“Fiscal Cliff” Averted After the Final Hour

It took Congress until the 13th hour to come to an agreement on a bill that would extend many of the Bush-era tax cuts through tax year 2013. The American Taxpayer Relief Act does include some modifications that target higher taxes for single individuals with income exceeding $400,000 and married couples with income above $450,000 annually. This income threshold is an improvement from the $200,000 to $250,000 definition of “wealthiest individuals” previously asserted by President Obama and certain members of Congress.

The highlights of the American Taxpayer Relief Act include:

1. Individual tax rates are being retained at the 10%, 15%, 25%, 28%, 33%, and 35% brackets as provided in the original Bush tax cuts. However, a new top tax rate of 39.6% will be imposed on taxable income exceeding $400,000 for single filers, $425,000 for head of household filers, and $450,000 for married taxpayers filing jointly ($225,000 for married filing separately).

2. The phase-out of itemized deductions and personal exemptions is being reinstated at higher threshold amounts. The phase-out begins at $250,000 of income for single taxpayers and $300,000 for taxpayers filing as married-jointly.

3. The previous capital gains and dividends rate of 15% is being retained for most taxpayers, and the 0% tax rate will remain in effect for taxpayers falling within the maximum tax brackets of 10 to 15%. However, the increased 20% rate will apply to individuals that are in the highest tax bracket threshold of $400,000/$450,000.

4. The Alternative Minimum Tax (AMT) exemption is increased to $78,750 for married filing jointly taxpayers and $50,600 for single filers, and will be permanently indexed for inflation. (This has often been referred to as the AMT patch by news media.)

5. The estate and gift tax lifetime exemption is being retained at $5 million indexed for inflation annually ($5.12 million in 2012), which is great news. However, the highest tax rate on estate and gift taxes exceeding the exemption increases from 35% to 40%.

6. The Child Tax Credit was scheduled to return to a maximum of $500 per qualified child at the end of 2012. However, this bill extends the maximum credit of $1,000 per qualified child through 2018.

7. The American Opportunity tax credit was also scheduled to expire at the end of 2012, but it will also be extended through 2018 for qualified tuition paid by taxpayers and their dependents.

8. The Act extends the $250 (above-the-line) deduction allowed for expenses incurred by educators through 2013.

9. The Act extends the exclusion from income of the discharge/forgiveness of qualified debt on a primary residence through 2013.

10. **The Act extends the special rule for contributions of capital gain real property made for conservation purposes in tax year 2012 and through 2013. This is a big win for those of you that are investors in property that was placed under a conservation easement in 2012. Instead of being limited to a deduction of 30% of income, taxpayers will be able to take qualified charitable deductions on conservation easements up to 50% of their adjusted gross income (100% for farmers).**

11. Among the extensions is a continued allowance of the increased Section 179 deduction on capital purchases (such as equipment) of $139,000 through 2013. This means you can directly write off the cost of eligible capital purchases that you would normally have to depreciate over several years as long as your total eligible purchases did not exceed $560,000 for the year. This expensing election was originally scheduled to sunset back to a maximum deduction of $25,000 prior to the passage of this act.

12. The Act also extended the 50% bonus depreciation write off on eligible new capital/equipment purchases through 2013.

While the passage of this act provides relief in many areas where taxes were set to increase for 2012 and 2013, it should be noted that some new taxes took effect January 1 of this year as a result of the health care reform legislation previously passed.

The FICA (payroll) tax relief that was provided in 2012, which decreased the social security portion of wages and self-employment income withheld from 6.2% to 4.2% for employees is <u>not</u> being extended. Therefore, we will see a 2% increase on the employee portion of social security taxes. The 2013 FICA limit is set at $113,700.

Also, there will also be an additional 0.9% tax on wages and other self-employment income that exceeds $250,000 for married-joint filers, $125,000 for married-separate filers, and $200,000 for singles. This is an additional hospital insurance tax being imposed on high-income taxpayers. (It should be noted that the income threshold for this tax was not increased as it was for the regular income taxes.)

Additionally, there will be a 3.8% Medicare tax imposed on investment income for taxpayers who exceed the income thresholds of $250,000 for married-joint filers, $125,000 for married-separate filers, and $200,000 for others. (It should be noted for this additional tax that the income threshold was not increased from the original levels.)

Finally, the itemized deduction for medical expenses will be more difficult to qualify for beginning January 1, 2013. Prior to 2013, medical expenses that exceed 7.5% of income were allowed as an itemized deduction. That left most taxpayers receiving minimal tax relief/benefits for the hardship of medical expenses incurred. Unfortunately, it is only going to become more difficult to realize a tax benefit from medical expenses in 2013 because only qualified expenses exceeding 10% of income will be allowable as an itemized deduction. This makes it very difficult for high income earners to derive any tax breaks from their medical deductions.

As you can see, there are a few unfriendly taxes coming into play as of January 1, 2013, but the extenders bill that just passed does provide relief on a lot of tax incentives that were scheduled to sunset. Based on all of these changes our firm is more committed than ever to ensure that our clients are informed of the ever evolving tax legislation and all available tax planning opportunities.

We, at Large & Gilbert, would like to wish you all a happy, healthy, and profitable New Year!! We appreciate the opportunity to serve and assist every one of you.

For more information and recent changes, please link to:
http://tax.cchgroup.com/downloads/files/pdfs/legislation/ATPR.pdf

Large & Gilbert is committed to keeping you up to date on the latest tax changes. If you have any questions, please contact:

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