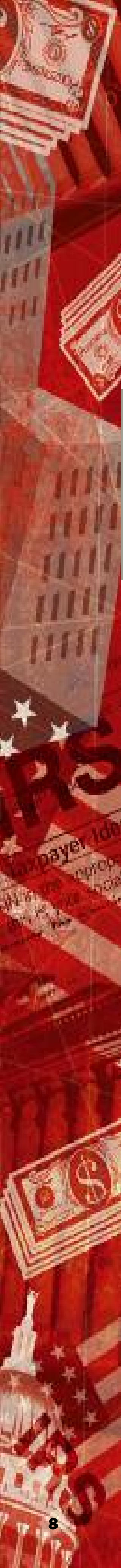

Anthony P. Curatola, Editor

Taxpayer Relief Act of 2012 and Individual Taxpayers

The American Taxpayer Relief Act of 2012 helped us avoid the fiscal cliff, but it's a stopgap solution. In general, all taxpayers will experience an increase in their tax obligation this year.

While many of us were waiting to ring in 2013, President Obama and Congress were busy wrapping up the details on legislation to avoid the fiscal cliff, which included the expiration or sunset of the Bush-era tax cuts. The cliff was avoided with the passage of the American Taxpayer Relief Act of 2012 (ATRA) (P.L. 112-240). This legislation provides a permanent fix (at least for now) for some tax provisions, a temporary fix for other tax provisions, and the expiration of other tax provisions. Although some claim that ATRA provides tax relief to the middle class, the fact is that the tax liability for all taxpayers will increase. This article highlights some of the more significant tax provisions.

Tax Rates

Throughout the Congressional debates leading up to the passage of the bill, the tax provision gaining the most attention—especially from small business owners—was the scheduled increase in tax rates. ATRA makes the Bush-era tax rate brackets for 2013 and thereafter permanent for taxpayers with taxable income below $450,000 and filing a joint tax return, $425,000 and filing as head of household, and $400,000 and filing as single. In the case of married taxpayers electing to file separately, the threshold is $225,000 (i.e., one-half of the married filing jointly). The much discussed 39.6% tax bracket has been created for taxpayers with taxable income above those threshold amounts.

One interesting aspect of the 39.6% tax bracket is its relationship to the 35% tax bracket. For single taxpayers, the 35% tax bracket is a mere range of $1,650 (income of $398,350 to $400,000). The ranges are wider for other tax filers: $26,650 for head of household filers and $51,650 for joint filers.

Itemized Deduction Limitations

The Pease limitation reduced a taxpayer's itemized deduction amount by 3% if his or her adjusted gross income (AGI) exceeded a threshold amount. The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) reduced the amount to 2% for 2006 and 2007, 1% for 2008 and 2009, and eliminated it for 2010. The provision was due to return to 3% in 2011 as a result of the sunset rule, but previous legislation was passed delaying the provision's return until 2013.

Under Act §101 of ATRA, the 3% reduction in itemized deductions as provided by IRC §68 is once again effective for tax year 2013 and thereafter. The "applicable amounts" are increased by ATRA to $300,000 for a joint return or a surviving spouse, $275,000 for head of household, $150,000 for married filing single, and $250,000 for all others. If the original tax provision was reactivated for 2013, the "applicable amount" would have been $178,150 for a joint return or a surviving spouse. The threshold amounts are indexed for inflation after 2013 in increments of $50. As was the case with the original tax provision, the reduction is limited to 80%.

Personal Exemption Limitations

Section 101 of ATRA also reintroduces the phase-out provision for the personal exemption amount that a taxpayer may claim under IRC §151. Under the new tax provision, the "applicable amounts" are tied to the amounts provided in IRC §68(b) for the reduction in itemized deductions and becomes effective for tax years 2013 and thereafter. The reduction calculation is 2% for each $2,500 or fraction thereof that the taxpayer's AGI exceeds the inflation-adjusted "applicable amounts."

As an aside, the 39.6% tax rate bracket begins for those taxpayers with taxable income above $400,000 or $450,000. The loss of itemized deductions as well as personal and dependent exemption amounts, however, begins at $250,000 or $300,000, which coincides with taxpayers in the 33% tax rate bracket—meaning taxpayers will reach higher tax brackets faster.

Alternative Minimum Tax

As part of the calculation for the Alternative Minimum Tax (AMT), a taxpayer is able to deduct an exemption amount in calculating the alternative minimum taxable income (AMTI) amount that wasn't indexed for inflation but has been adjusted annually for inflation by tax legislation over the past 12 or so years.

Section 104 of ATRA amends the AMT provision to include an inflation adjustment to the AMT exemption amount effective for tax years 2013 and thereafter. In addition, the exemption amounts are adjusted for inflation to 2012 and are as follows: $78,750 in the case of a joint return or a surviving spouse, $39,375 in the case of a married individual who files separately, $22,500 in the case of an estate or trust, and $50,600 in all other taxpayer cases other than a corporation.

Not surprising, the exemption amounts phase out under IRC §55(d)(3) at the rate of 25% of the amount by which the AMTI exceeds $150,000 in the case of a joint return or a surviving spouse, $75,000 in the case of a married individual who files separately or in the case of an estate or trust, and $112,500 in all other taxpayer cases other than a corporation. With those phase-out amounts, the change appears to affect more than just upper-income taxpayers, but at least there's no longer the worry about whether the exemption amounts will be indexed annually for inflation.

Capital Gains

Section 102 of ATRA continues some of the Bush-era tax cuts on income from capital gains and repeals others. The 15% tax on capital gain income continues to apply to taxpayers with income below the threshold for the 39.6% tax bracket. Thus, taxpayers whose taxable income might put them into or near this tax bracket may need to do some serious tax planning at year-end. The tax on capital gain income is subject to a tax rate of 20% for those in the 39.6% bracket. In addition, the 0% tax bracket on capital gain income continues to apply to those taxpayers with income below the threshold for the 15% tax bracket.

Before anyone jumps for joy that this provision for somewhat lower taxes is retained, remember that, beginning in 2013, a new 3.8% tax is imposed on net investment income that exceeds $250,000 for joint filing taxpayers and $200,000 for all other taxpayers. Therefore, taxpayers in the 33% tax bracket will pay close to 19% tax on capital income, and taxpayers in the 39.6% tax bracket will pay close to 24% tax on capital income. And don't forget: These same taxpayers will receive a reduction in both the personal and dependency exemption amount and the itemized deduction amount. In other words, taxes are increasing on taxpayers who are able and willing to invest.

Other Individual Tax Provisions

ATRA also makes permanent a number of other Bush-era tax provisions, including (1) the $10,000 (adjusted for inflation) adoption credit and income exclusion for employer-paid or reimbursed adoption expenses; (2) the 35% credit rate and $3,000 cap on expenses for one qualifying child and $6,000 cap on expenses for two or more qualifying individuals for the child and dependent care credit; (3) the $2,000 maximum contribution to a Coverdell education savings account and the inclusion of expenses incurred while attending an elementary, secondary, or post-secondary school; and (4) the exclusion of employer-provided education assistance up to $5,250.

Individual Tax Patches

Likewise, ATRA provided an extension to a number of other Bush-era tax provisions. A few of the tax provisions extended through December 31, 2013, include (1) the extension of the teachers' classroom expense deduction through 2013; (2) the parity extension in transit benefits; and (3) the deductibility of mortgage insurance premiums as qualified residence interest.

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Payroll Tax

The single tax provision affecting all wage earners in 2013 is the loss of the 2% cut in the Social Security tax. The Old-Age, Survivors, and Disability Insurance rate returns to 6.2% of the first $113,700 in 2013 (instead of 4.2% of the first $110,100). Wage earners and self-employed individuals could pay as much as $2,274 more during the current year.

Tax Filing

As a result of the enactment of ATRA on January 2, 2013, the IRS issued IR-2013-2 on January 8, 2013, announcing that it planned to open the 2013 filing season and begin processing individual tax returns on January 30, 2013. The delay resulted from the Service's need to update forms and complete programming and testing of its processing systems.

In addition, the IRS stated that although the January 30 date would accommodate the vast majority of tax filers, households with more complex tax returns wouldn't be able to start filing until late February or into March because of the need for more extensive changes to forms and processing systems. This group includes people claiming residential energy credits, depreciation of property, or general business credits. The IRS also noted that most of these tax filers typically file closer to the April 15 deadline or obtain an extension; hence, this isn't necessarily a hardship for them. **SF**

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