxable gains from assets held for investment (including the taxable portion of gains from selling a personal residence) and gross income from passive business activities. There are a number of income categories that are not included in the sum of NIIT; among them is tax-exempt bond interest. This new tax is calculated on a new form – Form 8960 – Net Investment Income Tax – Individuals, Estates, and Trusts.

Tax Bracket and Long-Term Capital Gains Tax Rate

The 39.6% tax bracket has been brought back by the current administration. It was introduced a number of years ago and removed by past administrations. The 39.6% rate will apply to taxable income

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Terrain

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above the following thresholds: MFJ -$450,000; Head of Household (HOH) - $425,000; Single - $400,000; and MFS - $225,000. Additionally, if you are subject to the 39.6% bracket, your qualified dividends and long-term capital gains will be subject to a 20% tax rate. All other qualified dividends and long-term capital gains will cap at 15%, with the exception of those taxpayers that fall into the 10% or 15% tax brackets. Those individuals can actually have the qualified dividends and long-term capital gains subject to the 0% capital gains tax bracket. This calculation involves a balance of exemptions, capital gain income, and deductions.

Medicare Tax

Many taxpayers are subject to the Medicare tax on employee wages and/or net self-employment (SE) income of 2.9%. Employees, as well as their employers, are subject to 1.45%. Self-employed persons pay the entire 2.9%. New for 2013, an extra 0.9% Medicare tax will be charged on wages and/or net SE income above the following thresholds: $200,000 if you file Single or HOH; $125,000 if you file MFS, or $250,000 of you and your spouse's combined wages and/or SE income if you file MFJ. These thresholds will not be adjusted for inflation in post-2013 years, as are many other tax thresholds. Additionally, the 0.9% additional Medicare tax will not qualify for the deduction for 50% of SE that you are allowed to claim against adjusted gross income.

Employers are obligated to withhold the additional tax beginning in the pay periods when wages exceed $200,000 for the calendar year.

Since this tax is paid through withholding on FICA wages and self-employment income exceeding $200,000 per year, employers are obligated to withhold the additional tax beginning in the pay periods when wages exceed $200,000 for the calendar year – without regard to an employees filing status or income from other sources. Your employer might withhold the tax even if you are not liable for it, or the tax might not be withheld even though you are liable for it. If you are an owner in an S-Corp, you might consider paying yourself less in wages, which would mean that more income will flow through to you from the S-Corp. S-Corp income is not subject to the 0.9% Medicare tax, but you will need to consider the amount of wages with consideration being given to whether a reasonable salary is being paid to the shareholder/manager. The IRS has been scrutinizing this area lately.

This new tax is calculated on a new form – Form 8959 – Additional Medicare Tax. This is where all of your wages, and your spouse's wages, if married, will be aggregated and the tax assessed. Additionally, a section on the form will account for all of the Medicare tax withheld. The tax ultimately becomes the responsibility of the taxpayer.

Alternative Minimum Tax

Besides the possibility of being subject to the 39.6% tax rate, the 20% capital gain rate and the 3.8% NIIT, you could be hit with the Alternative Minimum Tax (AMT). As part of the American Tax Relief Act (ATRA), Congress permanently increased the AMT exemptions retroactively to the 2012 tax year. Starting in 2013, the AMT exemptions will be indexed for inflation. The 2013 AMT exemption amounts are: MFJ - $80,800, Single and HOH - $51,900, and MFS - $40,400.

Medical Expense Deduction

As many of you 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 can't 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 went into effect 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.

Well, thanks to the 2010 healthcare reform package, this deduction floor has been raised to 10% of AGI.

Itemized Deduction Limitation

This 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. ATRA reinstated the Pease limitation beginning in 2013. 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% of the total itemized deductions. The threshold amounts are MFJ - $300,000, HOH - $275,000, Single - $250,000, and MFS - $150,000, which will be inflation adjusted for the tax years after 2013.

Personal Exemption Phaseout

Another 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 through 2012 by the 2010 Tax Relief Act. The personal exemption phaseout was reinstated by ATRA to begin with the 2013 tax year. 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. The AGI thresholds are the same as those for the Pease limitation and are inflation-adjusted for tax years after 2013.

Charitable Contributions May Help Lower Your Tax Bill

The following tips are to help ensure that your contributions qualify as tax deductible:

- You must give to a qualified organization to have a legitimate tax deduction. To confirm legitimacy, visit www.irs.gov/charities.

- You must file Form 1040, Individual Income Tax Return, and itemize your deductions on Schedule A.

- You can't take a deduction for contributions made to specific individuals, political organizations or candidates or most foreign organizations.

- If you receive a benefit because of your contribution, such as merchandise, tickets to a ball game, dinner or other goods and services, you can deduct only the amount that exceeds the fair market value of the benefit received.

- Donations of stock or other non-cash property are usually valued at the fair market value of the property. Generally, clothing and household items must be in good used condition or better to be deductible. Special rules apply to vehicle donations. Fair market value is generally the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all the relevant facts.

- Regardless of the amount, to deduct a contribution of cash, check or other monetary gift, taxpayers must maintain a bank record, payroll deduction records or a written communication from the organization containing the name of the organization, the date of the contribution and the amount of the contribution. For text message donations, a telephone bill will meet the recordkeeping requirement if it shows the name of the receiving organization, the date of the contribution and the amount given.

- To claim a deduction for contributions of cash or property equaling $250 or more, you must have a written acknowledgment from the qualified organization or certain payroll deduction records. The acknowledgement must be written and must include the amount contributed or a description of the property contributed and whether the organization provided any goods or services in exchange for the gift. If you received any goods or services, the acknowledgement must provide a description and good faith estimate of the value. The acknowledgement should state that the only benefit you received was, as an example: an intangible religious benefit, if that was the case.

- If the total deduction for all noncash contributions for the year is more than $500, taxpayers must complete and attach IRS Form 8283, Noncash Charitable Contributions, to their return.

- Taxpayers, donating an item or a group of similar items valued at more than $5,000, must also complete Section B of Form 8283, which generally requires an appraisal by a qualified appraiser.

Tax Appointments

The Tax and Business Services Department would like to encourage you to call us now for your 2014 tax appointment. In an effort to better serve you, we would like to schedule your 2014 tax appointment as soon as possible. If the tax appointments are made before April 1, we can be sure the tax returns will be completed by the filing deadline.

Make your appointment today to assure that your tax return will be completed and filed well before April 15, 2014.

Year End Tax Planning

If you read the "2013 Tax Terrain" article, the "Charitable Contribution" article, or have any other concerns from things that you have heard or read about new tax laws, please give us a call. We have sophisticated 2013 tax planning software to help you with any tax situations.

Now is the time to get a tax plan prepared to determine if you need to adjust your withholding taxes, adjust your estimated taxes, make decisions like taking gains or losses in your investment portfolio, contributing to your retirement plan, or making additional charitable contributions, to mention a few. Call now and set up your appointment to have a 2013 tax plan prepared and Happy New Year!

2013 Individual Income Tax Rate Structure

<table>
<tr><th colspan="2">Applicable Income*</th><th rowspan="2">Ordinary Income and STCGs</th><th rowspan="2">Dividends and LTCGs</th><th colspan="2">Affordable Care Act</th></tr>
<tr><th>Single</th><th>Joint</th><th>Earned Income</th><th>Net Investment Income</th></tr>
<tr><td>Up to $8,925</td><td>Up to $17,850</td><td>10%</td><td rowspan="2">0%</td><td rowspan="6">2.9%</td><td rowspan="6">0%</td></tr>
<tr><td>$8,926-$36,250</td><td>$17,851-$72,500</td><td>15%</td></tr>
<tr><td>$36,251-$87,520</td><td>$72,501-$146,400</td><td>25%</td><td rowspan="5">15%</td></tr>
<tr><td>$87,251-$183,250</td><td>$146,401-$223,050</td><td>28%</td></tr>
<tr><td>$183,251-$200,000</td><td>$223,051-$250,000</td><td>33%</td></tr>
<tr><td>$200,000 -$398,350</td><td>$250,001-$398,350</td><td>33%</td></tr>
<tr><td>$398,351-$400,000</td><td>$398,351-$450,000</td><td>35%</td><td rowspan="2">3.8%</td><td rowspan="2">3.8%</td></tr>
<tr><td>$400,001 and up</td><td>$450,001 and up</td><td>39.6%</td><td>20%</td></tr>
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***Applicable Income Range Key:**
- "Taxable Income" for Ordinary Income, STCGs, Dividends and LTCGs income tax rates.
- "Wages or Self-employment Income" for Earned Income Medicare tax rate.
- "MAGI" for Net Investment Income tax rate

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.