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TAX AND BUSINESS Alert™

January 2013

Deducting Home Mortgage Interest

The political debate on federal tax reform touches many topics, including the tax deduction for interest on home mortgage loans. At the time of publication, there was no way to determine if this deduction will continue or at what level, but we thought it would be a good time to review current federal law on deducting residential mortgage loan interest. If there is a law change, this information will help you assess its impact.

Interest paid on qualified residence debt is deductible, but limitations apply. Qualified residence debt can be either (a) home acquisition indebtedness (purchasing a home), or (b) home equity indebtedness (borrowing against the equity in your home). Qualified residence interest expense incurred on up to $1 million ($500,000 for married filing separately) of home acquisition indebtedness is fully deductible as an itemized deduction for regular tax purposes. Taxpayers generally can deduct interest on up to $100,000 ($50,000 for married filing separately) of home equity indebtedness. However, there are restrictions on the deductibility of qualified residential mortgage and home equity loan interest for alternative minimum tax (AMT) purposes.

Mortgage interest is only deductible when paid by the taxpayer who is the legal or equitable owner of the property. Thus, a taxpayer cannot deduct interest he or she pays on the mortgage of another person. This may occur, for example, if parents make mortgage payments for their adult children. Similarly, a taxpayer who holds a mortgage generally cannot deduct the interest if it is paid by another person.

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A qualified residence (for determining if the underlying debt is qualified residence debt) can be the taxpayer's principal residence and one other residence selected by the taxpayer for the tax year. In other words, if the taxpayer has several vacation homes in addition to a principal residence, the taxpayer can designate a different vacation home as the second qualified residence for different tax years. A residence, for regular tax purposes, is defined as (a) a house, (b) a condominium, (c) a mobile

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The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Tax Calendar

January 15—Individual taxpayers' final 2012 estimated tax payment is due unless Form 1040 is filed by January 31, 2013, and any tax due is paid with the return.

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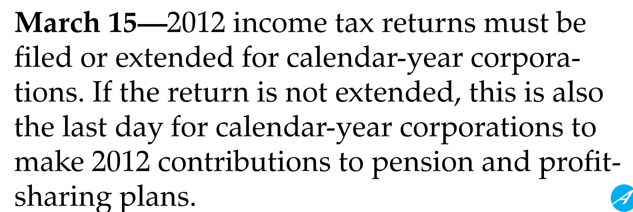
January 31—Most employers must file Form 941 (Employer's Quarterly Federal Tax Return) to report Medicare, social security, and income taxes withheld in the fourth quarter of 2012. (If your tax liability is less than $2,500, you can pay it in full with a timely filed return.) If you deposited the tax for the quarter in full and on time, you have until February 11 to file the return.

—Give your employees their copies of Form W-2 for 2012. If an employee agreed to receive Form W-2 electronically, have it posted on the website and notify the employee.

—File Form 940 [Employer's Annual Federal Unemployment (FUTA) Tax Return] for 2012. If your undeposited tax is $500 or less, you can either pay it with your return or deposit it. If it is more than $500, you must deposit it. However, if you deposited the tax for the year timely, properly, and accurately, you have until February 11 to file the return.

February 28—The government's copy of Form W-2 series returns (along with the appropriate transmittal form) should be sent in by today. However, if these forms will be filed electronically, the due date is extended to April 1.

—File Form W-3 (Transmittal of Wage and Tax Statements) along with Copy A of all the Forms W-2 you issued for 2012. If you file Forms W-2 electronically, your due date will be extended to April 1.



March 15—2012 income tax returns must be filed or extended for calendar-year corporations. If the return is not extended, this is also the last day for calendar-year corporations to make 2012 contributions to pension and profit-sharing plans.

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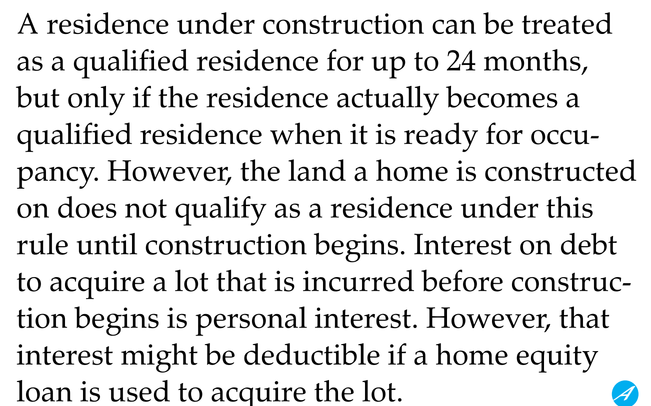
home, (d) a boat, (e) a house trailer, or (f) other property that under all the facts and circumstances can be considered a residence. Vacant land used for occasional camping does not qualify as a residence.

Planning Tip: Taxpayers with more than two homes should consider keeping a mortgage on their principal residence, and one other residence selected as a qualified residence, and paying off debt on any house(s) for which interest will not be deductible.

Spouses who file a joint return may treat their common principal residence, as well as property that otherwise qualifies as a second residence, whether it is owned jointly or by one spouse only, as a qualified residence.

Conversely, spouses who file separate returns may each take into account only one residence as the qualified residence, regardless of how the properties are owned. However, a deduction for a second residence is available if both spouses consent in writing to one of them taking into account both the principal and the second residence.



A residence under construction can be treated as a qualified residence for up to 24 months, but only if the residence actually becomes a qualified residence when it is ready for occupancy. However, the land a home is constructed on does not qualify as a residence under this rule until construction begins. Interest on debt to acquire a lot that is incurred before construction begins is personal interest. However, that interest might be deductible if a home equity loan is used to acquire the lot.

Filing Status Implications

For married taxpayers, the implications of filing a joint or separate return extend beyond tax rates and the standard deduction. Like many aspects of income taxation, there is usually more than one approach to finding the optimal solution. We have listed some of the more common implications of filing either a joint or separate return. Although not an exhaustive list, it highlights several issues to consider.

Some of the implications of filing a joint return include (among others):

- The requirement that individuals who file a joint return cannot be claimed as dependents on another return. This can be important when married students are still supported by their parents.
- An individual who files a joint return is not subject to the "kiddie tax" provisions.
- Joint filers are both responsible for the tax on their joint return. Thus, nontax factors should be considered (i.e., questionable business transactions). In addition, divorced taxpayers will each be liable for tax, interest, and penalties due on a joint return filed before the divorce.
- Finally, monthly Medicare premiums can increase substantially for a couple filing jointly versus filing separately, especially for a lower-income spouse.

The implications of filing a separate return include (among others):

- If one spouse itemizes deductions, the other must also, even if total deductions are less than the standard deduction.
- Taxpayers can generally only deduct expenses they actually paid versus those paid by either.
- Credits for child care, adoption, education, and earned income are generally not available.

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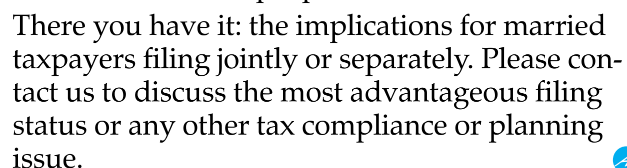
- If separate filers lived with their spouse during any part of the year, a greater percentage of social security benefits may be taxable because the income threshold for determining the taxable amount is reduced to zero.
- The exclusion of gain on the sale of a principal residence is limited to $250,000 (each) for separate filers versus $500,000 for a joint return.
- The $25,000 passive loss exception for actively managed rental real estate may be totally or partially lost. Also, one spouse's passive income cannot be offset by the other spouse's passive losses.
- The limit on the capital loss deduction on a separate return is $1,500 (each).
- No exclusion is allowed for interest income from Series EE bonds used for higher education expenses.
- The deduction for interest on qualified education loans is not available.
- Taxpayers filing separate federal returns typically must also file separate returns for state income tax purposes.

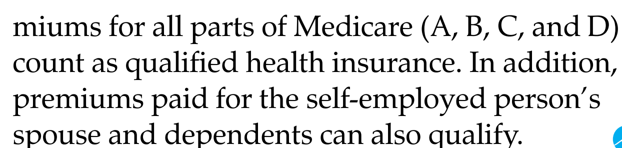


There you have it: the implications for married taxpayers filing jointly or separately. Please contact us to discuss the most advantageous filing status or any other tax compliance or planning issue.

Business Deduction for Medicare Insurance Premiums

Self-employed individuals, including qualifying sole proprietors, partners, and more-than-2% S corporation shareholder-employees, can deduct premiums paid for qualified health insurance (within limits) in computing their adjusted gross incomes (AGI).

There had been some confusion concerning whether certain Medicare premiums counted for this rule. Recent IRS guidance indicates that premiums for all parts of Medicare (A, B, C, and D) count as qualified health insurance. In addition, premiums paid for the self-employed person's spouse and dependents can also qualify.



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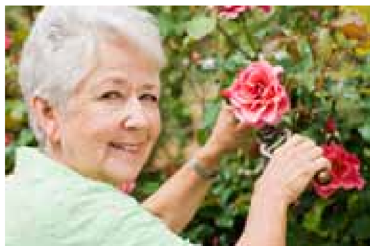
Retirement Contribution and Other Limitations for 2013

The IRS has announced cost-of-living adjustments affecting the dollar limitations for retirement plans, deductions, and other items. Several of the limitations are higher for 2013 because the increase in the cost-of-living index met the statutory threshold. However, some limitations did not meet that threshold and remain unchanged from 2012.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The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan increased from $17,000 in 2012 to $17,500 in 2013. The catch-up contribution limit for those age 50 and over remains unchanged at $5,500.

The contribution limit for both Roth and traditional IRAs has increased $500 from 2012. You can contribute up to $5,500 ($6,500 if you are age 50 or older by year-end) to your IRA in 2013 if certain conditions are met (i.e., sufficient earned income). For married couples, the combined contribution limits are $11,000 ($5,500 each) and $13,000 ($6,500 each if both are age 50 by year-end) when a joint return is filed, provided one or both spouses had at least that much earned income.

Keep in mind that contributions to traditional IRAs may be tax-deductible, subject to specific limitations that increase for 2013. When you establish and contribute to a Roth IRA, contributions are not deductible, but withdrawals are tax-free when specific requirements are satisfied. In addition, there are no mandatory distribution rules at age 70½ with a Roth IRA, and you can continue to make contributions past age 70½ if you meet the earned income requirement.

The 2013 limitation for SIMPLE retirement accounts increased $500 to $12,000. However, the SIMPLE catch-up contribution for those age 50 by year-end is unchanged from 2012 at $2,500.

The 2013 contribution limit for profit-sharing, SEP, and money purchase pension plans is the lesser of (1) 25% of the employee's compensation—limited to $255,000, an increase of $5,000 from 2012 or (2) $51,000, an increase of $1,000 from 2012.

The social security wage base, for computing the social security tax (OASDI), increases to $113,700 in 2013, up from $110,100 for 2012. The additional $3,600 for 2013 represents an increase of 3.3% in the wage base.

Finally, the annual exclusion for gifts increased by $1,000 and is $14,000 in 2013.

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