Tax Tips

American Taxpayer Relief Act of 2012—Individuals

Although Congress averted many of the consequences of a possible tumble over the fiscal cliff with last-minute action, you will want to be aware of the impact of the bill that was passed — known as the American Taxpayer Relief Act of 2012 — signed into law January 2, 2013. Below is an overview of the key provisions of this new law affecting individuals.

- **A Tax Increase on the Highest Incomes in 2013.** Although most taxpayers avoided a tax increase, rates did rise for top earners. Taxpayers (including those who receive income through partnerships and S corporations) who earn more than $400,000 ($450,000 for married taxpayers filing jointly) have a marginal tax rate of 39.6%. All other existing rates remain the same.
- **Higher Capital Gains Rates for Top Earners.** The same individuals who are subject to the new 39.6% top rate on income now face a 20% rate on capital gains and dividends, up from 15%. Taxpayers in the 10% and 15% income brackets have a zero capital gains rate and those in the middle will continue to pay 15%.
- **Higher Personal Exemptions Phase-out Levels.** The phase-out levels for personal exemptions and itemized deduction have been raised to $300,000 for married couples and surviving spouses and $250,000 for individuals.
- **Permanent AMT Inflation Indexing.** The alternative minimum tax originally was intended to prevent high-income individuals from avoiding taxes. In the absence of a patch for last year, more than 60 million middle-income taxpayers might have been subject to the AMT on their 2012 income. After years of last-minute AMT “patches,” the new law permanently indexes the AMT to inflation starting in tax year 2012.
- **Restoration of the Full Rate for Social Security and Medicare Taxes.** The law did not extend the 2% cut for the employees’ portion of the Social Security payroll tax, which means it will go back to the full rate of 6.2% on income up to $113,700 in 2013.
- **Clarity on Estate and Gift Taxes.** After years of uncertainty in this area, the new law holds the estate and gift-tax exclusion at $5 million, indexed for inflation ($5.12 million in 2012). The top tax rate jumped to 40% from 35% as of January 1, 2013, but without this change, it would have soared to 55% with a $1 million exclusion amount. The act made permanent the estate tax portability election, which allows a surviving spouse to use a deceased spouse’s unused exemption amount.
- **Education Tax Benefits Extended.** Many deductions for education expenses were set to expire at the end of last year, but they will remain in place under the new law. For example, the law extends the deduction for qualified education expenses through 2013 and retroactively for the 2012 tax year.
- **Conversions to Roth Retirement Plans.** The new law allows participants in an employer-sponsored 401(k) to transfer any amount to a Roth 401(k) — the funds will be taxed upon conversion.
- **Tax Relief for Mortgage Loan Modifications.** Taxpayers struggling to pay their mortgages, or whose home values have fallen below their purchase price, were given another year of tax relief on any qualifying “indebtedness income” they may receive as a result of a loan modification or short sale on their principal residence.

Also, taxpayers who have net investment income beginning in 2013 will face a 3.8% surtax on categories of certain unearned income, potentially increasing the total tax rate to 43.4%. This tax was already slated to go into effect as a result of health care reform.

If you have any questions regarding the above discussed topic or any other tax matter, please feel free to give me a call at (562) 698-9891.

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