2014 FEDERAL INCOME TAX CHANGES TO KNOW

Each year brings with it various changes to federal tax laws. Navigating all of those changes can be daunting, especially if you have little experience or knowledge about tax outside of filing income tax returns for yourself or your family.

From new taxes to modified contributions limits and filing limits, here are a number of federal tax law changes to know for 2014 (tax year 2013).

Same Sex Couples. 2014 marks the first time in US history that legally married same-sex couples can take advantage of a number of tax benefits previously only available to opposite-sex married couples. First off, in order to qualify, same-sex spouses must have validly entered into a legal marriage by a state that legally authorizes same-sex marriage. This applies even if a couple married in one state but lives in another state that does not currently recognize same-sex marriage. For example, a same-sex couple that married in Iowa but lives in Arkansas can still enjoy the federal tax benefits of marriage. These include all of the benefits that come with filing a joint income tax return.

Exemption Amounts. Due to inflation, the IRS frequently adjusts the amount that may be exempted from income for federal income tax purposes. For 2014 (tax year 2013), exemptions for individuals and dependents increase to $3,900 per person, up from $3,800 a year ago. While $100 doesn't seem like a lot, for larger families it makes a difference. For example, a family of 5 will be able to exempt an extra $500 from tax this year, which could amount to a tax savings of a few hundred dollars.

Standard Deduction. Like the personal and dependent exemption amounts, the standard deduction amount for individuals that do not itemize increases in 2014 as well. For married couples filing jointly (now including same-sex married couples) the standard deduction is $12,200 (up from $11,900 for the 2012 tax year), $8,950 for heads of household (up from $8,700 for the 2012 tax year), and $6,100 for singles and married individuals filing separately (up from $5,950 for tax year 2012).

Additional Tax Bracket. 2014 marks the creation of an additional tax bracket. Individuals with taxable income over $400,000 will now be subject to a tax of 39.6% (previously the top marginal tax rate was capped at 35%). For married couples filing jointly, the number is $450,000.

Net Investment Income Tax. Beginning this year, an additional tax of 3.8% will be imposed on net investment income of certain high net worth individuals. Also known as the Unearned Income Medicare Contribution Tax, it will apply to individuals with a modified adjusted gross income or net investment income over a threshold amount. For this year, that amount is $250,000 for married individuals filing jointly, $200,000 for singles and heads of household, and #125,000 for married individuals filing separately.

Capital Gains Rates. Beginning this year, there will be a change to the capital gains tax paid by investors depending on his or her marginal income tax bracket. Since 2003, the top rate for long term capital gains has been 15% (which non-so-coincidentally was also the rate for dividends) for investors regardless of marginal rate, however, beginning this year, that will change. Investors in the 25%, 25%, and 33% brackets will still pay 15% on long term capital gains (subject to the additional 3.8% additional net investment surtax). Changes begin with the 35% marginal rate taxpayers who will now pay 18.8% on their long term capital gains while the newly created 39.6% bracket will pay 23.8%.

For self-employed individuals and small business owners, here are a few more to be aware of for 2014.

Standard Mileage Rates. Individuals that use their vehicle to carry on their businesses can enjoy a nice deduction for business use of their vehicles. The deduction can be calculated based on either an actual expense method or standard mileage method. Using the actual expense method the actual costs of operating the vehicle for business may be deducted. Using the standard mileage method, individuals may deduct 56.5 cents for each mile traveled for business. However, a few words of caution- driving from home to work is not business-related travel in the eyes of the IRS, so don't try to write off your daily commute. Also, if you stop for personal reasons on the way to or from a business activity, the remaining miles traveled to or from the activity are considered personal in nature. Finally, much like any deduction, the IRS is very strict on whether a deduction should be permitted. If you decide to claim a deduction for business-related use of your vehicle make sure to keep good records so that your claims can be substantiated in the event of an audit.

Home Office Deduction. Beginning in 2014 (for 2013 income tax returns), there is a simplified option for those individuals claiming the infamous home office deduction for their small businesses. Long known for its potential to trigger an IRS audit, the home office deduction can provide a substantial break to those individuals actually entitled to claim it. In order to qualify, the space must be used *exclusively* for business use, and the use must be regular. That means that if your kids also use the space to play video games in the evening, it won't qualify. Also, if you only occasionally work from home but have a regular place of business as well, the deduction is not for you, as the office must be your principal place of business. Whether a home office is your principal place of business depends on the actual activities you conduct there, but generally speaking, if you use the space to primarily conduct the administrative and management tasks involved in your business, the space will qualify.

Previously, the amount of the home office deduction was calculated using a formula based on the percentage of the home used for business. However, the IRS now let's tax payers use a simpler method of calculating the deduction based on a simplified square footage calculation. With the simplified square footage calculation taxpayers can deduct $5 per square foot of office space up to 300 square feet. One benefit of this simplified approach is that it eliminates the challenges of tracking actual expenses like utilities. While the simplified calculation may produce a smaller deduction that the actual expense method it seems less likely to trigger an audit.

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