Supplement to J.K. Lasser's 1001 Deductions and Tax Breaks 2013

The tax law is not static, and there have been a number of changes affecting 2012 returns that were made after the book was printed. Since publication of the 2012 edition of *J.K. Lasser's 1001 Deductions and Tax Breaks*, Congress has enacted the American Taxpayer Relief Act to help avoid the fiscal cliff. It extended numerous tax breaks for 2012 that had expired at the end of 2011. It also created a permanent fix for the alternative minimum tax. The courts and the IRS have also made decisions and rulings on many tax items that can impact your 2012 return.

Here are key developments, some of which can apply to your 2012 return. Also included here to help you determine your withholding and estimated taxes for 2013 are some important changes effective in 2013. The changes presented in this Supplement are tied to the chapters in the book.

Introduction

Limits on qualifying for tax-favored items. The above-the-line deductions for educator expenses of up to $250 and tuition and fees had expired at the end of 2011, but have been extended retroactively. They apply for 2012 and 2013.

Standard deduction amounts. The basic standard deduction amounts for 2013 have been increased for all filing statuses.

Additional standard deduction amounts. The additional standard deduction amounts for age and/or blindness are $50 higher for 2013 than for 2012.These are the only additional standard deduction amounts set to apply in 2013.

Phase-out of itemized deductions. Starting in 2013, high-income taxpayers lose a portion of their itemized deductions due to a phase-out. The phase-out begins when adjusted gross income exceeds $250,000 for singles, $275,000 for heads of households, $300,000 for married filing jointly, and $150,000 for married filing separately.

Chapter 1—Your Family

Personal and dependency exemptions. The exemption amount has increased for 2013 to $3,900. However, the deduction for exemptions is phased out for taxpayers with adjusted gross income exceeding $250,000 for singles, $275,000 for heads of households, $300,000 for married filing jointly, and $150,000 for married filing separately.

Child tax credit. This credit, which had been set to revert to a lower amount after 2012, has been retained permanently at current levels. This means the credit is $1,000 for each qualifying child.

Earned income credit. The earned income credit amounts, including adjusted gross income limits, have been increased for 2013. Also, favorable rules for the credit, including a higher amount for those with three or more qualifying children, have been made permanent.

Dependent care credit. This credit, which had been set to revert to a lower amount after 2012, has been retained permanently at current levels. This means that expenses up to $3,000 for one qualifying dependent, and $6,000 for two or more qualifying dependents can be taken into account in figuring the credit, the maximum rate of which is 35%.

Adoption credit. The adoption credit limit for 2013 increases to $12,970. The current rules for the adoption credit have been made permanent, so that the dollar limit will be adjusted annually for inflation. The credit is no longer refundable, as it was in 2011.

Chapter 2—Medical Expenses

Itemized medical expenses. One important change takes effect in 2013: the threshold for deducting expenses increases to 10% of adjusted gross income. The 7.5%-of-AGI floor that applied in 2012 can continue to be used by those age 65 or older through 2016.

Driving for medical purposes. For 2013, the rate for medical driving is 24 cents per mile.

Long-term care coverage. The portion of long-term care insurance premiums that are treated as a deductible medical expense has increased slightly in 2013 for each age group.

Flexible spending arrangements (FSAs). In 2013, the maximum salary contribution to an FSA is capped at $2,500. This may be significantly lower than employer-set limits prior to 2013. The $2,500 cap will be adjusted for inflation starting in 2014.

Health savings accounts and Archer medical savings accounts. The contribution limits for HSAs and MSAs in 2013 have been increased.

Accelerated death benefits. For chronically ill individuals, the daily dollar limit excludable from gross income for 2013 is $320; excess amounts are taxable to the extent they exceed actual long-term care costs.

Chapter 3—Education Costs

Employer-paid courses. The $5,250 exclusion for employer-paid education assistance for any higher education was set to expire at the end of 2012; the exclusion has been made permanent. There is no change in the exclusion amount, which is *not* indexed for inflation.

American Opportunity credit. The credit of up to $2,500 (40% of which is refundable) has been extended through 2017; it had been set to expire at the end of 2012. The amount of the credit and other rules are not changed.

Lifetime learning credit. The modified adjusted gross income limits on eligibility to claim the credit have been increased slightly for 2013.

Tuition and fees deduction. The above-the-line deduction for tuition and fees of up to $4,000 has been extended for 2012 and 2013.

Student loan interest. The favorable rules for this deduction had been set to expire at the end of 2012; they have been made permanent. For 2013, there is no change to the modified adjusted gross income eligibility limits for claiming the deduction.

Interest on U.S. savings bonds. The modified adjusted gross income limits on eligibility to claim the exclusion for interest on bonds redeemed to pay qualified higher education costs have been increased for 2013.

Coverdell education savings accounts. The rules for this savings vehicle were set to revert to less favorable rules in 2013; the favorable rules have been made permanent. This means up to $2,000 can be contributed annually for a child's education and funds can be tapped tax free for primary, secondary, or higher education.

Chapter 4—Your Home

Mortgage interest deduction. The Tax Court has made it clear that when co-owners who are not married to each other own a home, the total mortgage interest deduction is limited to debt of up to $1.1 million on the residence ($1 million acquisition debt and $100,000 home equity debt). Each owner does not have a separate $1.1 million limit.

Mortgage insurance. The ability to treat mortgage interest as deductible mortgage interest had applied only for homes purchased through 2011, but this favorable rule has been extended for 2012 and 2013.

Cancellation of mortgage debt. The exclusion for income resulting from the cancellation of debt on a principal residence expired at the end of 2012; it is extended for one more year (through 2013).

Homebuyer credit for DC purchasers. The first-time homebuyer credit for those who purchased a home in the District of Columbia expired at the end of 2011 and was *not* extended.

Home sale exclusion. Starting in 2013, a 3.8% Medicare surtax applies to net investment income of high-income taxpayers; see Chapter 8. Proceeds from the sale of a principal residence in excess of the exclusion amount ($250,000 for singles and $500,000 for joint filers) are treated as investment income for purposes of this new tax. For example, say a married couple who owned their home for 20 years sell it in 2013 for $900,000. Their tax basis in the home (cost plus improvements) is $350,000, so their gain is $550,000. They qualify for the $500,000 exclusion, so $50,000 is investment income.

Moving expenses. Use of a vehicle for deductible moving purposes in 2013 is figured at the rate of 24 cents per mile.

Energy improvements. The residential energy property credit for making certain improvements, such as adding insulation or installing energy-efficient windows and exterior doors, expired at the end of 2011; it has been extended for 2012 and 2013.

Chapter 5—Retirement Savings

Traditional IRAs and Roth IRAs. The modified adjusted gross income limits on eligibility to make contributions have increased for 2013. The basic contribution limit rises to $5,500. The limit on the additional contribution amount for those who are at least 50 years old by the end of 2013 remains unchanged at $1,000.

401(k) and similar plans. The elective deferral contribution limit for 2013 has increased to $17,500. However, the additional contribution limit for those age 50 or older by the end of the year remains unchanged at $5,500.

In-plan rollovers. Until now, participants in 401(k) and similar plans were able to make rollovers to Roth 401(k)s (or similar designated Roth accounts) only upon leaving employment or attaining age $59^1/_2$. Starting in 2013, plans have the option of allowing participants to make an in-plan rollover from their regular 401(k) to a Roth account within the same plan at any time, even if distributions would not have been allowed under the prior law restrictions. The conversion is, of course, taxable.

Self-employed retirement plans. Contribution, benefit, and other limits for these plans have been increased for 2013.

SEPs. Contribution limits for these plans have been increased for 2013.

SIMPLEs. The contribution limit for SIMPLEs in 2013 increases to $12,000. However, the additional contribution limit for those age 50 or older by the end of the year remains unchanged at $2,500.

Retirement saver's credit. The modified adjusted gross income limits on eligibility to claim the retirement saver's credit for contributions to IRAs, 401(k)s, and similar plans have been increased for 2013. The credit can be claimed both on Forms 1040 and 1040A; it cannot be claimed on Form 1040EZ.

Charitable transfers of IRA distributions. The tax-free transfer to a public charity of IRA funds up to $100,000 annually by those age $70^1/_2$ expired at the end of 2011; it was extended for 2012 and 2013. Transitional relief for 2012 returns applied for certain actions taken in January 2013.

Chapter 6—Charitable Giving

Real estate donated for conservation purposes. The favorable percentage limitations on donations of realty for conservation purposes (50% of the contribution base, or 100% for farmers and ranchers) expired at the end of 2011; it has been extended for 2012 and 2013.

The Tax Court has made it clear that a conversation easement agreement can be a valid acknowledgment for the donation. The lack of a separate acknowledgment does not prevent a deduction.

IRA transfers to charity. See Chapter 5.

Leave-based donations to Hurricane Sandy victims. Some employers allow employees to contribute unused vacation, sick, or personal days to a leave donation program. Employees who participate and who opt to use their unused leave time to benefit victims of Hurricane Sandy are not taxed on this contribution. However, employees cannot claim any charitable deduction.

Chapter 7—Your Car

Business use of your personal car. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for business driving in 2013 is 56.5¢ per mile.

The dollar limits on depreciating passenger cars, trucks, and vans when the standard mileage rate is not used have not yet been announced for 2013. However, the first-year limit is increased by $8,000 for vehicles qualifying for bonus depreciation (i.e., new vehicles).

Electric vehicles. The credit for low-speed 2-, 3-, and 4-wheel vehicles expired at the end of 2011. The credit for 2- and 3-wheel vehicles has been extended for 2012 and 2013; the credit for 4-wheel vehicles was not extended. The basic credit for 4-wheel, highway-legal cars and trucks that use rechargeable electric batteries are not subject to an expiration date; this break ends when manufacturers attain certain sales volumes.

Chapter 8—Investing

Reporting basis. For 2012 and later years, the basis of mutual fund shares acquired after 2011 will have to be reported annually on Form 1099-B. The basis of debt securities acquired after 2013 will have to be reported annually.

Capital gains and qualified dividends. The 2012 tax rates (zero for those in the 10% or 15% tax bracket; 15% for those in the 25%, 33%, or 35% tax bracket) have been made permanent. However, high-income taxpayers will pay 20% on capital gains and qualified dividends starting in 2013. High-income taxpayers are those with taxable income above:

- $400,000 for single individuals
- $425,000 for heads of households

- $450,000 for joint filers and surviving spouses
- $225,000 for married filing separately

Gain on the sale of small business stock. The exclusion on gain from the sale of qualified stock acquired after 2011 was set to revert to 50%. However, the 100% exclusion has been retained for stock acquired in 2012 and 2013. Because such stock must be held more than 5 years in order to qualify for this exclusion, gain from the sale of qualified small business stock in 2012 has only a 50% exclusion.

According to a federal appellate court, the exclusion of gain for qualified small business stock does not apply to options, only to stock held more than 5 years.

Gain on empowerment zone assets. The rollover of gain from empowerment assets expired at the end of 2011; this break has been extended for 2012 and 2013.

However, the exclusion for gain on the sale of DC zone stock expired at the end of 2011 and was *not* extended.

NII tax. Starting in 2013, a 3.8% Medicare surtax applies to net investment income (NII) of high-income taxpayers. More specifically, the tax applies to the lesser of NII or the amount by which your modified adjusted gross income exceeds $200,000 ($250,000 if you are married filing jointly, or $125,000 if you are married filing separately). The key point to note is what is or is not NII. NII includes:

- Annuities
- Capital gains (other than excluded amounts, such as for home sales or sales of qualified small business stock)
- Dividends and interest
- Income from a trade or business in which you are passively involved
- Rents
- Royalties

NII does *not* include:

- Distributions from IRAs and qualified retirement plans
- Income from a trade or business in which you materially participate
- Social Security benefits

Chapter 9—Travel

Business travel per diem rates. The maximum federal per diem rate for travel starting October 1, 2012, through September 30, 2013, covering lodging and meals and incidental expenses (M&IE) within the continental United States (CONUS) in most locations is $123 per day ($77 for lodging and $46 for M&IE). A number of the rates to certain areas have changed. These rates can be found at www.gsa.gov (click on "Per Diem Rates").

The high-low substantiation rates for high-cost and all other areas within CONUS for the period October 1, 2012, through September 30, 2013, is unchanged from the previous fiscal period. The rates are $242 for travel to high-cost localities and $163 for travel to all other areas within CONUS. Of these rates, the meal portion remains unchanged at $65 for high-cost areas and $52 for all other areas within CONUS. Note that no new areas have been added to the high-cost list.

Medical and moving for work with your car. The IRS standard mileage rate for 2013 is 24 cents per mile.

Chapter 11—Real Estate

Home office deduction. If you use part of your home for business, you may be eligible for a home office deduction. Starting in 2013, you may deduct either your actual expenses or use an IRS-set standard deduction amount. This is $5 per square foot, up to a maximum of 300 square feet (the top deduction is $1,500). The basic rules for the home office deduction continue to apply. The deduction cannot exceed gross income from the home office activity. The standard deduction amount in excess of this gross income cannot be carried forward and is lost forever. The optional home office deduction does *not* apply for 2012 returns.

Special breaks for certain disaster victims. Unfortunately, natural and other disasters continue to occur. For example, there is relief for victims of Hurricane Sandy. Check with the IRS for special relief that may be available with respect to victims at www.irs.gov/businesses/small/article/0,,id=156138,00.html.

Chapter 13—Insurance and Catastrophes

Victims of Hurricane Sandy. Tax relief, similar to that provided to victims of Hurricane Katrina, has been proposed. Insiders speculate that relief will not be enacted until after the filing deadline for your 2012 income tax return. Thus, if you may be impacted by relief, consider filing an extension for your 2012 return to avoid the need to later file an amended return. Follow developments at www.irs.gov/uac/Newsroom/Help-for-Victims-of-Hurricane-Sandy.

Making an insurance claim. You cannot claim a casualty or theft loss if you have insurance but do not submit a claim. However, the fact that a claim is denied because an individual fails to document the loss does not prevent a casualty loss deduction, according to a federal appellate court.

Accelerated death benefits. For chronically ill individuals, the daily dollar limit excludable from gross income for 2013 is $320; excess amounts are taxable to the extent they exceed actual long-term care costs.

Chapter 14—Your Job

Reduction in Social Security tax. The 2 percentage point reduction in the employee's share of Social Security tax, which is part of FICA, expired at the end of 2012; it was *not* extended for 2013.

Educator expenses. The above-the-line deduction of up to $250 for educator expenses has been extended for 2012 and 2013.

Home office deduction. See Chapter 11.

Fringe benefits. A couple of benefits have been impacted for 2012 and/or 2013:

Transportation fringe benefits. Parity between the exclusion free parking with commuter passes and van pooling (collectively called transportation fringe benefits) expired at the end of 2011; it has been retained for 2012 and 2013. This means that the exclusion is $240 per month in 2012 ($245 per month in 2013) for these benefits. Employers are required to make adjustments to W-2 forms for 2012 reflecting these exclusion amounts.

Adoption assistance. The exclusion amount for 2013 is $12,970.

Income earned abroad. The foreign earned income exclusion for 2013 has been increased to $97,600.

Chapter 15—Your Business

Equipment purchases. Two key changes impact write-offs for equipment purchases in 2012 and 2013:

- *First-year expensing.* The dollar limit for the Sec. 179 deduction is $500,000 in both 2012 and 2013. The dollar limit starts to phase-out when equipment purchases exceed $2 million.
- *Bonus depreciation.* After 2012, 50% bonus depreciation had been set to expire; it has been retained for 2013.

Home office deduction. See Chapter 11.

Employment-related tax credits. A number of these credits expired at the end of 2011; they have been extended for 2012 and 2013:

- Work opportunity credit
- Empowerment zone credit
- Indian employment credit
- Wage differential payment credit (for payments to certain activated reservists)

Note that the Social Security tax credit on certain tips for workers in the restaurant and tavern businesses is permanent and did not need to be extended.

Self-employment tax. The 2 percentage point reduction in the Social Security portion of self-employment tax was *not* extended beyond 2012. Thus, the self-employment tax rate in 2013 is 15.3% (12.4% for the Social Security portion on net earnings up to $113,700) and 2.9% for the Medicare portion); one-half of self-employment tax is deductible.

Standard mileage rate. The IRS announced the standard mileage rate, used in lieu of deducting the actual costs of business driving, for 2013; it is 56.5¢ per mile.

Those who own their vehicles and use the standard mileage rate for 2013 must reduce the vehicle's basis by 23¢ per mile (the same rate that applies in 2012).

Business-related tax credits. The following credits, which had expired at the end of 2011, apply for 2012 and 2013:

- Credit for wages paid in an empowerment zone
- Energy-efficient appliance credit
- Energy-efficient home credit
- Indian employment credit
- New markets credit
- Research credit
- Work opportunity credit

Chapter 16—Miscellaneous Items

State and local sales taxes. For those who itemize their personal deductions, the option to deduct state and local sales taxes instead of state and local income taxes had expired at the end of 2011; it was extended for 2012 and 2013.

Gifts you receive. The annual exclusion amount for 2013 is $14,000 per recipient. Of course, the recipient can receive any amount tax free (the exclusion impacts only the gift tax, if any, owed by the person making the gift).

Government benefits. Payments under the Emergency Homeowners' Loan Program (EHLP) are tax free.

Alternative minimum tax. The alternative minimum tax (AMT) exemption amounts have been permanently adjusted for inflation. The exemption amounts are:

Filing status	2012 exemption	2013 exemption
Single/head of household	$50,600	$51,900
Married filing jointly/surviving spouse	$78,750	$80,800
Married filing separately	$39,375	$40,400

Exemption phase-out. Starting in 2013, the exemption amounts start to phase out when alternative minimum taxable income (AMTI) exceeds $115,400 for singles and heads of households, $153,900 for married filing jointly and surviving spouses, and $76,950 for married filing separately.

Tax credit offsets to the AMT. The ability to use nonrefundable personal tax credits, such as the lifetime learning credit and the dependent care credit, to offset not only regular income tax, but also the alternative minimum tax expired at the end of 2011; this favorable rule has been made permanent. Thus, nonrefundable credits can be used to offset both regular tax and the AMT.