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The American Taxpayer Relief Act of 2012: Averting the "fiscal-cliff"

After weeks, indeed months of proposals and counter-proposals and high-stakes drama, Congress has passed legislation to avert the so-called "fiscal cliff," at least on the tax side. Here are the highlights:

Individuals

Tax rates. The legislation permanently extends the Bush-era income tax rates for all taxpayers except for taxpayers with taxable income above certain thresholds: $400,000 for single individuals and $450,000 for married couples filing joint returns.

For 2013 and beyond, the federal income tax rates are 10, 15, 25, 28, 33, 35, and **39.6** percent. Before, the top rate was 35%. The IRS is expected to issue revised income tax withholding tables to reflect the 2013 rates as quickly as possible.

Stealth tax hikes. The new law reinstates the limitation on itemized deductions and personal exemption exemption after 2012 for higher income individuals but at revised thresholds. The new thresholds for being subject to both are $300,000 for married couples and surviving spouses, $275,000 for heads of households, $250,000 for unmarried taxpayers; and $150,000 for married couples filing separately.

- *Of particular importance and benefit to Washington state residents: the bill protects the sales-tax deduction for years 2012 and 2013.*

Capital gains. *The taxpayer-friendly Bush-era capital gains and dividend tax rates have been modified. Generally, the new law increases the top rate for qualified capital gains and dividends from 15% to 20%. The 20% rate will apply when a taxpayer's income exceeds the higher $400k+ thresholds discussed above. The 15% Bush-era tax rate will continue to apply to all other taxpayers (in some cases zero percent for qualified taxpayers within the 15%-or-lower income tax bracket).*

Payroll tax cut. The employee-side payroll tax holiday is not extended. Before 2013, the employee-share of OASDI taxes was at a reduced 4.2% (vs. 6.2%) on the Social Security wage base (with a similar tax break for self-employed individuals). For 2013, the 2% reduction is no longer available and the employee-share of OASDI taxes reverts to 6.2% The employer-share of OASDI taxes remains at 6.2%. As a result of the expiration of the payroll tax holiday, everyone who receives a paycheck or self-employment income will see an increase in taxes in 2013.

Alternative Minimum Tax ("AMT"). In recent years, Congress routinely "patched" the AMT to prevent its encroachment on middle income taxpayers. The new law includes good news for many taxpayers, as it patches permanently the AMT by giving taxpayers higher exemption amounts and other targeted relief beginning 2012 and later --and the exemption amounts will be inflation-adjusted after 2012.

Federal estate tax. Few issues have complicated family wealth planning in recent years as has the federal estate tax. Recent laws have changed the maximum estate tax rate multiple times. Most recently, the 2010 Taxpayer Relief Act set the maximum estate tax rate at 35% with an inflation-adjusted exclusion of $5 million for estates of decedents dying before 2013. Effective January 1, 2013, the maximum federal estate tax will rise from 35% to 40%, but will continue to apply an inflation-adjusted exclusion of $5 million. The new law also makes permanent portability between spouses and some Bush-era technical enhancements to the estate tax.

Charitable giving. Congress has long used the tax laws to encourage charitable giving. The American Taxpayer Relief Act extends a popular charitable giving incentive through 2013: Tax-free IRA distributions to charity by individuals aged 70 1/2 and older up to maximum of $100,000 per taxpayer per year. A special transition rule allows individuals to recharacterize distributions made in January 2013 as made on December 31, 2012.

Child tax credit and related incentives. The American Taxpayer Relief Act makes permanent the $1,000 child tax credit. Most of the Bush-era enhancements are also made permanent or extended.

Education incentives. A number of popular education tax incentives are extended or made permanent: The American Opportunity Tax Credit is extended through 2017. Enhancements to Coverdell Education Savings Accounts are made permanent, such as the $2,000 maximum contribution. The student loan interest deduction is made more attractive by the permanent suspension of its 60-month rules. The new law also extends permanently the exclusion from income and employment taxes of employerprovided education assistance up to $5,250. Additionally, the above-the-line deduction for qualified tuition and related expenses is extended through 2013.

Businesses

Bonus depreciation/small business expensing. The new law renews 50% bonus depreciation for 2013. Code Sec. 179, small business expensing, is also extended through 2013, which allows a generous $500,000 expensing allowance and a $2 million investment limit. Without the new law, the expensing allowance was scheduled to drop to $25,000 with a $200,000 investment limit.

Tax extenders. A host of business tax incentives are extended through 2013. Some of these include the following:

- Research tax credit
- Work Opportunity Tax Credit
- New Markets Tax Credit
- Employer wage credit for military reservists
- Tax incentives for empowerment zones
- Indian employment credit

What's next?

The negotiations and passage of the new law are likely a dress rehearsal for the debt limit and subsequently, comprehensive tax reform during President Obama's second term. There is growing support by the President and the GOP to make the tax code more simple and fair for individuals and businesses. Congress and the Obama administration also must tackle sequestration (across-the-board spending cuts), which the American Taxpayer Relief Act delayed for two months. All this and more is expected to keep federal tax policy in the news during 2013.

This letter is intended to provide taxpayers with information about the American Taxpayer Relief Act, which Congress passed and President Obama signed in January 2013. (01/02/2013).

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