Overview of the tax provisions in the 2012 American Taxpayer Relief Act

The recently enacted 2012 American Taxpayer Relief Act is a sweeping tax package that includes, among many other items, permanent extension of the Bush-era tax cuts for most taxpayers, revised tax rates on ordinary and capital gain income for high-income individuals, modification of the estate tax, permanent relief from the AMT for individual taxpayers, limits on the deductions and exemptions of high-income individuals, and a host of retroactively resuscitated and extended tax breaks for individual and businesses. Here's a look at the key elements of the package:

- *Tax rates.* For tax years beginning after 2012, the 10%, 15%, 25%, 28%, 33% and 35% tax brackets from the Bush tax cuts will remain in place and are made permanent. This means that, for most Americans, the tax rates will stay the same. However, there will be a new 39.6% rate, which will begin at the following thresholds: $400,000 (single), $425,000 (head of household), $450,000 (joint filers and qualifying widow(er)s), and $225,000 (married filing separately). These dollar amounts will be inflation-adjusted for tax years after 2013.
- *Estate tax*. The new law prevents steep increases in estate, gift and generation-skipping transfer (GST) tax that were slated to occur for individuals dying and gifts made after 2012 by permanently keeping the exemption level at $5,000,000 (as indexed for inflation). However, the new law also permanently increases the top estate, gift, and GST rate from 35% to 40% It also continues the portability feature that allows the estate of the first spouse to die to transfer his or her unused exclusion to the surviving spouse. All changes are effective for individuals dying and gifts made after 2012.
- *Capital gains and qualified dividends rates.* The new law retains the 0% tax rate on long-term capital gains and qualified dividends, modifies the 15% rate, and establishes a new 20% rate. Beginning in 2013, the rate will be 0% if income falls below the 25% tax bracket; 15% if income falls at or above the 25% tax bracket but below the new 39.6% rate; and 20% if income falls in the 39.6% tax bracket. It should be noted that the 20% top rate does not include the new 3.8% surtax on investment-type income and gains for tax years beginning after 2012, which applies on investment income above $200,000 (single) and $250,000 (joint filers) in adjusted gross income. So actually, the top rate for capital gains and dividends beginning in 2013 will be 23.8% if income falls in the 39.6% tax bracket. For lower income levels, the tax will be 0%, 15%, or 18.8%.
- *Personal exemption phase-out.* Beginning in 2013, personal exemptions will be phased out (i.e., reduced) for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers). Taxpayers claim exemptions for themselves, their spouses and their dependents. Last year, each exemption was worth $3,800.
- *Itemized deduction limitation.* Beginning in 2013, itemized deductions will be limited for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers).

- *AMT relief*. The new law provides permanent alternative minimum tax (AMT) relief. Prior to the Act, the individual AMT exemption amounts for 2012 were to have been $33,750 for unmarried taxpayers, $45,000 for joint filers, and $22,500 for married persons filing separately. Retroactively effective for tax years beginning after 2011, the new law permanently increases these exemption amounts to $50,600 for unmarried taxpayers, $78,750 for joint filers and $39,375 for married persons filing separately. In addition, for tax years beginning after 2012, it indexes these exemption amounts for inflation.
- *Tax credits for low to middle wage earners.* The new law extends for five years the following items that were originally enacted as part of the 2009 stimulus package and were slated to expire at the end of 2012: (1) the American Opportunity tax credit, which provides up to $2,500 in refundable tax credits for undergraduate college education; (2) eased rules for qualifying for the refundable child credit; and (3) various earned income tax credit (EITC) changes.
- *Cost recovery*. The new law extends increased expensing limitations and treatment of certain real property as Code Section 179 property. It also extends and modifies the bonus depreciation provisions with respect to property placed in service after Dec. 31, 2012, in tax years ending after that date.
- *Tax break extenders.* Many of the “traditional” tax extenders are extended for two years, retroactively to 2012 and through the end of 2013. Among many others, the extended provisions include the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes, the $250 above-the-line deduction for certain expenses of elementary and secondary school teachers, and the research credit.
- *Pension provision.* For transfers after Dec. 31, 2012, in tax years ending after that date, plan provision in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution.
- *Payroll tax cut is no more*. The 2% payroll tax cut was allowed to expire at the end of 2012.

Limits on deductions and exemptions in the 2012 American Taxpayer Relief Act

Among the tax increases in the recently enacted 2012 American Taxpayer Relief Act are provisions that impose, or in some cases reinstate, caps on tax breaks for top earners. The new rules reinstate the personal exemption phase-out (PEP) and so-called Pease limit on itemized deductions — named after its author, former Ohio Democratic representative Don Pease . Both were created in 1990 in an effort to generate more government revenue without raising the marginal tax rates but were phased out by 2010. Now they are back. Here's how they work:

PEP limitations to apply to "high earners." Taxpayers claim exemptions for themselves, their spouses and their dependents. Last year, each exemption was worth $3,800. Under the new law, for tax years beginning after 2012, the Personal Exemption Phaseout (PEP), which had previously been suspended, is reinstated with a starting threshold for those making $300,000 for joint filers and a surviving spouse; $275,000 for heads of household; $250,000 for single filers; and $150,000 (one-half of the otherwise applicable amounts for joint filers) for married taxpayers filing separately. Under the phaseout, the total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by 2% for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. These dollar amounts are inflation-adjusted for tax years after 2013.

Pease limitations to apply to "high earners." For tax years beginning after 2012, the "Pease" limitation on itemized deductions, such as the ones taken for mortgage interest, charitable giving and state and local taxes paid, and which had previously been suspended, is reinstated with a starting threshold for those making $300,000 for joint filers and a surviving spouse; $275,000 for heads of household; $250,000 for single filers; and $150,000 (one-half of the otherwise applicable amounts for joint filers) for married taxpayers filing separately. Thus, for taxpayers subject to the "Pease" limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income (AGI) exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions. These dollar amounts are inflation-adjusted for tax years after 2013.

AMT relief in the 2012 American Taxpayer Relief Act

I am writing to provide details regarding key provisions in the recently enacted 2012 American Taxpayer Relief Act which provide permanent relief to individual taxpayers from the alternative minimum tax, or AMT. Earlier temporary measures to deal with the unintended creep of the AMT's reach expired at the end of 2011, meaning that millions of additional taxpayers would have faced paying the tax on their 2012 returns without the new relief.

Brief overview of the AMT.

The AMT is a parallel tax system which does not permit several of the deductions permissible under the regular tax system, such as property taxes. Taxpayers who may be subject to the AMT must calculate their tax liability under the regular federal tax system and under the AMT system taking into account certain “preferences” and “adjustments.” If their liability is found to be greater under the AMT system, that's what they owe the federal government. Originally enacted to make sure that wealthy Americans did not escape paying taxes, the AMT has started to apply to more middle-income taxpayers, due in part to the fact that the AMT parameters are not indexed for inflation.

In recent years, Congress has provided a measure of relief from the AMT by raising the AMT “exemption amounts”—allowances that reduce the amount of alternative minimum taxable income (AMTI), reducing or eliminating AMT liability. (However, these exemption amounts are phased out for taxpayers whose AMTI exceeds specified amounts.) For 2011, the AMT exemption amounts were $74,450 for married couples filing jointly and surviving spouses; $48,450 for single taxpayers; and $37,225 for married filing separately. However, for 2012, those amounts were scheduled to fall back to the amounts that applied in 2000: $45,000, $33,750, and $22,500, respectively. This would have brought millions of additional middle-income Americans under the AMT system, resulting in higher federal tax bills for many of them, along with higher compliance costs associated with filling out and filing the complicated AMT tax form.

New law provides permanent fix.

To prevent the unintended result of having millions of middle-income taxpayers fall prey to the AMT, Congress has once again applied a “patch” to the problem by extending the 2011 exemption amounts, increased slightly, but this time the patch is intended as a permanent fix. Under the new law, for tax years beginning in 2012, the AMT exemption amounts are increased to: (1) $79,750 in the case of married individuals filing a joint return and surviving spouses; (2) $50,600 in the case of unmarried individuals other than surviving spouses; and (3) $39,375 in the case of married individuals filing a separate return. Most importantly, these amounts will indexed for inflation after 2012, meaning that the annual “patches” will no longer be needed.

Personal credits may be used to offset AMT.

Another provision in the new law provides AMT relief for taxpayers claiming personal tax credits. The tax liability limitation rules generally provide that certain nonrefundable personal credits (including the dependent care credit and the elderly and disabled credit) are allowed only to the extent that a taxpayer has regular income tax liability in excess of the tentative minimum tax, which has the effect of disallowing these credits against the AMT. Temporary provisions had been enacted which permitted these credits to offset the entire regular and AMT liability through the end of 2011. The new law extends this provision permanently.

Individual extenders in the 2012 American Taxpayer Relief Act

In addition to permanently extending the Bush-era tax cuts for most taxpayers, revising tax rates on ordinary and capital gain income for high-income individuals, modifying the estate tax, providing permanent relief from the AMT, and imposing limits on the deductions and exemptions of high-income individuals, the recently enacted 2012 American Taxpayer Relief Act extends a host of important tax breaks for individuals. I'm writing to give you an overview of these key tax breaks that were extended by the new law. Please call our office for details of how the new changes may affect you.

The new law extends the following items for the period indicated beyond their prior termination date as shown in the listing:

> ... the deduction for certain expenses of elementary and secondary school teachers, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;
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> ... the exclusion for discharge of qualified principal residence indebtedness, which applied for discharges before Jan. 1, 2013 and which is now continued to apply for discharges before Jan. 1, 2014;
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> ... parity for the exclusions for employer-provided mass transit and parking benefits, which applied before 2012 and which is now revived for 2012 and continued through 2013;
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> ... the treatment of mortgage insurance premiums as qualified residence interest, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

... the option to deduct State and local general sales taxes, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

... the special rule for contributions of capital gain real property made for conservation purposes, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

... the above-the-line deduction for qualified tuition and related expenses, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013; and

... tax-free distributions from individual retirement plans for charitable purposes, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013. Because 2012 has already passed, a special rule permits distributions taken in 2012 to be transferred to charities for a limited period in 2013. Another special rule permits certain distributions made in 2013 as being deemed made on Dec. 31, 2012.

Roth conversions for retirement plans in the 2012 American Taxpayer Relief Act

I am writing to tell you of an interesting opportunity arising from a provision in the recently enacted 2012 American Taxpayer Relief Act. The new provision permits individual to convert any portion of their balance in an employer-sponsored tax-deferred retirement plan account into a Roth account under that plan.

Roths are a popular retirement plan option because they offer several advantages, namely:

- Earnings within the account are tax-sheltered (as they are with a regular qualified employer plan or IRA).
- Unlike a regular qualified employer plan or IRA, withdrawals from a Roth IRA aren't taxed if some relatively liberal conditions are satisfied.
- A Roth IRA owner does not have to commence lifetime required minimum distributions (RMDs) after he or she reaches age 70 1/2, as is generally the case with regular qualified employer plans or IRAs.
- Beneficiaries of Roth IRAs also enjoy tax-sheltered earnings (as with a regular qualified employer plan or IRA) and tax-free withdrawals (unlike with a regular qualified employer plan or IRA). They do, however, have to commence regular withdrawals from a Roth IRA after the account owner dies.

The catch under the new law conversion provision, and it's a big one, is that the conversion will be fully taxed, assuming the conversion is being made with pre-tax dollars (money that wasn't taxed to an employee when contributed to the qualified employer-sponsored retirement plan) and the earnings on those pre-tax dollars. For example, a taxpayer in the 28% federal tax bracket who converted $100,000 from an employer-sponsored plan funded entirely with deductible dollars to a Roth IRA would owe $28,000 of tax. So, in deciding whether to pursue a Roth conversion, one would need to weigh the price of paying tax now against the advantages afforded by future tax-free withdrawals and freedom from the RMD rules.

The conversion option for retirement plans would only be available if employer plan sponsors include this feature in the plan. The provision is effective for post-2012 transfers, in taxable years ending after Dec. 31, 2012.

Extension of the American Opportunity Credit in the 2012 American Taxpayer Relief Act

The recently enacted 2012 Taxpayer Relief Act includes a 5-year extension (through 2017) of the American Opportunity tax credit for college costs. Added to the tax code in 2009 as a temporary replacement of the previous Hope tax credit, the American Opportunity credit both increased the tax relief available for students from middle-income families and also extended relief for the first time to students from lower-income families. Now that the American Opportunity tax credit has been extended for five years, it might be a good time to review the tax benefits available under that credit, with an eye to how it compares with the Hope credit, which would have been in effect over the next two years had the American Opportunity credit not been extended.

- Families with a family member in college can benefit from a tax credit for tuition and fees. From a taxpayer's point of view, a credit is almost always preferable to a deduction, because a credit reduces taxes owed, while a deduction only reduces taxable income. The maximum amount of the American Opportunity tax credit is $2,500 (up from a maximum credit of $1,800 under the Hope credit). The credit is 100% of the fist $2,000 of qualifying expenses and 25% of the next $2,000, so the maximum credit of $2,500 is reached when a student has qualifying expenses of $4,000 or more.
- While the Hope credit was only available for the fist two years of undergraduate education, the American Opportunity tax credit is available for up to four years.
- Under the Hope credit, qualifying expenses were narrowly defined to include just tuition and fees required for the student's enrollment. Textbooks were excluded, despite their escalating cost in

recent years. The American Opportunity tax credit expands the list of qualifying expenses to include textbooks.

- The Hope credit was nonrefundable, i.e., it could reduce your regular tax bill to zero but could not result in a refund. This meant that if a family didn't owe any taxes it couldn't benefit form the credit, which prompted critics to argue that the credit was thus denied to the very families most in need of help affording college. The American Opportunity tax credit addresses this criticism to a degree by providing that 40% of the credit is refundable. This means that someone who has at least $4,000 in qualified expenses and who would thus qualify for the maximum credit of $2,500, but who has no tax liability to offset that credit against, would qualify for a $1,000 (40% of $2,500) refund from the government.
- The Hope credit was not available to someone with higher than moderate income. Under the credit's “phaseout” provision, taxpayers with adjusted gross income (AGI) over $50,000 (for 2009) saw their credits reduced, and the credit was completely eliminated for AGIs over $60,000 (twice those amounts for joint filers). Under the American Opportunity tax credit, taxpayers with somewhat higher incomes can qualify, as the phaseout of the credit begins at AGI in excess of $80,000 ($160,000 for joint filers).

Expensing and additional first-year depreciation in the 2012 American Taxpayer Relief Act

The recently enacted 2012 Taxpayer Relief Act includes a wide-ranging assortment of tax changes affecting both individuals and business. On the business side, two of the most significant changes provide incentives to invest in machinery and equipment by allowing for faster cost recovery of business property. Here are the details.

Enhanced small business expensing (Section 179 expensing). Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is “capitalized” and depreciation deductions are allowed for most property (other than land), but are spread out over a period of years. However, to help small businesses quickly recover the cost of capital outlays, small business taxpayers can elect to write off these expenditures in the year they are made instead of recovering them through depreciation. The expense election is made available, on a tax year by tax year basis, under Section 179 of the Internal Revenue Code, and is often referred to as the “Section 179 election” or the “Code Section 179 election.” The new law makes three important changes to the Code Section 179 expense election

First, the new law provides that for tax years beginning in 2012 or 2013, a small business taxpayer will be allowed to write off up to $500,000 of capital expenditures subject to a phaseout (i.e., gradual reduction) once capital expenditures exceed $2,000,000. For tax years beginning after 2013, the maximum expensing amount will drop to $25,000 and the phaseout level will drop to $200,000.

Second, the new law extends the rule which treats off-the-shelf computer software as qualifying property through 2013.

Finally, the new law extends through 2013 the provision permitting a taxpayer to amend or irrevocably revoke an election for a tax year under Section 179 without IRS's consent.

Extension of additional first-year depreciation. Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, by permitting an additional fist-year write-off of the cost. For qualified property acquired and placed in service after Dec. 31, 2011 and before Jan. 1, 2013 (before Jan. 1, 2014 for certain longer-lived and transportation property), the additional first-year depreciation was 50% of the cost. The new law extends this additional first-year depreciation for investments placed in service before Jan. 1, 2014 (before Jan. 1, 2015 for certain longer-lived and transportation property).

The new law also extends for one year the election to accelerate the AMT credit instead of claiming additional first-year depreciation.

The new law leaves in place the existing rules as to what kinds of property qualify for additional first-year depreciation. Generally, the property must be (1) depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified leasehold improvements. Also the original use of the property must commence with the taxpayer – used machinery doesn't qualify.

Business extenders in the 2012 American Taxpayer Relief Act

In addition to permanently extending the Bush-era tax cuts for most taxpayers, revising tax rates on ordinary and capital gain income for high-income individuals, modifying the estate tax, providing permanent relief from the AMT, and imposing limits on the deductions and exemptions of high-income individuals, the recently enacted 2012 American Taxpayer Relief Act extends a host of important tax breaks for businesses. I'm writing to give you an overview of these key tax breaks that were extended by the new law. Please call our office for details of how the new changes may affect you or your business.

Depreciation provisions modified and extended. The following depreciation provisions are retroactively extended by the Act:

... 15-year straight line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;

... 7-year recovery period for motorsports entertainment complexes;

... accelerated depreciation for business property on an Indian reservation;

... increased expensing limitations and treatment of certain real property as Section 179 property;

... special expensing rules for certain film and television productions; and

... the election to expense mine safety equipment.

The new law also extends and modifies the bonus depreciation provisions with respect to property placed in service after Dec. 31, 2012, in tax years ending after that date.

Business tax breaks extended. The following business credits and special rules are also extended:

... The research credit is modified and retroactively extended for two years through 2013.

... The temporary minimum low-income tax credit rate for nonfederally subsidized new buildings is extended to apply to housing credit dollar amount allocations made before Jan. 1, 2014.

... The housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds is extended two years.

... The Indian employment tax credit is retroactively extended for two years through 2013.

... The new markets tax credit is retroactively extended for two years through 2013.

... The railroad track maintenance credit is retroactively extended for two years through 2013.

... The mine rescue team training credit is retroactively extended for two years through 2013.

... The employer wage credit for employees who are active duty members of the uniformed services is retroactively extended for two years through 2013.

... The work opportunity tax credit is retroactively extended for two years through 2013.

... Qualified zone academy bonds are retroactively extended for two years through 2013.

... The enhanced charitable deduction for contributions of food inventory is retroactively extended for two years through 2013.

... Allowance of the domestic production activities deduction for activities in Puerto Rico applies for the first eight tax years of the taxpayer beginning after Dec. 31, 2005, and before Jan. 1, 2014.

... Exclusion from a tax-exempt organization's unrelated business taxable income (UBTI) of interest, rent, royalties, and annuities paid to it from a controlled entity is extended through Dec. 31, 2013.

... Treatment of certain dividends of regulated investment companies (RICs) as "interest-related dividends" is extended through Dec. 31, 2013.

... Inclusion of RICs in the definition of a "qualified investment entity" is extended through Dec. 31, 2013.

... The exception under subpart F for active financing income (i.e., certain income from the active conduct of a banking, financing, insurance or similar business) for tax years of a foreign corporation beginning after Dec. 31, 1998, and before Jan. 1, 2014, for tax years of foreign corporations beginning after Dec. 31, 2005, and before Jan. 1, 2014.

... Look-through treatment for payments between related controlled foreign corporations (CFCs) under the foreign personal holding company rules is extended through Jan. 1, 2014.

... Exclusion of 100% of gain on certain small business stock acquired before Jan. 1, 2014.

... Basis adjustment to stock of S corporations making charitable contributions of property in tax years beginning before Dec. 31, 2013.

... The reduction in S corporation recognition period for built-in gains tax is extended through 2013, with a 10-year period instead of a 5-year period.

... Various empowerment zone tax incentive, including the designation of an empowerment zone and of additional empowerment zones (extended through Dec. 31, 2013) and the period for which the percentage exclusion for qualified small business stock (of a corporation which is a qualified business entity) is 60% (extended through Dec. 31, 2018).

... Tax-exempt financing for New York Liberty Zone is extended for bonds issued before Jan. 1 2014.

... Temporary increase in limit on cover over rum excise taxes to Puerto Rico and the Virgin Islands is extended for spirits brought into the U.S. before Jan. 1, 2014.

... American Samoa economic development credit, as modified, is extended through Jan. 1, 2014.

Energy-related tax breaks extended in the 2012 American Taxpayer Relief Act

In addition to permanently extending the Bush-era tax cuts for most taxpayers, revising tax rates on ordinary and capital gain income for high-income individuals, modifying the estate tax, providing permanent relief from the AMT, and imposing limits on the deductions and exemptions of high-income individuals, the recently enacted 2012 American Taxpayer Relief Act extends a host of important energy-related tax breaks for individuals and businesses. I'm writing to give you an overview of these key tax breaks that were extended by the new law. Please call our office for details of how the new changes may affect you or your business.

The various energy credits extended include:

- The nonbusiness energy property credit for energy-efficient existing homes is retroactively extended for two years through 2013. A taxpayer can claim a 10% credit on the cost of: (1) qualified energy efficiency improvements , and (2) residential energy property expenditures, with a lifetime credit limit of $500 ($200 for windows and skylights).
- The alternative fuel vehicle refueling property credit is retroactively extended for two years through 2013 so that taxpayers can claim a 30% credit for qualified alternative fuel vehicle refueling property placed in service through Dec. 31, 2013, subject to the $30,000 and $1,000 thresholds.
- The credit for 2- or 3-wheeled plug-in electric vehicles is modified and retroactively extended for two years through 2013.
- The cellulosic biofuel producer credit is modified and extended one year through 2013.
- The credit for biodiesel and renewable diesel is retroactively extended for two years through 2013.
- The production credit for Indian coal facilities placed in service before 2009 is extended one year. The credit applied to coal produced by the taxpayer at an Indian coal production facility during the 8-year period beginning on Jan. 1, 2006, and sold by the taxpayer to an unrelated person during such 8-year period and the tax year.

- The credits with respect to facilities producing energy from certain renewable resources is modified and extended one year. A facility using wind to produce electricity will be a qualified facility if it is placed in service before 2014.
- The credit for energy-efficient new homes is retroactively extended for two years through 2013.
- The credit for energy-efficient appliances is retroactively extended for two years through 2013.
- The additional depreciation deduction allowance for cellulosic biofuel plant property is modified and extended one year.
- The special rule for sale or disposition to implement federal energy regulatory commission (FERC) or State electric restructuring policy for qualified electric utilities is retroactively extended for two years through 2013.
- The alternative fuels excise tax credits for sale or use of alternative fuels or alternative fuel mixtures is retroactively extended for two years though 2013.