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# American Taxpayer Relief Act of 2012

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On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 into law (the "Act"). The Act represents a partial resolution of the "fiscal cliff" by addressing the expiration of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act"), as well as a two-month delay of the activation of the budget sequestration provisions of the Budget Control Act of 2011 (the "2011 Act"). What follows is a summary of some of the significant provisions of the Act:

- The two-year old "payroll tax holiday" was allowed to expire. Thus, all wage earners will see an automatic 2% increase in their social security tax withholding on wages up to $113,700 for 2013 (This will increase taxes for all wage earners in an amount up to $2,202 this year).

- A new 39.6% tax bracket on "taxable income" in excess of $400,000 (for individuals), $425,000 (for heads of households) and $450,000 (for married couples), but the rates below those thresholds will remain at their 2012 levels (10%, 15%, 25%, 28%, 33% and 35%) (and the above-referenced income thresholds will adjust with inflation). In addition, the Act increases the tax rate on long-term capital gains and qualified dividends from 15% to 20% for taxpayers in the highest bracket (39.6%). However, the Health Insurance High-Income surcharge (3.8%) continues to apply to investment income of individuals with adjusted gross income in excess of $250,000 (this income threshold **will** **not** automatically adjust with inflation), effectively raising the rate on long-term capital gains and qualified dividends for higher income taxpayers to 23.8% (or 20% + 3.8%). The tax rate on long-term capital gains and qualified dividends for taxpayers in all other tax brackets will remain at 2012 levels (i.e. 15%).

- Reinstatement of the "Pease" limitation on itemized deductions and the personal exemption will begin to phase-out tax deductions and credits for incomes over $250,000 (for individuals), $275,000 (for heads of households) and $300,000 (for married couples) (these income thresholds will adjust with inflation). These limits existed before the Bush-era tax cuts and disappeared entirely in 2010.

- A permanent fix to the alternative minimum tax (AMT), in that the AMT will now only apply to a person with "AMT taxable income" in excess of $50,600 ($78,750 per married couple), indexed annually for inflation.

- Federal unemployment benefits will be extended for another year and some tax credits will be extended for five years, including the American Opportunity Credit, the Enhanced Child Tax Credit and the Earned Income Tax Credit.

- The top estate, gift and generation-skipping transfer (GST) tax rate is increased from 35% to 40%, but the $5 million exemption (with inflation adjustments from 2011) per taxpayer for each of those taxes is made permanent. Thus, the exemption from estate, gift and GST taxes for 2013, as adjusted for inflation, is $5.25 million per person ($10.5 million per married couple). The “portability” provisions introduced in the 2010 Act are also made permanent, which allow a surviving spouse to aggregate the unused estate tax exemption of a deceased spouse with the surviving spouse’s exemption.

- The income tax deduction for charitable gifts remains intact, subject to itemized deduction limitations. In addition, Congress has reinstated the ability of taxpayers over age 70½ to make gifts directly to charity from an IRA (and thus avoid income tax). However, Congress added the following provisions to address 2012 charitable gifts:

- During the month of January 2013, a taxpayer over age 70½ may pay an aggregate of up to $100,000 to one or more public charities directly from his or her IRA, and the taxpayer may elect to treat such withdrawals as made on December 31, 2012.

- If a taxpayer withdrew from his or her IRA during December 2012, the taxpayer may elect to treat up to $100,000 of the December withdrawal as a direct payment to charity if the taxpayer: (1) paid the amount in cash to a public charity in December 2012; or (2) pays the cash amount to a public charity by January 31, 2013.

- For 2013, aggregate charitable gifts of $100,000 may be made directly from an IRA to a public charity by a taxpayer older than 70½. However, to avoid potential confusion about the applicable tax year (see above), it would be prudent for taxpayers to wait until February 2013 to make such gifts.

- A qualified retirement plan (such as a 401(k) or 403(b) plan) may permit participants to contribute to a Roth account within the retirement plan (not all retirement plans include this flexibility). Roth accounts are funded with after-tax income and, thus, withdrawals from Roth accounts are income tax free when taken (Roth accounts also do not have required minimum distribution requirements). If a qualified retirement plan contains a Roth provision, plan participants will now be permitted to transfer amounts from the pre-tax portion of the qualified plan to a designated Roth account. As the transfer will be treated as a taxable qualified rollover contribution to the new Roth account, it will be subject to income tax (on the value of the assets when rolled over).

- Extension of the following individual tax benefits for one year: (1) Deduction for state sales tax; (2) Deduction above the line for school teacher expenses ($250); (3) Extension of employer-provided mass transit and parking benefits; (4) Exclusion from income of up to $2 million of forgiven debt on a taxpayer’s principal residence if the discharged debt is the result of declining value or the taxpayer’s declining financial condition; and (5) Non-business energy property credit for energy-efficient homes.

- The budget sequestration created by the 2011 Act is delayed by two months, to give Congress additional time for further negotiations on reducing the deficit.

The Act opens tax and estate planning opportunities because it impacts so many tax rules, everything from income tax rates to retirement planning. Congress intended to make permanent many of the changes, which creates a climate for tax planning unlike the recent past where uncertainty was the rule and not the exception. Please contact our office if you have any questions about how the American Taxpayer Relief Act of 2012 might affect you and how you might be able to maximize your tax savings.

**About the Author**: Mr. Fernandez focuses his practice on structuring and implementing estate and tax planning strategies for individuals and closely held businesses. His work includes assisting clients with all of the legal and tax aspects of the administration of decedent's estates. If you have any questions about the Act, please contact Mr. Fernandez (afernandez@wispearl.com) or one of the other attorneys in Wisler Pearlstine's Tax and Estate Planning Practice Groups.

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