Polsinelli Shughart


TAX & BUSINESS PLANNING

IN THE NEWS

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### A Tax & Business Planning Update

# Congress's Passage of the American Taxpayer Relief Act of 2012

*The Tax and Business Planning group provides these e-Alerts periodically to keep our clients, taxpayers, and businesses updated on recently adopted legislation and key changes in tax laws.*

After much contention, Congress passed the American Taxpayer Relief Act of 2012, and President Obama signed the legislation on January 2, 2013. The Act avoids automatic sunset provisions that were scheduled to take effect beginning 2013 under the so-called "Bush-era tax cuts." Though the Act is nowhere as comprehensive as what many lawmakers envisioned, there are positive aspects for a majority of taxpayers. The summary below highlights key provisions from the Act.

## Major Tax Provisions Affecting Individuals

### Individual Income Tax Rates

The Act makes permanent the lower Bush-era income tax rates for all taxpayers with taxable income at or below certain thresholds—$400,000 for single filers, $450,000 for joint filers, and $425,000 for heads of household. Individual marginal tax rates of 10, 15, 25, 28, 33, and 35 percent at the end of 2012 will remain the same, but there will be an additional 39.6 percent bracket for income exceeding the threshold amounts listed above.

The Act did not extend the temporary two-percentage point reduction in payroll taxes for employees and self-employed individuals. The rate for an employee's share of FICA will revert back to 6.2 percent (formally 4.2 percent) on wages up to $113,700 for 2013. The rate for the FICA portion of self-employment income will revert back to 12.4 percent (formerly 10.4 percent) on self-employment income up to $113,700 for 2013.

## Capital Gains / Dividends

The Act raises the individual maximum tax rate for long-term capital gains and qualified dividends from the previous 15 percent rate to 20 percent for individuals with taxable income at or above $400,000 for single filers, $450,000 for joint filers, and $425,000 for heads of household.

Long-term capital gains and qualified dividends will continue to be subject to a 0 percent rate for taxpayers whose ordinary income is generally taxed at a rate below 25 percent. Taxpayers that are subject to a 25 percent or greater rate on ordinary income, but whose income level falls below the above thresholds, will continue to be taxed at a 15 percent rate on long-term capital gains and qualified dividends.

The below examples illustrate this concept:

### Example 1

A joint filer has $600,000 of taxable income, which is partially comprised of $200,000 in net long-term capital gains. Under the Act, the first $50,000 of net long term capital gains (bringing total taxable income up to the $450,000 threshold amount) is taxed at the lower 15 percent capital gains rate, with the remaining $150,000 taxed at the new 20 percent capital gains rate.

### Example 2

A joint filer has $600,000 of taxable income, which is partially comprised of $400,000 in net long-term capital gains. Under the Act, the first $250,000 of capital gains (bringing taxable income up to the $450,000 threshold amount) is taxed at the lower 15 percent capital gains rate, with the remaining $150,000 of capital gains taxed at the new 20 percent capital gains rate.

### Example 3

A joint filer has $600,000 of taxable income, which is totally comprised of $600,000 of net long-term capital gains. The taxpayer will pay a 0 percent rate on the capital gains up to $72,500 (the 25 percent rate bracket for joint filers). For the amount of capital gains exceeding $72,500 and up to the $450,000 threshold amount, the capital gain rate will be 15 percent. The remaining $150,000 will be taxed at the new 20 percent rate.

(Note that these examples do not take into account the new 3.8 percent Medicare surtax on capital gains and other net investment income. *Click here for more information*.)

## Alternative Minimum Tax

The Act also permanently extends the alternative minimum tax (AMT) "patch," preventing an estimated 30 million taxpayers from being subject to the AMT. The Act retroactively sets the 2012 AMT exemption amounts to $78,750 for joint filers, $50,600 for individual filers,

and $39,375 for married filing separate filers. These amounts are indexed for inflation in subsequent years. The 2013 AMT exemption amounts are projected to be $80,750 for joint filers, $51,900 for single individuals, and $40,375 for married filing separate filers.

## Limitations on Itemized Deductions and Personal Exemption Phase-out

- The Act reinstates limitations on itemized deductions and personal exemptions that have not applied in recent years. The phase out of itemized deductions and personal exemptions is permanently repealed on taxable income at or below $250,000 for individual filers, $300,000 for joint filers, and $275,000 for heads of household. Taxpayers with taxable income above these thresholds will see their itemized deductions and personal exemptions limited. These limitations do not otherwise affect taxpayers subject to the AMT.

- In certain circumstances, these provisions could limit the benefit of itemized deductions, including charitable deductions for taxpayers making significant donations.

## Other

A number of individual tax provisions have been retroactively extended through at least 2013, such as:

- So-called "Marriage Penalty Relief" matters (including standard deductions and income tax rates).

- The adoption credit and the income exclusion for employer-paid or reimbursed adoption expenses up to $10,000.

- Enhancements to the earned income credit.

- The deduction for qualified tuition and related expenses.

- The $1,000 child tax credit.

- The American Opportunity Tax Credit for qualified tuition expenses.

- The exclusion for discharge of qualified principal residence indebtedness.

- The treatment of mortgage insurance premiums as qualified residence interest.

- The option to deduct state and local general sales taxes as an itemized deduction.

- The special rule for contributions of capital gain real property made for conservation purposes.

- The provision allowing tax-free distributions from an IRA to public charities, by individuals aged 70 1/2 or older, up to a maximum of $100,000 per taxpayer. Significant tax planning opportunities may be available related to distributions made in December 2012 to be treated as charitable distributions. A similar rule allows distributions made in January 2013 to be re-characterized as made on December 31, 2012. Elections to take advantage of these provisions must be made with the IRS by January 31, 2013.

# Major Tax Provisions Affecting Businesses

## Bonus Depreciation

The Act extends 50 percent bonus depreciation to property placed in service before January 1, 2014. To be eligible for bonus depreciation, qualified property must be depreciable under the Modified Accelerated Cost Recovery System and have a recovery period of 20 years or less.

## Enhanced Section 179 Expensing

The Act increases the maximum expensing amounts under Code Sec. 179 for 2012 and 2013 to $500,000 (previously $125,000). This provision allows businesses to write off equipment and other purchases currently, rather than depreciating them over several years. The Act also increases the investment-based phase-out amount for tax years beginning in 2012 or 2013 to $2,000,000. However, for tax years beginning after 2013, the maximum expensing amount is scheduled to drop to $25,000, and the investment-based phase-out amount is scheduled to drop to $200,000.

## Shortened S Corporation Built in Gain Recognition Period

Under the general rule, for a period of 10 years after a C corporation elects to be an S corporation (the "Recognition Period"), any net unrealized built-in gain of the sale of such corporation's assets that are in existence as of the effective date of the S election would remain subject to tax at C corporation rates. Then, after the expiration of that Recognition Period, any unrealized built-in gain would no longer be subject to tax at the corporation level. The Act shortens the recognition period for sales of assets in 2012 and 2013 to five years for built in gains. After 2013, the previous 10 year recognition period will once again apply. Accordingly, S corporations that are subject to this shortened period may want to consider selling assets in 2013.

## Extension of Certain Energy-Related Breaks

The Act extends through 2013 the production tax credit for facilities that produce energy from wind facilities.

A credit is available to individuals who make energy efficiency improvements to their existing residence. The lifetime credit limit is $500 ($200 for windows and skylights). The Act extends this credit through December 31, 2013.

Other energy tax incentives extended by the Act through 2013 include:

- Credits for alternative fuel vehicle refueling property.
- Credits for cellulosic biofuel production.
- Credits for biodiesel and renewable diesel.
- Production credits for Indian coal facilities.
- Credit for energy-efficient new homes.
- Credit for energy-efficient appliances.
- Allowance for cellulosic biofuel plant property.
- Special rules for sales of electric transmission property.

- Tax credits and outlay payments for ethanol.

Certain incentives were *not* extended by the Act:

- Credits for refined coal facilities.
- Percentage depletion for oil and gas from marginal wells (no longer suspended).
- Grants for certain energy property in lieu of tax credits.

## Other

A number of business tax provisions have been retroactively extended through at least 2013, such as:

- The Research Tax Credit, which rewards taxpayers who engage in qualified research activities with a tax credit.
- The Work Opportunity Tax Credit, which rewards employers that hire individuals from certain targeted groups with a tax credit.
- The 15-year recovery period for qualified leasehold improvements, qualified retail improvements, and qualified restaurant property.
- The 100 percent exclusion for gain on sale of qualified small business stock.

## Federal Estate, Gift, and Generation-Skipping Taxes

Under the Act, the estate, gift, and generation skipping transfer (GST) tax exemption amount is permanently set to $5 million per person (indexed for inflation). Based on inflation data, the exemption amount is $5,250,000 for 2013. However, for 2013 and future years, the maximum estate tax rate will be 40 percent (formerly 35 percent in 2012). Under the Act, transfers over $500,000 are taxed at 37 percent, transfers over $750,000 are taxed at 39 percent, and transfers over $1,000,000 are taxed at 40 percent.

The Act also makes "portability" of a spouse's unused exemption permanent, effectively giving a married couple the ability to pass at least $10 million in assets free of estate or gift tax. Surviving spouses will be able to utilize any of the pre-deceasing spouse's exemptions, as long as he or she makes the proper election.

The Act also extends the deductions for state estate taxes. ■

## For More Information

If you would like to discuss any of these legislative changes, portions of the Act not covered in this e-Alert, or other possible actions, please contact one of the authors listed below or another member of the Tax & Business Planning group:


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About our

# Tax and Business Planning Group

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# About

## Polsinelli Shughart

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