# Income, Gift, and Estate Tax Update

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I. Income Tax Rates

Lower regular income tax rates and higher alternative minimum tax exemptions are now permanent, but a 39.6% regular tax rate is reinstated for some higher-income taxpayers.

No changes were made to corporate income tax rates or brackets. Trusts and estates generally are subject to the same income tax rates as individuals, but their income brackets are substantially narrower.

A. Regular Income Tax

Effective for tax years beginning after December 31, 2012

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Taxable Income Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>35% Rate</td>
</tr>
<tr>
<td>Single</td>
<td>$ 398,350</td>
</tr>
<tr>
<td>Head of household</td>
<td>$ 398,350</td>
</tr>
<tr>
<td>Married filing jointly</td>
<td>$ 398,350</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$ 199,175</td>
</tr>
<tr>
<td>Estates and trusts</td>
<td>N/A</td>
</tr>
</tbody>
</table>

The 39.6% bracket is restored for higher-income taxpayers, and the top capital gains tax rate rises to 20% for those taxpayers.

The 10%, 15%, 25%, 28%, 33%, and 35% graduated federal income tax rates remain in effect for 2013 and subsequent years. However, the 35% bracket is narrowed (and eliminated for trusts and estates) because a 39.6% rate is created for higher-income taxpayers, as shown in Figure 1. Taxpayers filing as surviving spouses—also called qualifying widow(er)s—are subject to the same tax brackets as married couples filing joint returns.

The dollar thresholds shown in Figure 1 will be adjusted for inflation for tax years beginning after 2013.

FIGURE 1 Taxable Income Thresholds for 35% and 39.6% Tax Rates

1. Marriage Penalty Relief

Marriage penalty relief for income taxed in the 10% and 15% rate brackets is now permanent. The income ranges for single individuals and married persons filing separate returns are identical, and the 10% and 15% brackets for married couples filing a joint return are equal to twice the single/married filing separately amounts.

2. Long-Term Capital Gains

For individuals whose total taxable income does not exceed the top limit of the 15% income tax bracket, the income tax rate for long-term capital gains is zero percent. The tax rate for capital gains is 15% for income that does not exceed the top of the 35% income tax bracket, and the 20% tax rate for capital gains is restored to the extent that the individual’s income would otherwise be taxed at the 39.6% rate.

Observation

Extensions “Permanent” in Current Law

The ATRA and this chapter refer to numerous extensions of prior law tax benefits as “permanent.” In this context, “permanent” means there is no expiration date. However, the provisions are permanent only until Congress chooses to repeal or otherwise change them.
3. **Qualified Dividends**

Qualified dividends will continue to be taxed at the same tax rates as those for long-term capital gains.

**B. Alternative Minimum Tax**

Effective for tax years beginning after December 31, 2011

Higher statutory exemption amounts (adjusted for inflation) are now permanent, as is the allowance of nonrefundable personal credits to reduce alternative minimum tax.

The alternative minimum tax (AMT) rates remain at 26% and 28%, but the exemption amounts based on filing status are increased. Figure 2 shows the exemption amounts for 2013 that will be included in the instructions for Form 6251, Alternative Minimum Tax—Individuals.

**FIGURE 2 AMT Exemption Amounts for 2013**

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>AMT Exemption Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single or head of household</td>
<td>$51,900</td>
</tr>
<tr>
<td>Married filing jointly or surviving spouse</td>
<td>$80,800</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$40,400</td>
</tr>
<tr>
<td>Estates and trusts</td>
<td>$23,100</td>
</tr>
<tr>
<td>Minimum for “kiddie tax” if no earned income</td>
<td>$ 7,150</td>
</tr>
</tbody>
</table>

The AMT exemption amount is reduced by 25¢ for each $1 that alternative minimum taxable income (AMTI) exceeds the beginning of the AMTI phaseout range for each filing status. For years after 2012 the phaseout of the exemption amount for individual taxpayers is indexed for inflation. Figure 3 shows the beginning and ending AMTI phaseout amounts for 2013 for each filing status.

**FIGURE 3 AMT Exemption Phaseouts**

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Start of AMTI Phaseout</th>
<th>End of AMTI Phaseout</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single or head of household</td>
<td>$ 115,400</td>
<td>$323,000</td>
</tr>
<tr>
<td>Married filing jointly or surviving spouse</td>
<td>$ 153,900</td>
<td>$477,100</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$  76,950</td>
<td>$ 238,550</td>
</tr>
<tr>
<td>Estates and trusts</td>
<td>$  76,950</td>
<td>$ 169,350</td>
</tr>
</tbody>
</table>

1. **Application of AMT Rates**

For years before 2013 the 26% AMT rate was applied to the first $175,000 of AMTI ($87,500 if married filing separately), and the 28% rate was applied to any excess AMTI amounts.

Beginning in 2013, this threshold is inflation adjusted. The 2013 threshold amount for applying the 28% rate to excess AMTI is $179,500 ($89,750 if married filing separately).

2. **Use of Personal Credits**

Individual taxpayers can continue to use all nonrefundable personal credits (such as the adoption credit, child tax credit, dependent care credit, education credits, retirement savings credit, and home energy credits) to reduce their total income tax liability (regular income tax plus AMT).
The nonrefundable credits still cannot reduce other federal tax liabilities, such as self-
employment tax or retirement plan and other excise taxes.

Observation
Benefited Taxpayers
The rule allowing all nonrefundable personal credits to reduce AMT as well as regular tax in excess of the
tentative minimum tax benefits middle-income taxpayers who have:
(1) a tentative minimum tax that is just a little below their regular tax or is in excess of their regular tax due
to the personal and dependent exemptions deduction and other deductions that are not allowed in
computing the tentative minimum tax such as the standard deduction or certain itemized deductions; and
(2) substantial nonrefundable personal credits.

The 7% AMT preference item for the exclusion of gain from the sale of qualified small
business stock (QSB stock) [I.R.C. § 1202] is also now permanent. If QSB stock is acquired after
September 27, 2010, and before January 1, 2014, 100% of the gain is excluded from gross income
without an addback for AMT. This change does not affect 2013 returns because of the 5-year
holding requirement for QSB stock, but it does affect 2013 decisions on stock acquisitions.

II. Net Investment Income Tax
Effective for tax years beginning after December 31, 2012

A new 3.8% tax applies to some income of higher income taxpayers.

The new 3.8% net investment income tax (NIIT) imposed by I.R.C. § 1411 applies to the net
investment income of individuals, estates, and trusts that have modified adjusted gross income
(MAGI) above statutory threshold amounts. The tax must be included on their income tax returns
for their first tax year beginning on or after January 1, 2013.

A. NIIT Basics
Individuals who are subject to U.S. income taxes, except for certain nonresident aliens, will owe
the tax if they have net investment income and also have MAGI that exceeds the thresholds
shown in Figure 4. These amounts are not scheduled to be adjusted in future years for inflation.

FIGURE 4 MAGI Thresholds for the NIIT

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing jointly</td>
<td>$250,000</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$125,000</td>
</tr>
<tr>
<td>Single</td>
<td>$200,000</td>
</tr>
<tr>
<td>Head of household (with qualifying person)</td>
<td>$200,000</td>
</tr>
<tr>
<td>Qualifying widow(er) with dependent child</td>
<td>$250,000</td>
</tr>
</tbody>
</table>

The amount subject to the 3.8% tax is the lesser of the individual’s net investment income or
the individual’s excess MAGI.

Certain foreign source income is the only increase in an individual’s adjusted gross income
(AGI) to determine MAGI for the NIIT. Individuals must add back the excess of any foreign
earned income amount excluded from gross income under I.R.C. § 911(a)(1) less the amount of
any related deductions that are taken into account in computing AGI or any exclusions disallowed
because of I.R.C. § 911(d)(6)’s denial of double benefits. Additional adjustments are required if
the taxpayer owns an interest in a controlled foreign corporation (CFC) or a passive foreign
investment company (PFIC).
A nonresident alien is not subject to the NIIT unless he or she is married to a U.S. citizen or resident, makes the I.R.C. § 6013(g) election to be treated as a resident alien for purposes of filing a joint return, and makes a further election to be subject to the NIIT, as explained later in this section. If a nonresident alien does not make the NIIT election, the married filing separately threshold for the NIIT applies to his or her U.S. spouse.

Estates and trusts generally are subject to the NIIT if they have undistributed net investment income and also have AGI that exceeds the dollar amount at which the highest tax bracket for an estate or trust begins for the tax year (for tax year 2013, this threshold amount is $11,950). Special computational rules apply for certain types of trusts, such as charitable remainder trusts and electing small business trusts. Grantor trusts [I.R.C. §§ 671–670] are not separately subject to the tax because their income is included in the grantor’s income. Income tax–exempt trusts such as charitable trusts and qualified retirement plan trusts are also not subject to the NIIT.

B. Net Investment Income
In general, investment income includes, but is not limited to, gross income from interest, dividends, capital gains, rental and royalty income, nonqualified annuities, and income from businesses that are involved in trading of financial instruments or commodities as well as businesses that are passive activities for the taxpayer (within the meaning of I.R.C. § 469). Net investment income is reduced by investment expenses properly allocable to the income.

Common types of income that are not investment income are wages, unemployment compensation, operating income from a nonpassive business, social security benefits, alimony, tax-exempt interest, self-employment (SE) income, Alaska permanent fund dividends, and distributions from retirement plans described in I.R.C. §§ 401(a), 403(a), 403(b), 408, 408A, and 457(b).

The following items are common examples of gains taken into account in computing net investment income (to the extent that gains are not otherwise offset by capital losses):
1. Gains from the sale of stocks, bonds, and mutual funds
2. Capital gain distributions from mutual funds
3. Gain from the sale of investment real estate (including gain from the sale of a home that is not excluded from gross income under I.R.C. § 121)
4. Gains from the sale of passive activity interests in partnerships and S corporations

Example 1: Basic NIIT Computation
Barnaby Bullfinch is single. He has $180,000 of wages and received $90,000 from a passive partnership interest, which is considered net investment income. His MAGI is $270,000, which exceeds the $200,000 NIIT threshold for single taxpayers by $70,000.

Barnaby’s NIIT is based on the lesser of his $70,000 excess MAGI or his $90,000 net investment income. His NIIT is $2,660 (3.8% × $70,000).

III. Additional Medicare Tax
Effective for tax years beginning after December 31, 2012

A new 0.9% Medicare surtax applies to earned income over a specified threshold.

A 0.9% additional Medicare tax applies to wages and SE income that exceed a threshold amount based on an individual’s filing status.

Proposed regulations [REG-130074-11] were issued on December 5, 2012. The proposed regulations providing guidance to employers and individuals for the additional hospital insurance tax (additional Medicare tax) on certain earned income include amendments to Treas. Reg.

For this purpose, the term employment taxes means the Federal Insurance Contributions Act (FICA) tax imposed on employers and employees, the Railroad Retirement Tax Act (RRTA) tax imposed on employers and employees, and federal income tax withholding.

A. FICA and RRTA Taxes
The Affordable Care Act (ACA) added I.R.C. § 3101(b)(2), which increases the employee portion of Medicare tax for wages received in any tax year beginning after December 31, 2012, by an additional 0.9% of FICA wages in excess of certain threshold amounts. Because I.R.C. § 3201(a) sets the RRTA tax rate equal to the FICA tax rates in I.R.C. § 3101(a) and (b), the additional 0.9% rate also applies to RRTA compensation.

The additional Medicare tax differs from the regular Medicare tax in that the additional tax is not imposed until wages exceed a threshold amount, and the threshold amount for application of the tax is based on the filing status of the individual. The additional Medicare tax is also different in that there is no employer portion to correspond to the amount owed by the employee. The threshold amounts for the additional Medicare tax are shown in Figure 5.

**FIGURE 5 Earned Income Thresholds for the Additional Medicare Tax**

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing jointly</td>
<td>$250,000</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$125,000</td>
</tr>
<tr>
<td>Single</td>
<td>$200,000</td>
</tr>
<tr>
<td>Head of household (with qualifying person)</td>
<td>$200,000</td>
</tr>
<tr>
<td>Qualifying widow(er) with dependent child</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

The threshold amount for the additional Medicare tax applies separately to the FICA and the RRTA. Accordingly, an individual does not combine FICA wages and RRTA compensation in determining whether the additional Medicare tax applies under the FICA or under the RRTA.

B. Self-Employment Tax
The ACA also added I.R.C. § 1401(b)(2), which increases the Medicare tax on self-employment (SE) income for any tax year beginning after December 31, 2012, by an additional 0.9% of SE income in excess of the threshold amounts. This is coordinated with the additional Medicare tax under the FICA, so that the SE threshold amounts are reduced (but not below zero) by the amount of FICA wages taken into account in determining additional Medicare tax.

I.R.C. § 1401(b)(2)(B) does not include a similar coordination with the additional Medicare tax under the RRTA. Therefore, the amount of compensation taken into account in determining additional Medicare tax under the RRTA will not reduce the threshold amounts for determining the additional Medicare tax on SE income.

C. Estimated Taxes
I.R.C. § 6654 imposes an addition to tax in the case of an individual’s underpayment of estimated tax. The penalty does not apply to individuals who have sufficient income tax withholding on wages or who make adequate estimated tax payments throughout the year.

An employee may not request that the employer deduct and withhold the additional Medicare tax on wages of $200,000 or less. However, employees may use Form W-4 to request additional income tax withholding from their wages to cover their total tax liability on Form 1040.
The additional Medicare tax is subject to the estimated tax payment requirements. To the extent the tax is not withheld from wages, it must be included when calculating and making estimated tax payments.

IV. Individual Taxpayer Deductions
Some popular itemized deductions and adjustments to gross income are back for the 2012 and later tax years. In general, the tax benefits of specific deductions are extended temporarily, whereas phaseouts of overall deductions are reinstated with no expiration date.

A. Personal Exemptions Deduction Phaseout
Effective for 2013 and later tax years

A taxpayer’s exemption deduction will again be reduced by 2% for each $2,500 ($1,250 for married taxpayers who file separate returns)—rounded up—of AGI that exceeds an applicable amount. The thresholds are different than in prior years and now vary by filing status, as shown in Figure 6. The thresholds will be adjusted for inflation in tax years beginning after 2013.

For 2013 the exemption deduction amount is $3,900 per exemption before any phaseout.

**FIGURE 6 Exemption Deduction Phaseout Ranges for 2013**

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Start of Phaseout</th>
<th>End of Phaseout</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$ 250,000</td>
<td>$ 372,501</td>
</tr>
<tr>
<td>Head of household</td>
<td>$ 275,000</td>
<td>$ 397,501</td>
</tr>
<tr>
<td>Married filing jointly or surviving spouse</td>
<td>$ 300,000</td>
<td>$ 422,501</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$ 150,000</td>
<td>$ 211,251</td>
</tr>
</tbody>
</table>

B. Standard and Itemized Deductions
An overall limitation reduces itemized deductions for higher-income taxpayers, and the marriage penalty relief is extended to all future years for taxpayers claiming the standard deduction.

1. Overall Limitation
Effective for 2013 and later tax years

The same higher-income taxpayers whose exemption deductions are reduced because of their AGI will also see some of their itemized deductions reduced. The overall limitation on itemized deductions does not apply to the deductions for medical expenses, investment interest, nonbusiness casualty and theft losses, or gambling losses, but other deductions are reduced by the lesser of 3% of the taxpayer’s excess AGI or 80% of the taxpayer’s itemized deductions that are subject to the phaseout.

The filing status–based thresholds for the start of the phaseout are the same as those shown in Figure 6. However, because the rules for this limitation are different than those for the exemption deduction phaseout, there is no definitive endpoint, and all taxpayers will be entitled to at least 20% of their otherwise allowable itemized deductions.

The itemized deduction phaseout does not apply to estates or trusts filing Form 1041, U.S. Income Tax Return for Estates and Trusts.
2. **Marriage Penalty Relief**

Effective for 2013 and later tax years

The basic standard deduction for a married couple filing jointly will remain equal to two single standard deductions.

The basic standard deduction for a joint return is 200% of the single standard deduction, rather than the 167% amount in effect before the EGTRRA. The basic standard deduction for a married individual filing a separate return is equal to the deduction for a single individual.

The additional standard deductions for age and/or blindness are still differentiated, with the single amount generally equal to 125% of the amount for a married individual. The additional standard deduction for age and/or blindness for 2013 is $1,500 for an unmarried taxpayer and $1,200 for a married taxpayer.

C. **State and Local Sales Taxes**

Effective for 2012 and 2013

The option to deduct sales tax instead of income tax is extended for 2 years.

Taxpayers who itemize deductions may choose between deducting state and local general sales taxes and deducting state and local income taxes. Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have a state income tax, but this option can also benefit some residents of other states.

This deduction will **not** be available for tax year 2014 absent further congressional action.

D. **Qualified Conservation Easements**

Effective for 2012 and 2013

The enhanced deduction is available for easements granted before 2014.

Farmers and ranchers who enter into qualified conservation easements before 2014 continue to be eligible to deduct the easement’s value up to 100% of their contribution base (generally, their AGI), with a 15-year carryover period. Other individuals have a 50% limitation, with the same 15-year carryover. Without the extension all donors would have a 30% limitation and a 5-year carryover period.

The enhanced deduction will not be available for contributions made in tax year 2014 absent further congressional action.

V. **Business Deductions**

Several cost recovery provisions were extended for 2012 and 2013. Additional first-year depreciation (AFYD) was reinstated for 2012 and 2013, along with a higher limit on the I.R.C. § 179 deduction and the educator’s expense deduction.

Many businesses can choose to accelerate their cost recovery for depreciable property placed in service during 2012 and 2013. These provisions generally will expire for property placed in service in 2014 absent further congressional action.

A. **I.R.C. § 179 Expensing**

Effective for tax years beginning in 2012 and 2013

The ceiling for the I.R.C. § 179 deduction remains at $500,000 for tax years beginning in 2012 and 2013.

For tax years beginning in 2012 and 2013, taxpayers may choose to expense up to $500,000 of the cost of qualifying property purchased for use in an active trade or business. The investment
limit—after which the maximum deduction is reduced dollar-for-dollar—remains at $2,000,000 for these years. Off-the-shelf computer software continues to be qualified property, as does the qualified real property that was I.R.C. § 179 property in 2010 and 2011. Taxpayers may also continue to make or revoke I.R.C. § 179 elections for their 2012 and 2013 tax years on timely filed amended returns.

The expense ceiling is scheduled to revert to $25,000 for tax years beginning in 2014, when the investment limit will drop to $200,000 unless Congress enacts further legislation dealing with I.R.C. § 179.

B. Additional First-Year Depreciation
Effective for calendar year 2013

The 50% additional first-year depreciation allowance is extended for only 1 year.

Qualified property placed in service before during calendar year 2012 was eligible for a 50% AFYD deduction, and this allowance was extended to qualified property placed in service before January 1, 2014. Qualified longer production period property is eligible if placed in service before January 1, 2015. The $8,000 increase in the limit for first-year depreciation for a passenger automobile continues to apply if AFYD is elected.

Corporations may also continue to elect to forgo AFYD in exchange for making certain long-term unused minimum tax credits refundable.

C. Educator’s Expense Deduction
Effective for 2012 and 2013

The classroom expense deduction for elementary and high school employees is reinstated for 2012 and 2013.

School employees working with children in grades kindergarten through 12 may deduct up to $250 each year of substantiated out-of-pocket expenses incurred in 2012 and 2013 for classroom materials as an adjustment to gross income. The deduction will not be available for costs incurred in 2014 absent further congressional action.

VI. Education Benefits
Several tax benefits related to the cost of post-secondary education are extended, with some of the provisions made permanent.

A. Qualified Tuition Deduction
Effective for 2012 and 2013

Taxpayers may choose between deducting some tuition costs and claiming an education credit for the student.

The qualified tuition deduction for up to $4,000 of tuition and fees paid for attendance at any level of post-secondary education is extended to amounts paid before 2014. This deduction (an adjustment to gross income) will not be available for tax year 2014 absent further congressional action.

B. Student Loan Interest Deduction
Effective for 2013 and future years

The enhancements to the deduction for interest paid on student loans are now permanent.
The 60-month limitation on the student loan interest deduction is repealed, and the higher-AGI limits continue to apply for tax years after 2012. For both 2012 and 2013, the deduction will phase out for taxpayers with MAGI between $60,000 and $75,000 ($125,000 and $155,000 for joint returns). Adjustments for inflation may change the phaseout range in subsequent years. This deduction is also an adjustment to gross income.

C. Coverdell Education Savings Accounts
Effective for 2013 and future years

Taxpayers may continue to contribute up to $2,000 annually to an account for each eligible child.

Contributions to Coverdell education savings accounts (ESAs) are not deductible, but earnings grow tax-deferred, and qualified distributions are excludable from gross income. Elementary and secondary school expenses, as well as costs for post-secondary education, are eligible expenses.

Without enactment of the ATRA, the maximum annual contribution per child would have dropped to $500.

D. Employer Educational Assistance
Effective for 2013 and future years

Employers may provide each employee with up to $5,250 annually of tax-free assistance for the employee’s post-secondary education expenses.

Assistance under an I.R.C. § 127 plan can be provided for an employee’s undergraduate or graduate-level study, which generally does not have to be job-related. Allowable expenses include tuition, fees, and similar payments, plus books, supplies, and equipment. Eligible tools or supplies cannot be retained by the employee after completion of the instruction. Costs of meals, lodging, or transportation are also not eligible expenses.

E. Health Professions Grants
Effective for 2013 and future years

Grants under certain health service scholarship programs are excludable from gross income even if the recipient is required to provide services.

The gross income exclusion for scholarships granted through the National Health Service Corps scholarship program and the F. Edward Hebert Armed Forces Health Professions scholarship program is now permanent. Both awards require the recipients to provide future medical services, which otherwise would bar an exclusion under I.R.C. § 117.

VII. Individual Taxpayer Credits
The personal tax credit provisions in effect for 2012 will remain in effect at least for tax years beginning before 2018, and several of these benefits no longer have expiration dates.

A. Adoption Credit
Effective for tax years after 2012

Enhancements to the adoption credit are extended permanently, but it is not refundable.

The dollar-for-dollar of qualified expense adoption credit remains in effect (for both special needs children and those without special needs) at the $10,000 level, as adjusted annually for inflation. For 2013 the maximum credit is $12,970 per eligible child. This maximum credit is phased out for higher-income taxpayers: for 2013, the phaseout begins at a $194,580 modified adjusted gross income (MAGI) and ends at a $234,580 MAGI.
The refundable adoption credit in I.R.C. § 36C was not reenacted, but the I.R.C. § 23 nonrefundable adoption credit may be carried forward for up to 5 succeeding tax years if it exceeds the individual’s tax liability in the credit year.

B. Child Tax Credit
Generally effective for tax years after 2012

The child tax credit will remain at $1,000 per eligible child through the 2017 tax year.

Taxpayers generally may claim a $1,000 credit for each dependent child under age 17. The $1,000 credit amount is now permanent. It does not include an inflation adjustment for future years.

Currently the child tax credit becomes refundable if the allowable credit exceeds the individual’s tax liability and he or she has earned income exceeding $3,000. The refundable amount is the lesser of 15% of the taxpayer’s earned income in excess of $3,000 or the $1,000 maximum credit. This provision was extended through the 2017 tax year.

C. Dependent Care Credit
Effective for tax years after 2012

The 2001 enhancements to the child and dependent care credit are permanent.

The 35% maximum credit rate and the $3,000 expense base for one qualifying dependent ($6,000 for two or more qualifying dependents) are extended permanently.

The 35% credit rate applies to taxpayers with an AGI that does not exceed $15,000. The rate is reduced by 1% for each $2,000 of additional AGI, so that it drops to 20% for taxpayers whose AGI is at least $43,000.

D. Earned Income Credit
Generally effective for tax years after 2012

The earned income credit simplification rules are now permanent, and two provisions for a more generous credit are extended through 2017.

The earned income credit (EIC) simplification rules generally restrict the definition of earned income to amounts received for services that are included in gross income. (An elective exception applies to combat pay.) AGI is used instead of MAGI in applying the credit phaseout. Any qualifying child must reside with the taxpayer for more than 6 months. The tiebreaker rules when two or more taxpayers claim the same qualifying child begin with parental relationship rather than with AGI. AMT is not a factor in computing the EIC.

The EIC provisions that increased the income ranges for joint returns and increased the credit amount for three or more qualifying children are extended through 2017.

E. Education Credit
Effective for tax years beginning before 2018

The enhanced Hope credit is extended through 2017.

The American opportunity credit—an enhanced Hope credit—is extended through 2017 and can be used for 4 years of post-secondary education. The credit can be up to $2,500, and 40% of it can be refundable. Certain required materials and supplies continue to be eligible expenses.
F. Residential Energy Credit  
Effective for property placed in service in 2012 and 2013

The nonbusiness energy property credit is reinstated for 2012 and 2013.

The 10% credit for qualified energy efficiency improvements to the taxpayer’s main home was extended for improvements made during 2012 and 2013. The total credit is limited to $500 for all tax years after 2005, and the credit for windows is limited to $200 for all tax years after 2005. See Form 5695, Residential Energy Credits.

This deduction will not be available for tax year 2014, absent further congressional action.

VIII. Exclusions from Gross Income
Three exclusions are extended temporarily, and the enhanced provisions for employer-provided adoption assistance are now permanent.

A. Charitable Donations of IRAs  
Effective for 2012 and 2013

Taxpayers who are at least age 70½ may have individual retirement arrangement distributions made directly to eligible charities during 2012 and 2013 without inclusion in gross income.

A $100,000 limitation applies annually. Because this law was not in effect during 2012, qualifying taxpayers who took distributions from their individual retirement arrangements (IRAs) in December 2012 were permitted to transfer the funds to an eligible charity during January 2013 and treat the transfer as an eligible charitable distribution.

Eligible IRA owners could also elect to have transfers made during January 2013 treated as made during 2012 for purposes of the minimum required distribution (MRD) rules for IRAs and the $100,000 annual limit for charitable transfers from IRAs.

In all other situations the transfer must be made directly by the IRA trustee or custodian to the charity. This deduction will not be available for tax year 2014 absent further congressional action.

B. Cancellation of Home Mortgage Debt  
Effective for 2013

Taxpayers whose acquisition debt for their main homes is forgiven can qualify for an income exclusion through 2013.

Lenders may write down mortgage debt for homebuyers whose acquisition debt for their main homes exceeds the property’s fair market value. The exception for including this canceled debt (up to $2,000,000) in gross income—without regard to bankruptcy or insolvency—is extended only through 2013.

C. Roth Plan Rollovers  
Effective for rollovers after December 31, 2012

A provision to increase revenue allows employer plans to adopt amendments that permit more in-plan Roth rollovers, resulting in current-year taxation.

The terms of a qualified employer plan determine when distributions may be made to employees. Even if no other statutory distribution restriction applies, a profit-sharing plan generally may allow an in-service distribution only after a fixed period that must be at least 2 years [Treas. Reg. § 1.401-1(b)(1)]. A money purchase pension plan generally may not allow an in-service distribution before the employee attains age 62 (or normal retirement age under the plan, if earlier).
If a plan has a qualified Roth contribution program, any amount eligible for distribution can be rolled over within the plan into a designated Roth account (referred to as an in-plan Roth rollover). This rollover is essentially a form of Roth conversion, and the distribution is subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus the amount transferred is included in gross income (except to the extent it represents a return of after-tax contributions), and the 10% early distribution tax does not apply.

Because an in-plan Roth direct rollover merely changes the tax character of the amount, a distribution that is rolled over in an in-plan direct rollover is not treated as a distribution for certain purposes under the plan, including certain purposes related to participant or spousal consent, plan loans, and anti-cutback protections under the plan.

The ATRA expands the amounts eligible for in-plan Roth direct rollover to include amounts that are not distributable under the plan. A 401(k) plan, the federal Thrift Savings Plan (TSP), a 403(b) plan, or a governmental 457(b) plan that includes a qualified Roth contribution program is permitted to allow individuals to elect an in-plan transfer of any amount not otherwise distributable to a designated Roth account maintained under the plan for the benefit of the individual.

This in-plan transfer is treated as an in-plan Roth direct rollover, even though the plan cannot allow an actual distribution of the amount transferred because of the in-service distribution rules. The rollover does not change the basic character of these amounts as not being distributable under the plan.

Planning Pointer
Amendment Needed to Apply New Rules
A plan can adopt an amendment that allows new in-service distributions from the plan’s non-Roth accounts that are conditioned on the participant rolling over the distribution in an in-plan Roth direct rollover. The IRS has posted numerous questions and answers about designated Roth accounts within employer plans at www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-on-Designated-Roth-Accounts.

IX. Estate and Gift Taxes
The estate and gift tax rules in effect for 2010–2012 are extended permanently, but the top tax rate increases to 40% for deaths and transfers in 2013 and future years. A $5,000,000 lifetime cumulative exemption (indexed annually for inflation) is allowed to each U.S. individual before a wealth transfer tax (gift, estate, or generation-skipping) is imposed.

A. Unified Estate and Gift Tax Credit
Effective for 2013 and future years

The lifetime cumulative amounts per taxpayer that are exempt from the estate, gift, and generation-skipping transfer taxes (the applicable exclusion amount) are $5,000,000 (indexed annually for inflation beginning in 2012), and a surviving spouse can add the unused portion of the applicable exclusion amount from the first spouse to die to his or her applicable exclusion amount.

The unified credit for gift and estate taxes is equal to the estate or gift tax due on the applicable exclusion amount. The applicable exclusion amount is $5,000,000, adjusted for inflation beginning in 2012. The applicable exclusion amounts, as indexed for inflation, are $5,120,000 for 2012 and $5,250,000 for 2013.

The estate of an individual who died in 2011 or thereafter can elect to add the deceased spouse’s unused exclusion amount to the surviving spouse’s applicable exclusion amount. The surviving spouse can use the added applicable exclusion amount for lifetime gifts or for transfers at death.

12
B. Estate and Gift Tax Rates
Effective for 2013 and future years

The maximum rate for gift and estate taxes is 40% beginning in 2013.

The EGTRRA changes to the estate and gift tax rates are extended permanently, except that the maximum tax rate is increased to 40% from the 35% rate under prior law. Figure 7 shows the top tiers of the estate and gift tax rate schedule.

![FIGURE 7 Top Tiers of Estate and Gift Tax](image)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 500,000</td>
<td>$ 750,000</td>
<td>$155,800, plus 37% of $ 500,000</td>
</tr>
<tr>
<td>$ 750,000</td>
<td>$1,000,000</td>
<td>$248,300, plus 39% of $ 750,000</td>
</tr>
<tr>
<td>$1,000,000</td>
<td>N/A</td>
<td>$345,800, plus 40% of $1,000,000</td>
</tr>
</tbody>
</table>

C. State Death Taxes
Effective for 2013 and future years

The credit for state death taxes is permanently replaced by a deduction for state death taxes.

The EGTRRA phased out the credit for state death taxes and replaced it with a deduction for state death taxes. That change is now permanent.

Observation
State Death Taxes
This change in the federal estate tax rules permanently eliminates any state death taxes that were defined by reference to the federal estate tax credit for state death taxes.

D. Installment Payment of Estate Taxes
Effective for 2013 and future years

Changes make it easier to qualify for installment payment of estate taxes.

Estates that include eligible closely held businesses may qualify to pay some of the estate tax in up to 10 installments if the business’s value constitutes more than 35% of the estate. The EGTRRA changes that increased the allowable number of partners and shareholders in a closely held business from 15 to 45 and treated stock in qualifying lending and finance businesses as stock in an active trade or business company are extended permanently.

X. Defense of Marriage Act

All legal same-sex marriages are valid for all federal tax purposes, including income, gift, and estate taxes.

In Rev. Rul. 2013-17, released August 29, 2013, the Treasury Department and the IRS announced that all legal same-sex marriages will be recognized for federal tax purposes. Couples who validly entered into a marriage in a jurisdiction whose laws authorize the marriage will be treated as married for federal tax purposes regardless of whether the couple lives in a jurisdiction that recognizes same-sex marriage or a jurisdiction that does not recognize same-sex marriage.

The ruling implements federal tax aspects of the June 26, 2013, Supreme Court decision in United States v. Windsor [133 S. Ct. 2675] that invalidated a key provision of the 1996 Defense
of Marriage Act (DOMA). The *Windsor* decision held that § 3 of the DOMA is “unconstitutional as a deprivation of the equal liberty of persons that is protected by the Fifth Amendment.”

The DOMA excluded a same-sex partner from the definition of spouse in federal statutes by stating that “the word ‘marriage’ means only a legal union between one man and one woman as husband and wife, and the word ‘spouse’ refers only to a person of the opposite sex who is a husband or a wife.”

*Note*  
Fifth Amendment to the Constitution  
Many citizens associate the Fifth Amendment with the criminal defense right not to be a witness against oneself. However, a subsequent phrase in the amendment states that a person shall not “be deprived of life, liberty, or property, without due process of law.”

**A. Ruling Affects All Items**  
Rev. Rul. 2013-17 applies to all federal tax provisions where marriage is a factor, including filing status; personal and dependency exemption deductions; the standard deduction; eligibility for and exclusion of employee benefits; IRA contributions; and claiming the earned income tax credit, child tax credit, and dependent care credit.

Any same-sex marriage legally entered into in one of the fifty states, the District of Columbia, a U.S. territory, or a foreign country is covered by the ruling. However, the ruling does not apply to registered domestic partnerships, civil unions, or similar formal nonmarital relationships recognized under state law.

Legally married same-sex couples generally must file their 2013 federal income tax return using either the married filing jointly (MFJ) or married filing separately (MFS) filing status. The same rule applies to original returns for 2012 or a prior year that are filed on or after September 16, 2013.

**B. Claims for Refunds**  
Individuals who are or were in same-sex marriages may (but are not required to) file returns choosing to be treated as married for federal tax purposes for any prior tax year still open under the statute of limitations. All items reported on the return that are affected by marital status must be consistent with the marital status reported on the return.

Some employees who purchased same-sex spouse health insurance coverage through employer plans on an after-tax basis may treat the amounts paid for that coverage as pretax and excludable from income.

Taxpayers who previously filed income tax returns as unmarried and want to file as married should file Form 1040X, Amended U.S. Individual Income Tax Return, to claim a refund of income taxes. Taxpayers may file a refund claim for gift or estate taxes using Form 843, Claim for Refund and Request for Abatement.

**C. Wisconsin Income Taxes**  
DOMA § 2, which was not repealed by the *Windsor* decision, allows states to refuse to recognize same-sex marriages performed in other states. Wisconsin does not recognize same-sex marriages. Therefore, same-sex couples who file a married filing jointly federal return will must separate their income and deductions on Schedule S, Allocation of Income to be Reported by Same-Sex Couples Filing a Joint Federal Return, and report them on single Wisconsin income tax returns.

Schedule S shows the amount of income as reported on the federal return that is allocable to each individual, and determines the federal adjusted gross income to be used for Wisconsin tax purposes. Wisconsin marital property law does not apply to this allocation.
XI. Affordable Care Act

The 2010 Affordable Care Act (ACA) includes provisions that are first effective in 2013 and later years.

A. Medical Loss Ratio Rebates

|Medical loss ratio (MLR)| is the percentage of premium dollars that an insurance company spends on providing health care and improving the quality of care, versus how much is spent on administrative and overhead costs, including executive salaries and bonuses. The ACA generally requires that 80% to 85% of the money collected by insurance companies be spent on health care services and health care quality improvement. If insurance companies do not meet these goals because their administrative costs or profits are too high, they must provide rebates to consumers.

Rebates are taxable income if the taxpayer received a tax benefit from payment of the premium that is rebated.

B. Mandatory Health Care coverage in 2014

In 2014 the ACA will require most U.S. residents to obtain “minimum essential coverage” for health care costs.

The ACA assigns shared responsibility to federal and state governments, insurers, employers, and individuals to improve the availability, quality, and affordability of health insurance coverage in the United States. Mandatory coverage will begin in 2014 for most Americans.

- Insurance market reforms increase the ability of individuals to enroll in health insurance coverage regardless of preexisting conditions and do not permit insurers to charge higher premium prices based on factors other than age, tobacco use, rating area, or family size.

- Individuals and small businesses will be able to purchase private health insurance through competitive market places called “affordable insurance exchanges.” The exchanges allow insurance companies to compete for business on a level playing field and will give qualified consumers a choice of health plans.

- The small business health insurance premium tax credit will be enhanced.

- To balance the insurance market reforms, a nonexempt individual must maintain minimum essential coverage or make a shared responsibility payment.

- A refundable health insurance premium tax credit will help some individuals pay for the required coverage.

- Employers with at least 50 full-time equivalent employees must offer qualified health coverage to their full-time employees or make a “shared responsibility payment,” beginning in 2015.

C. Individual Tax Credit

New I.R.C. § 36B provides a refundable tax credit to help eligible individuals and families afford health insurance coverage.

The credit can be received via advance monthly payments made to the issuer of a qualified health plan.

When an individual enrolls for coverage through a state exchange, the exchange will make an advance determination of credit eligibility for individuals seeking financial assistance. Using
information available at the time of enrollment, the exchange will determine both whether the individual meets the requirements for advance credit payments and the amount of the advance payments, if applicable.

To be eligible for a premium tax credit, an individual must be an applicable taxpayer, defined as a taxpayer who meets three criteria:

1. His or her household income for the tax year is between 100% and 400% of the federal poverty line (FPL) for the taxpayer’s family size.
2. He or she may not be claimed as a dependent by another taxpayer.
3. If married, the taxpayer and spouse must file a joint return.

Figure 8 shows the 2013 FPL income guidelines, published January 24, 2013, in the Federal Register [78 F.R. 5182-5193] for the 48 contiguous states and the District of Columbia. Thus an individual who lives alone in any state except Alaska or Hawaii needs $45,960 of income to reach 400% of the poverty level, and a family of four can have more than $90,000 of income before becoming ineligible for a premium credit, depending on its insurance cost.

A U.S. citizen who is eligible for Medicaid is not required to purchase other insurance. The Medicaid income limit before the ACA was enacted was 100% of the FPL. The ACA increases the financial eligibility level for Medicaid to 133% of the FPL, but did not adopt the higher income limit.

1. **Premium Assistance Computation**

   The premium assistance amount for a coverage month is the lesser of the following two amounts:
   1. The premiums for the month for one or more qualified health plans that cover a taxpayer or family member
   2. The excess of the adjusted monthly premium for the benchmark plan that applies to the taxpayer over one-twelfth of the product of the taxpayer’s household income and the applicable percentage for the tax year

   The adjusted monthly premium, in general, is the premium an insurer would charge for the plan adjusted only for the ages of the covered individuals.
Therefore, the monthly premium assistance amount is the lesser of the premium for the qualified health plan in which a taxpayer or family member enrolls or the excess of the premium for the benchmark plan over the applicable percentage of the taxpayer’s household income. Each exchange will have its own benchmark plan.

**a. Applicable Percentage**

In general, the applicable percentage of the taxpayer’s household income represents the amount of the taxpayer’s required out-of-pocket contribution to the premium cost if the taxpayer purchases the benchmark plan. The remainder of the premium for the benchmark plan is the premium assistance amount.

The applicable percentage increases as the taxpayer’s household income increases as a percent of the FPL for the taxpayer’s family size. Figure 9 shows the applicable percentage ranges for 2014. The applicable percentages may be adjusted after 2014.

![FIGURE 9 Applicable Income Percentage Ranges for Individual Credit](image)

<table>
<thead>
<tr>
<th>Household Income Range (Percentage of FPL)</th>
<th>Beginning Applicable Percentage</th>
<th>Ending Applicable Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 100% but less than 133%</td>
<td>2.00%</td>
<td>2.00%</td>
</tr>
<tr>
<td>At least 133% but less than 150%</td>
<td>3.00%</td>
<td>4.00%</td>
</tr>
<tr>
<td>At least 150% but less than 200%</td>
<td>4.00%</td>
<td>6.30%</td>
</tr>
<tr>
<td>At least 200% but less than 250%</td>
<td>6.30%</td>
<td>8.05%</td>
</tr>
<tr>
<td>At least 250% but less than 300%</td>
<td>8.05%</td>
<td>9.50%</td>
</tr>
<tr>
<td>At least 300% but less than 400%</td>
<td>9.50%</td>
<td>9.50%</td>
</tr>
</tbody>
</table>

**b. Online Calculator**

The Henry J. Kaiser Family Foundation offers an interactive subsidy calculator on its website at http://kff.org/interactive/subsidy-calculator/. The required entries are:

- annual income;
- whether employer coverage is available;
- family size; and
- numbers of adults and children enrolling in exchange coverage.

The calculator is intended to illustrate how families in varying circumstances may be affected by the tax credits and limits on age rating included in the law. The website notes that premiums will vary from region to region and are based on assumptions insurers make in setting premiums and that Medicaid eligibility varies substantially by state.

**2. Reconciliation and Repayment**

A taxpayer must reconcile the actual credit for the tax year computed on the taxpayer’s tax return with the amount of any advance payments.

- If a taxpayer’s credit amount exceeds the amount of the advance payments, the taxpayer may receive the excess as an income tax refund.
- If a taxpayer’s advance payments exceed the credit amount, the taxpayer owes the excess as an additional income tax liability.

However, the law [I.R.C. § 36B(f)(2)(B)] places caps on the repayment for taxpayers with household income under 400% of the FPL.

Figure 10 shows the repayment limitation amounts for 2014. Beginning in 2015 these caps will be adjusted to reflect changes in the cost of living.
FIGURE 10 Caps on Repayment of Excess Advance Credit

<table>
<thead>
<tr>
<th>If Household Income Is</th>
<th>Single Filing Status</th>
<th>Any Other Filing Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 200% of FPL</td>
<td>$300</td>
<td>$600</td>
</tr>
<tr>
<td>At least 200% but less than 300% of FPL</td>
<td>$750</td>
<td>$1,500</td>
</tr>
<tr>
<td>At least 300% but less than 400% of FPL</td>
<td>$1,250</td>
<td>$2,500</td>
</tr>
</tbody>
</table>

3. Adjustment on Wisconsin income tax return
For purposes of computing the subtraction for medical care insurance on the Wisconsin income tax return, the amount paid by the individual for medical care insurance must be reduced by any premium assistance credit under section 36B of the Internal Revenue Code.

D. Individual Shared Responsibility Payment
To ensure effective and efficient implementation of the insurance market reforms included in the ACA, the ACA includes an individual shared responsibility provision [I.R.C. § 5000A]. This provides individuals who do not qualify for an exemption with two options:
1. Have minimum essential coverage for each month beginning after December 31, 2013
2. Make a shared responsibility payment when filing his or her federal income tax return
   A taxpayer will be liable for the shared responsibility payment if any nonexempt individual who may be claimed by the taxpayer as a dependent for a tax year does not have minimum essential coverage in a month included in that tax year. Married taxpayers filing a joint return are jointly liable for the shared responsibility payment. The Treasury Department and the IRS issued proposed regulations [REG-148500-12, 78 F.R. 7314] for this provision on January 30, 2013.

1. Exempt Individuals
I.R.C. § 5000A(d) and (e) exempt many individuals from the shared responsibility payment, including some whose religious beliefs conflict with accepting the benefits of private or public insurance and individuals who do not have an affordable health insurance coverage option available.

   a. Membership Exemptions
   - An individual is exempt if he or she is a member of a recognized religious sect described in I.R.C. § 1402(g)(1) and adheres to the established tenets or teachings of that sect. [I.R.C. § 1402(g)(1) provides the exemption from SE tax for members of a qualified religious sect.]
   - An individual is also exempt for a month that the individual is a member of a health care sharing ministry.
   - An individual is exempt for a month that the individual is a member of a federally recognized Indian tribe, as defined in I.R.C. § 45A(c)(6).

   b. Financial Status Exemptions
   - An individual is exempt for a month in which the individual lacks access to affordable minimum essential coverage. For this purpose, an individual lacks access to affordable coverage if the individual’s required annual contribution for minimum essential coverage exceeds a percentage of the individual’s household income for the year for which an
exemption is being claimed [45 C.F.R. 155.600 and following sections, and 45 C.F.R. 156.600 and following sections]. For 2014 the applicable percentage is 8%.

- An individual is exempt for a month included in a calendar year if the individual’s household income for the tax year is less than the amount of gross income that is the threshold for a federal income tax filing requirement for the individual’s filing status.
- An individual is exempt for a month if the applicable state exchange determines that a hardship prevented the individual from obtaining coverage under a qualified health plan for that month.

**c. Other Exemptions**

- An individual is exempt for a month that ends during a short coverage gap—a continuous period of less than 3 months when the individual does not have minimum essential coverage. The length of a gap in coverage is determined without regard to the calendar years in which months in the gap occur. If an individual has more than one short coverage gap in a calendar year, the exemption applies only to the earliest short coverage gap.
- An individual is exempt for a month that the individual is not a citizen or national of the United States and is not an alien who is lawfully present in the United States.
- An individual is exempt for a month that the individual is incarcerated, except for incarceration pending the disposition of charges.

**2. Minimum Essential Coverage**

I.R.C. § 5000A(f) defines *minimum essential coverage* as one of the following five categories of coverage:

1. Coverage under a specified government sponsored program
2. Coverage under an eligible employer-sponsored plan
3. Coverage under a health plan offered in the individual market within a state
4. Coverage under a grandfathered health plan
5. Other health benefits coverage that the Treasury and HHS recognize for purposes of I.R.C. § 5000A(f)

Specified government sponsored programs include Medicare, Medicaid, CHIP, Department of Defense medical coverage (including the TRICARE program), veterans’ health care programs, and the health plan for Peace Corps volunteers.

An eligible employer-sponsored plan is a group health plan or group health insurance coverage offered by an employer to the employee that is a governmental plan or any other plan or coverage offered in the small or large group market within a state. An eligible employer-sponsored plan also includes a grandfathered health plan offered in a group market.

A grandfathered health plan is a group health plan or health insurance coverage that provided coverage as of March 23, 2010 (the enactment date of the Affordable Care Act) or in which an individual was enrolled as of that date.

**a. Excepted Benefits**

Health coverage that consists of certain excepted benefits is *not* minimum essential coverage. There are four categories of excepted benefits:

1. Accidental death and dismemberment coverage, disability insurance, general liability insurance, automobile liability insurance, workers’ compensation, credit-only insurance (for example, mortgage insurance), and coverage for employer-provided on-site medical clinics
2. Limited scope dental or vision benefits, long-term care benefits, and benefits provided under certain health flexible spending arrangements

3. Insurance that is separate from—and not coordinated with—any group or individual health plan maintained by the same plan sponsor that provides coverage for only a specified disease or illness (for example, cancer-only policies) or fixed indemnity insurance (for example, a policy that pays a fixed dollar amount, such as $100 per day, of hospitalization or illness, regardless of the amount of medical expense incurred)

4. Supplemental policies, certificates, or contracts that are separate from the primary health coverage—including Medicare supplemental policies (also known as Medigap or MedSupp insurance), TRICARE supplemental policies, and similar supplemental coverage to coverage under a group health plan

b. Individuals Residing Abroad
An individual is treated as having minimum essential coverage for a month if the individual is a bona fide resident of a U.S. possession for the month or if the month occurs during any period that the individual qualifies as a bona fide resident of a foreign country or meets the physical presence test under I.R.C. § 911(d)(1)(A) or (B) for the foreign earned income exclusion.

3. Shared Responsibility Payment
The shared responsibility payment for any tax year is generally the sum of monthly penalty amounts for all months in the tax year in which any nonexempt individual for whom the taxpayer is liable did not have minimum essential coverage. However, it is also capped at an amount equal to the national average premium for bronze-level qualified health plans offered through exchanges for the applicable family size. The applicable national average bronze plan premium may vary from month to month during the year to account for changes in the taxpayer’s family size.

The monthly penalty amount is one-twelfth of the greater of a flat dollar amount or a percentage-of-income amount.

- The flat dollar amount is the total of the applicable dollar amounts for all nonexempt individuals without minimum essential coverage for whom the taxpayer is liable, limited to 300% of the applicable dollar amount. The applicable dollar amount begins at $95 in 2014 and increases in subsequent years, as shown in Figure 11. A cost-of-living adjustment (COLA) will apply for calendar years beginning after 2016. The applicable dollar amount for a child who is under age 18 at the beginning of a month is one-half of the regular applicable dollar amount.

- The percentage-of-income amount is calculated as the excess of the taxpayer’s household income over the taxpayer’s federal income tax return filing threshold multiplied by the percentage figure shown in Figure 11.

### FIGURE 11 Shared Responsibility Payment

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>Later Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicable dollar amount per person</td>
<td>$95</td>
<td>$325</td>
<td>$695</td>
<td>COLA applies</td>
</tr>
<tr>
<td>Cap on applicable dollar amount</td>
<td>$285</td>
<td>$975</td>
<td>$2,085</td>
<td>COLA applies</td>
</tr>
<tr>
<td>Percentage applied to income</td>
<td>1.0%</td>
<td>2.0%</td>
<td>2.5%</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

Examples 2 and 3 are adapted from the examples in Prop. Reg. § 1.5000A-4(d).
Example 2: Unmarried Taxpayer Without Minimum Essential Coverage

Quentin Quail, who is unmarried and has no dependents, does not have minimum essential coverage for any month in 2016, and does not qualify for any exemption. His household income is $120,000. Assume that his applicable filing threshold for 2016 is $12,000 and the annual national average bronze plan premium for his family size (one person) is $5,000.

Quentin’s flat dollar amount is $695, as shown in Figure 11, and his monthly penalty amount based on that dollar amount is $58 ($695 ÷ 12).

His excess income is $108,000 ($120,000 – $12,000) and his percentage-of-income amount is $2,700 ($108,000 × 2.5%). Thus his monthly penalty amount based on excess income is $225 ($2,700 ÷ 12).

Because the $225 amount is greater than the $58 amount, his penalty is $225 for each month he lacked minimum essential coverage. Because he was not covered for any month during 2016, his shared responsibility payment is $2,700 ($225 × 12), which is less than the $5,000 limit for 12 months of noncoverage based on the national average premium for a family of one.

Question 1.
How much would the penalty be if the tax year is 2014?

Answer 1.
If his excess household income is still $108,000, his required payment is $1,080 ($108,000 × 1%). Quentin’s applicable dollar amount is only $95, but the excess income penalty is the greater amount.

Question 2.
What if Quentin obtained minimum essential coverage that is effective July 31 through December 31?

Answer 2.
Because he is covered for at least 1 day in each of 6 months, his shared responsibility payment is one-half of the amount that would apply for the entire 12-month year.

Example 3: Family without Minimum Essential Coverage

Paul and Penelope Puffin are married and file a joint return for 2016. They have three dependent children who are ages 21, 15, and 10. No member of the family has minimum essential coverage for any month in 2016. Their household income is $120,000. Assume that their applicable filing threshold for 2016 is $24,000 and that the national average annual bronze plan premium for a family of five is $20,000.

Because the applicable dollar amount for a child under age 18 is one-half of the regular amount, and they have two children under age 18, their flat dollar amount is $2,780 ($695 × 4). However, the dollar amount cap is $2,085, as shown in Figure 11, so their monthly penalty based on the dollar amount is $173.75 ($2,085 ÷ 12).

Their excess household income is $96,000 ($120,000 – $24,000) and their percentage-of-income amount is $2,400 ($96,000 × 2.5%), for a $200 ($2,400 ÷ 12) monthly penalty amount.

Because the $200 is greater than the $173.75, the monthly penalty is $200. Because all members of the family lacked coverage for all 12 months, the total of the monthly penalty amounts is $2,400 ($200 × 12). This is less than the $20,000 amount for 12 months of noncoverage based on the national average bronze plan premium, so the Puffins’ shared responsibility payment for 2016 is $2,400.

Question 1.
What if the tax year were 2014?
Answer 1.
If the tax year were 2014 and their excess income were still $96,000, their penalty would be $960 ($96,000 × 1%).

Question 2.
What is the effect if the Puffins had only one dependent child, and that child turned 18 during September of their calendar-year tax year?

Answer 2.
Their shared responsibility payment would be lower because it would be calculated for 2½ people for 9 months and for 3 people for 3 months.

An individual who is liable for a shared responsibility payment must report the payment with the individual’s federal income tax return for the tax year that includes the month or months for which the payment is owed. The payment is payable upon notice and demand by the IRS, and it is generally assessed and collected in the same manner as an assessable penalty under I.R.C. §§ 6671–6725. Unlike the assessable penalties, however, the IRS may not file notice of lien or levy on the taxpayer’s property for failing to pay the assessed shared responsibility payment. Further, a taxpayer may not be subject to criminal prosecution or penalty for failing to pay the assessed shared responsibility payment in a timely manner.

XII. Wisconsin Income Tax Update

A. Internal Revenue Code (IRC) Update

1. Wisconsin income based on IRC provisions as of December 31, 2010
Wisconsin Acts 19 and 20 adopted many specific IRC provisions as of January 1, 2013 and 2014 but other 2010 provisions remain in effect. Many federal provisions that have a sunset date were not considered to avoid future differences.

2. Tax years beginning January 1, 2013 – same as federal for:
- Rollover to Roth IRA not treated as distribution
- Installment method for accrual basis taxpayers
- 10% floor on itemized medical expense deduction
- 20% penalty on early HSA/MSA distributions

3. IRC provisions still not adopted by Wisconsin
- Discharge of debt on principle residence
- Deduction for educator expenses
- Treatment of mortgage insurance premiums as interest
B. Income Tax Rates Reduced
Effective for taxable years beginning on or after January 1, 2013, the individual income tax rates are reduced as follows:

<table>
<thead>
<tr>
<th>Rate</th>
<th>Bottom Rate</th>
<th>2nd Rate</th>
<th>3rd Rate</th>
<th>4th Rate</th>
<th>Top Rate</th>
</tr>
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<tr>
<td>Before</td>
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<td>6.15%</td>
<td>6.50%</td>
<td>6.75%</td>
<td>7.75%</td>
</tr>
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<td>After</td>
<td>4.40%</td>
<td>5.84%</td>
<td>6.27%</td>
<td>7.65%</td>
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</tr>
</tbody>
</table>

C. Farming loss add-back eliminated
For taxable years beginning before January 1, 2014, the addition to income for farm losses is limited for persons who are not actively engaged in farming. The addition to income is eliminated for taxable years beginning on or after January 1, 2014.

D. Higher education tuition subtraction phase-out indexed for inflation
The federal AGI thresholds for phasing out the subtraction for tuition and mandatory fees are now indexed for inflation. For tax years beginning January 1, 2013 the indexed ranges are:

- $50,850 - $61,020 (single or head of household)
- $81,350 - $101,690 (married filing jointly)
- $40,680 - $50,850 (married filing separately)

E. New private school tuition subtraction paid for dependents
Effective for tax years beginning on or after January 1, 2014, a subtraction from income is allowed for tuition expenses that are paid by a claimant for tuition for a pupil to attend an eligible institution.

- For each elementary pupil, the maximum amount of tuition expenses which a claimant may subtract in a taxable year is $4,000.
- For each secondary pupil, the maximum amount of tuition expenses which a claimant may subtract in a taxable year is $10,000.

F. Depreciation and Section 179 Expense
a. For taxable years beginning on or after January 1, 2014, Wisconsin has conformed to federal depreciation on January 1, 2014. The Legislature has to adopt any changes after that date to conform to federal.
b. For taxable years beginning on or after January 1, 2014, section 179 of the Internal Revenue Code, relating to expensing of depreciable business assets, applies for Wisconsin. “Internal Revenue Code” means the federal Internal Revenue Code in effect for the year in which the property is placed in service.

G. Adjustment for federal and Wisconsin basis differences
Starting with the first taxable year beginning after December 31, 2013, and for each of the next four taxable years, a subtraction is provided for 20% of the amount determined by subtracting the combined federal adjusted basis of all depreciated or amortized assets as of the last day of the taxable year beginning in 2013 that are also being depreciated or amortized for Wisconsin from the combined Wisconsin adjusted basis of those assets on the same day.
H. Manufacturing and agricultural credit
For taxable years beginning on or after January 1, 2014, the manufacturing and agriculture credit may be offset only against the amount of the tax imposed upon or measured by the business operations of the claimant on which the credit is computed.