Tax Tips

Key Tax Developments During the First Quarter of 2013-Part 1

The following is part one of a two part summary of the most important tax developments that have occurred in the first three months of 2013 that may affect you, your family, your investments, and your livelihood. You may want to review these developments to determine the steps you should implement to take advantage of the favorable ones and to minimize the impact of those that are unfavorable.

American Taxpayer Relief Act of 2012. In early January, Congress passed, and the President signed into law, the American Taxpayer Relief Act of 2012. On the individual side of things, the Act extended the “Bush-era” tax rates for most taxpayers, but also added a new top 39.6% rate that applies to taxable income in excess of certain thresholds. It also raised the top rate on capital gains and qualified dividends to 20%, permanently “patched” the alternative minimum tax, and reinstated and extended many other tax breaks.

With respect to businesses, the Act retroactively reinstated and extended a host of business tax breaks, including the research credit, increased business property expensing amounts, and bonus first-year depreciation. It also extended many energy-related tax provisions.

New Health FSA limit for 2013. An IRS publication discusses how the new $2,500 health flexible spending arrangement (health FSA) contribution limitation affects both employers and employees. Health FSAs are benefit plans established by employers to reimburse employees for health care expenses, such as deductibles and co-payments. They are usually funded by employees through salary reduction agreements, although employers may contribute as well. Qualifying contributions to and withdrawals from FSAs are tax-exempt.

In discussing the new limit, the IRS points out that, as in the past, an employer may establish its own plan limitation, as long as the plan limit doesn't exceed this statutory limit. For plan years beginning after 2013, the $2,500 limitation will be indexed for inflation. The IRS notes that the $2,500 limit isn't applicable to dependent care FSAs, health savings accounts, Archer medical savings accounts, or any contributions an employee makes toward health insurance premiums. The IRS also stresses that limit applies on an employee-by-employee basis. That is, $2,500 is the maximum amount that an employee may contribute in 2013, regardless of the number of individuals (e.g., spouse or dependents) whose medical expenses may be reimbursed under the plan. However, if two people are married, and each has the opportunity to participate in a health FSA, whether through the same employer or through different employers, each may contribute up to $2,500.

Guidance on tax treatment of participants in HUD's Home Affordable Modification Program. The IRS has provided guidance to borrowers, mortgage loan holders and loan servicers on the tax consequences of participating in the Principal Reduction Alternative offered in the Home Affordable Modification Program (HAMP-PRA) sponsored by the Department of the Treasury and the Department of Housing and Urban Development (HUD). Under HAMP-PRA, the principal of the borrower's mortgage may be reduced over three years by a predetermined amount called the “PRA Forbearance Amount” if the borrower satisfies certain conditions during a trial period.

The IRS explains that, at the time of the modification, the borrower realizes discharge of indebtedness income equal to any excess of the adjusted issue price of the old mortgage loan (which was satisfied in the deemed exchange) over the issue price of the new (post-modification) mortgage loan. Unless an exclusion applies—for example, the principal residence indebtedness exclusion or the insolvency exclusion—the borrower includes in gross income the discharge of indebtedness income for the tax year in which the permanent modification occurs. However, the guidance allows a borrower to choose to report the discharge of indebtedness income over a three-year period in certain situations.

If you have any questions regarding the above discussed topic or any other tax matter, please feel free to give me a call at (562) 698-9891.

Richard Scrivanich, Partner
For Harvey & Parmelee LLP