Tax Law Changes For 2013
The American Taxpayer Relief Act of 2012

As we begin a new year in 2013 we are all digesting the tax changes many people will face under the new **American Taxpayer Relief Act of 2012** (the Law) that was crafted, negotiated and finalized after much wrangling in Congress. The final votes in Washington, DC were taking place on New Year's Day, leaving us with this new law that has something for almost everyone to contend with. The new legislation attempts to stop all of us from going over what has been coined the "Fiscal Cliff". Although the law prevents over 98% of American taxpayers from having to face tax hikes, it basically creates a permanent extension of the 2001/2003 Bush-era tax cuts we have all enjoyed these past years. There was no solution in the Law to the needed spending cuts that were also supposed to be ironed out, so this area is still up for needed work by Congress.

The Law fixes some tax provisions yet at the same time creates some new types of taxes, together with thresholds and rates of taxes, that many taxpayers will now have to contend with starting this year and for the foreseeable future. There is actually almost something in this for everyone who works, and together with the Affordable Health Care Act (known as "ObamaCare") which was passed several years ago now, there are a number of new income threshold amounts to consider and tax rates to apply. In the sections below I will outline for you the major new provisions that you should review to see if any of them would apply to your tax situation.

Overview of Major Components of the new Law -

- The tax rate and law changes implemented by the Affordable Health Care Act (Obama Care Bill) includes a new 3.8% new tax on unearned income (interest, dividends, and capital gains) and a new .9% Medicare tax on earned income (basically salary and self-employment type income) over $200K and $250K thresholds that will be in effect as of 1/1/13.
- Payroll withholding taxes for employees will revert back to the 6.2% level from the 4.2% level we have had for the last 2 years. So anyone who has salary or self-employment type income will pay the additional 2% as of 1/1/2013.
- New income tax thresholds and tax rates increases will be implemented for those with taxable income over $400K for a single person and $450K for married couples. The top tax bracket rate rises from 35% to 39.6%. The remaining tax brackets are extended at their current levels and remain the same.
- Dividends and capital gains rates will go up to 20% for those with taxable income levels over the above new limits above. The Law makes permanent the 0% and 15% long term capital gain tax rates for income below the above new limits above.
- The alternative minimum tax is "fixed" so it will not create additional taxes for individuals retroactively for 2012 and beyond.
- Exemptions and Itemized Deductions – Reinstates for 2013 the provision that phases out itemized deductions and personal exemptions, but now for those with adjusted gross income over $250,000 for singles and $300,000 for couples.
- Estate tax: Keeps the taxable estate level at those over $5 million, but increases the tax rate from 35% to 40%.
- A two (2) year extension of charitable donation of IRA amounts withdrawn and paid directly to charities for those individuals age 70 ½ and over.
- For business use fixed asset acquisitions – extends for one (1) year the ability to take an extra 50% bonus depreciation on assets placed in service; ability to depreciate new fixed assets in the year of acquisition (Section 179); and to depreciate leasehold improvements over 15 years instead of 39 years.

Additional Discussion of Certain Major Provisions - Permanent Extension of 2001 Tax Relief [Act §101]

The Law, by repealing the sunset provision in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), permanently extends, the following provisions:

Reduction in income tax rates for individuals

Under prior law, the 10% individual income tax bracket was set to expire at the end of 2012. Upon expiration, the lowest tax rate would have been 15%. The Law permanently extends the 10% individual income tax bracket. Under prior law, the 25%, 28%, 33%, and 35% individual income tax brackets would have expired at the end of 2012. Upon expiration, the rates would have become 28%, 31%, 36%, and 39.6% respectively.

The Law permanently extends the 25%, 28%, 33% and 35% tax brackets on income at or below $400,000 (individual filers), $425,000 (heads of households), $450,000 (married filing jointly and surviving spouses), and $225,000 (married filing separately). For taxpayers above the threshold amounts, which will be adjusted for inflation, the Law reinstates the 39.6% bracket.
Effective for taxable years beginning after December 31, 2012.

Repeal of phase-out for personal exemptions

Prior to EGTRRA, the law provided a phase out of the personal exemption for certain higher income individuals. For 2006 through 2009, EGTRRA reduced the phase out amount and then repealed the personal exemption phase-out for 2010. The 2010 TRA extended the repeal through 2012:

The Law permanently extends the repeal of personal exemption phase-out on income at or below $250,000 (individual filers), $275,000 (heads of households), $300,000 (married filing jointly and surviving spouses), and $150,000 (married filing separately). These amounts are adjusted for inflation. For taxpayers with adjusted gross income above the threshold amounts, the personal exemption phase-out reduction applies.
Effective for taxable years beginning after December 31, 2012.

Phaseout of overall limitation on itemized deductions

Prior to EGTRRA, the amount of itemized deductions that a taxpayer could claim was reduced, to the extent the taxpayer's AGI is above a defined certain amount that was adjusted for inflation each year. EGTRRA phased out this reduction for 2006 through 2009 and then repealed this limitation on itemized deductions for 2010. The 2010 TRA extended the repeal through 2012.

The Law permanently extends the repeal of the defined limitation on income at or below $250,000 (individual filers), $275,000 (heads of households), $300,000 (married filing jointly and surviving spouses), and $150,000 (married filing separately). These amounts are to be adjusted for inflation.
At income levels above the thresholds, the limitation applies to reduce itemized deductions by the lesser of (1) 3% of the excess of adjusted gross income above the threshold amounts, or (2) 80% of the amount of itemized deductions otherwise allowable.
Effective for taxable years beginning after December 31, 2012.

The Law permanently extends the 15% (0%) capital gains rates for taxpayers below the 39.6% tax bracket.

For taxpayers in the 39.6% bracket, the long-term capital gains rate will be set at 20%. These changes also apply for AMT purposes. Note that such income will be considered net investment income under ObamaCare Bill at a 3.8% tax which is effective beginning in 2013 under the health care reform law.
Effective for taxable years beginning after December 31, 2012.

Dividends of individuals taxed at capital gain rates

Prior law allowed qualifying dividends to be considered within the definition of "net capital gain" and be taxed at the preferential rates for capital gains. As extended by the 2010 TRA, for taxpayers below the 25% bracket a 0% rate applies, and for taxpayers in the 25% bracket and above, the rate is 15%. Under the 2010 TRA, these rates were set to expire at the end of 2012.

The Law permanently extends the current rates for taxpayers below the 39.6% tax bracket. For taxpayers in the 39.6% tax bracket, the rate that qualifying dividends will be taxed at is 20%. Similar rules apply for AMT. Note that such income will be considered net investment income for the 3.8% tax under ObamaCare.
Effective for taxable years beginning after December 31, 2012.

Permanent Alternative Minimum Tax Relief

For a joint return or a surviving spouse, the Law sets the AMT exemption amount to $78,750 for tax years beginning in 2012. For an individual who is not married and is not a surviving spouse, the Law sets the AMT exemption amount to $50,600 for tax years beginning in 2012. For married taxpayers filing separate returns, the AMT exemption amount is set at $39,375 for tax years beginning in 2012 (1/2 the amount of married taxpayers filing jointly).

Beginning in 2013 the Law adjusts these amounts for inflation.
The Law repeals the general rule limiting the aggregate amount of certain nonrefundable personal credits to the excess of the taxpayer's regular tax over the tentative minimum tax. The Law makes permanent the AMT patch provision that allows all of the nonrefundable personal credits to be taken to the full extent of both regular tax and AMT liability. In addition, the Law removes separate limitations on certain credits so that all nonrefundable personal credits would be subject to the same limitation.
Effective for taxable years beginning after December 31, 2011.

Extension of Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes Through 2013

The Law allows taxpayers age 70 1/2 or older to make tax-free distributions to charities from their traditional individual retirement accounts (IRAs) and Roth IRAs up to $100,000 per taxpayer, per taxable year. This provision had expired at the end of 2011. In order to, in effect, retroactively reinstate this provision, the Law permits individuals to make charitable transfers during January of 2013 as if they were made on December 31, 2012.
Effective for distributions made in taxable years beginning after December 31, 2011.

New Roth Conversion Flexibility

The Law will now allow individuals to convert their existing 401(k) plan assets to a Roth 401 (k) if the employer offers designated Roth accounts under the plan, regardless of whether the individual is allowed to take a distribution out of the plan. This means someone who has not attained the age under the plan to take a distribution would now be able to make this taxable conversion.

Miscellaneous Extension Provisions Under the New Law

- The American Opportunity Tax Credit (the $2,500 tax credit for college expenses that replaced the prior Hope Scholarship Credit in 2009) is extended 5 years - it was scheduled to lapse at the end of 2012, and will now run until 2017. The Child Tax Credit and the Earned Income Tax Credit were also extended over the same 5-year time period.

A series of 'extender rules are retroactively patched for 2012 and extended one year through 2013, including:

- Deduction for up to $250 expenses for elementary and secondary school teachers

- Exclusion from income of discharged mortgage debt (necessary to prevent a short sale from triggering income tax consequences for the amount of debt that was discharged)

-Deduction of mortgage insurance premiums as qualified residence interest

-Deduction for state and local sales taxes paid (in lieu of state and local income taxes paid, useful in states that have little or no income taxes)

- Above-the-line deduction for up to $4,000 of higher-education-related expenses (although in practice, this provision is rarely used due to the availability of the American Opportunity Tax Credit, which was also extended)

-Business provisions, including the Work Opportunity Tax Credit, is increased.

So as you can see there are many facets to the new Law and ObamaCare that may impact the amount of taxes you will owe starting in 2013. You may want to consult with us to see what planning is needed for your particular tax situation, and how to anticipant the additional amounts needed to be paid in during the year to avoid tax return due date surprises in April of 2014.

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