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American Taxpayer Relief Act of 2012

Dear Clients:

After weeks of negotiations, Congress finally passed legislation to avert the tax side of the "fiscal cliff." The President signed the *American Taxpayer Relief Act of 2012* into law on January 2, 2013.

In addition to the above, as part of the Affordable Care Act starting in 2013, Net Investment Income is subject to a 3.8% Medicare Surtax for Individuals with Modified Adjusted Gross Income of $250,000 filing as married filing jointly ($125,000 married filing separate) and $200,000 for all other individuals. However, Retirement Plan Distributions and non-taxable income such as municipal bond interest are exempt. Trusts or Estates with undistributed net investment income will be subject to the Medicare Surtax on the lesser of the adjusted gross income in excess of the threshold amount ($11,950 for 2013) or their "undistributed net investment income". Moreover, Higher Income Individuals are subject to a new additional 0.9% Medicare Surtax on earned income in excess of $250,000 when married filing jointly, $125,000 when married filing separate and $200,000 for all others. For more details, please refer to our website or contact our office.

Here is a summary of the major provisions of the new law.

- **Payroll tax rates**
  In 2011 and 2012, taxpayers enjoyed a "payroll tax holiday" in the form of 2% lower social security taxes on wages and self-employment earnings. The new law did not extend the lower rate beyond 2012, and taxpayers will once again pay social security tax at a 6.2%, not 4.2%, rate.

- **Income tax rates**
  The Bush-era tax rates are extended permanently. However, for taxpayers whose income exceeds $400,000 (single), $425,000 (head of household), $450,000 (married filing joint), there is a new top tax rate of 39.6% on income above those levels.

- **Capital gains and dividends**
  The new law also sets a 20% tax rate on long-term capital gains and qualified dividends for those who fall into the top 39.6% tax rate. All other taxpayers will continue with the 2012 rates – 15% for most people and 0% for those in the 10% and 15% ordinary income brackets.

- **AMT**
  The alternative minimum tax (AMT) has a permanent "fix" that is inflation adjusted annually and is retroactive to January 1, 2012. The 2012 exemption amounts are $50,600 (single) and $78,750 (couples).

- **Deductions and exemptions**
  Itemized deductions and personal exemptions are limited or phased out for higher-income taxpayers. For those with income above $250,000 (single) and $300,000 (couples), deductions are reduced by 3% of the income over the threshold, with an 80% limit on reductions. Personal exemptions are phased out above the same income thresholds, without the 80% cap. Additionally, as a part of the Affordable Care Act passed earlier, the threshold for medical expenses is increased from 7.5% of Adjusted Gross Income to 10% for taxpayers below 65 years of age.

- **Families**
  Several provisions affecting families were set to expire at the end of 2012. The new law extends or makes permanent the following credits:

  * The child tax credit of $1,000 per qualifying child under age 17.

  * Enhancements to the earned income credit.

  * The adoption credit and the income exclusion for employer-paid or reimbursed adoption expenses, indexed annually for inflation.

  * The 35% credit for child and dependent care, with expenses capped at $3,000 for one individual and $6,000 for two or more.

- **Education tax breaks**
  The new law extends the American Opportunity Tax Credit, with a $2,500 maximum credit, through 2017. The above-the-line deduction for up to $4,000 of qualified tuition and related expenses is made retroactive for 2012 and extended through 2013. The 60-month limit for deducting up to $2,500 of student loan interest is permanently eliminated. The maximum contribution allowed for Coverdell education savings accounts is permanently set at $2,000 a year. The exclusion from income for employer-provided education assistance of up to $5,250 is made permanent.

- **"Extenders"**
  The new law once again extends a number of the individual taxpayer "extenders" through 2013. The items include the following: an optional deduction for state and local sales tax in lieu of state and local income tax, the $250 deduction for classroom supplies paid by teachers, and the IRA-to-charity transfer of up to $100,000 by taxpayers age 70½ or older.

- **Miscellaneous**
  The new law extends through 2013 the exclusion from income for cancellation of mortgage debt of up to $2 million on a principal residence. It allows for the deduction of mortgage insurance premiums and the tax credit for making energy improvements to a home.

- **Estate and gift tax**
  The estate tax exemption was scheduled to drop in 2013 to $1 million with a top tax rate of 55%. The new law permanently sets the exemption at $5 million and sets the top tax rate at 40%. The exemption will be adjusted annually for inflation.

- **Business provisions**
  There are a number of provisions in the new law that will affect businesses.

  * The first-year expensing option (Section 179) was increased retroactively for 2012 and extended through 2013 at $500,000 for new and used equipment. The investment limit is set at $2,000,000.
  * The 50% bonus depreciation was extended through 2013 and applies only to new equipment.
  * The research tax credit is extended through 2013.
  * The Work Opportunity Tax Credit is extended through 2013. This credit is available to businesses that hire individuals from targeted groups, such as veterans.
  * About two dozen more business "extenders" are available for both 2012 and 2013 tax returns.

The *American Taxpayer Relief Act of 2012* contains several other provisions that could affect your personal and business tax situation. Keep in mind that Congress will have a very busy 2013 in addressing additional tax matters, possibly including a complete overhaul of the income tax code. Stay in touch with us for updates on what Congress is doing. We are here to help you pay no more tax than the law requires. Please contact us if you have questions on this latest law.

Best Regards,

David L. Buterbaugh, PC