Wealth Management Systems Inc.

Tax Time Roundup: What's Changed This Year?

Although tax season got off to a late start this year (the IRS officially began accepting returns for the 2013 tax year on January 31), the April 15 deadline has not changed. The IRS expects to receive more than 148 million returns and -- using history as a guide -- the agency reports that many will include potentially costly errors or overlooked deductions.

High-income taxpayers will see the rates they pay on ordinary income, capital gains, dividends, and other forms of investment income increase when they file their 2013 tax return.

This year is also the first year that many of the tax law changes that were enacted in early 2013 will be implemented. Following are a few major changes to keep in mind as you roll up your sleeves -- or head off to your tax preparer's office.

Tax Filing for Same-Sex Married Couples

In accordance with a major Supreme Court decision last year, the IRS has ruled that, "If you have a same-sex spouse whom you legally married in a state (or foreign country) that recognizes same-sex marriage, you and your spouse generally must use the married filing jointly or married filing separately filing status on your 2013 return, even if you and your spouse now live in a state (or foreign country) that does not recognize same-sex marriage."[1]

Couples who were married prior to 2013 and who were not allowed to file jointly in the past may generally file amended returns for the previous three tax years (i.e., back to 2010). In addition, married couples that were previously denied tax benefits for expenditures such as health insurance and medical care may now claim those deductions or adjustments in their amended filings.

Higher Tax Rates

High-income taxpayers will see the rates they pay on ordinary income, capital gains, dividends, and other forms of investment income increase when they file their 2013 tax return.

Income tax. The income tax rate rose to 39.6%, from 35% in 2012 for individuals with ordinary taxable income of more than $400,000 or for married couples filing joint tax returns who have income that exceeds $450,000.

Capital gains and dividends. Likewise, the same income thresholds apply when determining the rate investors will pay on long-term capital gains and dividends. Those with incomes that exceed the new limit will pay a higher 20% rate; most others will continue to pay the lower 15% rate. And those in the 10% and 15% brackets will have a 0% capital gains rate.

Rates on long-term capital gains apply to gains resulting from assets held for more than one year. Short-term capital gains on assets held for one year or less are taxed at ordinary federal income tax rates.

New 3.8% tax. Upper-income Americans also may be hit by the new 3.8% tax on "net investment income," which effectively increases the top rate on most long-term capital gains to 23.8%. This tax applies to interest, dividends, royalties, annuities, rents, and other passive activity income, but does *not* include distributions from IRAs or qualified retirement plans, qualified annuity payouts, or income from tax-exempt municipal bonds. Generally, the new tax applies to single taxpayers with a modified adjusted gross income (MAGI) of $200,000 or more and to married couples filing jointly with a MAGI of $250,000 or more.

Additional Medicare tax. The same taxpayers whose income exposes them to the net investment income tax may also be hit by an additional 0.9% Medicare tax on wages, other compensation, and self-employment income.

New "Stealth Taxes"

Less obvious tax increases also referred to as "stealth taxes," because they tend to fly under the radar screens of most taxpayers, are meant to restrict or eliminate personal exemptions and itemized deductions for high-earning Americans. For instance, under the new tax law, eligibility to claim the personal exemption ($3,900 for individuals in 2013) will begin to phase out for couples with incomes of $300,000 or individuals with incomes of $250,000. The same thresholds apply to itemized deductions, such as charitable donations and mortgage interest.

Medical expenses. Another deduction that has been reduced pertains to unreimbursed medical expenses. For 2013, the threshold for claiming medical and dental expenses that are not covered by health insurance has been raised. Such expenses must now exceed 10% of your adjusted gross income, up from 7.5% in 2012. (Note that the threshold for the deduction remains at 7.5% for individuals age 65 and older until December 31, 2016.)[2]

Don't Miss Deductions

Probably the biggest decision you will need to make when filing your tax return is whether to take the standard IRS-allowed deduction or to itemize individual deductions. For 2013, the standard deduction amounts are as follows:

- Single or Married filing separately: $6,100
- Married Filing Jointly: $12,200
- Head of Household: $8,950

Generally, when determining whether or not to itemize, you should consider if you have certain expenses, for example, mortgage interest, student loan interest, or charitable donations, that exceed the standard deduction. If so, then itemizing probably makes sense for you.

Because there are so many deductions and tax credits available -- and because the rules governing them change nearly every year -- it is wise to enlist the services of a tax professional to ensure that you: a) take advantage of every deduction/credit you are eligible for; and b) avoid making costly errors or omissions.

For more on what is new for tax year 2013, see IRS Publication 17 or consult with your tax professional.

Sources:

[1]The Internal Revenue Service, Publication 17 "Tax Guide 2013 for Individuals," November 26, 2013.

[2]The Internal Revenue Service, "Changes to Itemized Deduction for 2013 Medical Expenses," January 2, 2014.

Additional sources:

Wealth Management Systems Inc., "2014 Tax Guide: What You Need to Know."

The Wall Street Journal, "What You Need to Know About Your 2013 Income Taxes," February 8, 2014.