The American Taxpayer Relief Act of 2012

Almost Over the Cliff

President Obama and Congressional leaders hammered out a last-minute agreement that averted many of the tax increases that were a significant part of what had been popularly termed the "Fiscal Cliff." Signed into law by the President on January 2, 2013, the American Taxpayer Relief Act of 2012 (ATRA 2012) made permanent many of the Bush-era income and estate tax cuts as well as providing additional tax relief for a still-struggling economy.

ATRA 2012 did not address the mandatory, across-the board budget cuts that had been required under the provisions of the Budget Control Act of 2011. Instead, the effective date of these spending reductions was delayed until March 1, 2013.

The following is a brief summary of a few of the provisions of ATRA 2012. Except where noted, the provisions are generally effective for tax years beginning after 2012.

- **Individual income tax rates** – The marginal rates for most individual taxpayers will remain at 10%, 15%, 25%, 28%, 33%, and 35%. A revived 39.6% rate will apply to taxpayers with incomes above $450,000 for Married Filing Jointly and Surviving Spouses; $425,000 for Head of Household; $400,000 for Single; and $225,000 for Married Filing Separately.
- **Marriage penalty relief** – The standard deduction and the 15% bracket for married taxpayers will permanently remain at 200% of that for Single taxpayers.
- **Long term capital gains and qualified dividends** – For taxpayers with incomes high enough to be subject to the 39.6% bracket, the tax rate on long-term capital gains and qualified dividends will be 20%. For taxpayers in the 25%, 28%, 33%, or 35% brackets, a 15% rate will apply. For those taxpayers in the 10% or 15% marginal brackets, a 0% rate will be applicable.
- **Individual alternative minimum tax (AMT)** – The new law retroactively increases the AMT exemption amounts for 2012 to $78,750 for Married Filing Jointly and Surviving Spouses; $50,600 for Single taxpayers; and $39,375 for Married Filing Separately. These increases in the individual exemption amounts are permanent and will be subject to adjustment for inflation in future years. Nonrefundable personal credits are allowed in full against the AMT.
- **Personal exemption phase-out** – Requires taxpayers whose income exceeds certain limits to phase-out their personal and dependent exemptions. For 2013 these limits are: $300,000 for Married Filing Jointly and Surviving Spouses; $275,000 for Head of Household; $250,000 for Single; and $150,000 for Married Filing Separately. The thresholds will be subject to adjustment for inflation for years after 2013.
- **Itemized deduction phase-out** – For 2013, requires taxpayers whose incomes exceed specified limits to reduce certain, otherwise deductible items on Schedule A. The same threshold amounts applicable to the personal exemption phase-out (see above) apply to the itemized deduction phase-out. These threshold amounts will be subject to adjustment for inflation in future years.
- **Deduction for state and local sales taxes** – Extends to 2012 and 2013 a taxpayer's option to deduct state and local sales taxes, in lieu of deducting state and local income taxes.
- **Child and dependent care credit** – The new law makes permanent the EGTRRA increases in the amount of allowable expenses ($3,000 for one qualifying dependent, $6,000 for two qualifying dependents) and a maximum rate of 35%.

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- **Child tax credit** – Makes permanent the EGTRRA enhancements to the child tax credit, which provides taxpayers with a credit of up to $1,000 per qualifying child. The reduced income threshold ($3,000) for the refundable portion of the credit is extended through December 31, 2017.
- **Unreimbursed educator expenses** – Reinstates for 2012, and extends to 2013, the deduction from gross income allowed to qualifying teachers of up to $250 in unreimbursed classroom expenses.
- **Mortgage debt relief** – Extends the exclusion from gross income for cancellation of principal residence debt income for one year, to December 31, 2013.
- **Mortgage insurance premiums as qualified residence interest** – Extends to 2012 and 2013 the treatment of qualified mortgage insurance premiums as deductible principal residence interest.
- **Earned Income Tax Credit** – Makes permanent many of the EGTRRA changes to the Earned Income Tax Credit (EITC). Extends through 2017 the marriage penalty relief provisions and the 45% credit rate for families with three or more qualifying children.
- **Estate, gift, and GSTT taxes** – The new law makes permanent the estate tax changes contained in the 2010 Tax Relief Act, with a $5 million exclusion (adjusted for inflation in 2013 to $5.25 million) and a stepped-up (or stepped-down) basis for inherited assets. The top marginal bracket is increased to 40%. The estate and gift tax exclusion and rates are once again "unified." The Generation-Skipping Transfer Tax (GSTT) is also subject to a $5.25 million exclusion and a top marginal rate of 40%.
- **Deceased spousal unused exclusion amount** – The ability to transfer the unused portion of a deceased spouse's applicable exclusion amount to a surviving spouse is made permanent.
- **Deduction for state death taxes** – The deduction from the gross estate of state and local death taxes is made permanent. The state death tax credit – phased out by EGTRRA from 2002-2004 - is permanently repealed.
- **Contributions of capital gain real property for conservation purposes** – Extends the expanded deduction available for the donation of a qualified conservation easement for two additional years, 2012 and 2013.
- **Tax-Free IRA distributions to Charity** – Extends to 2012 and 2013 the exclusion from gross income of qualified charitable distributions from IRAs. Because the extension was passed after the end of 2012, special provisions allow taxpayers an extra month (through the end of January 2013) to make donations deductible for 2012.
- **Coverdell Education Savings Accounts** – Makes permanent the expanded EGTRRA provisions applicable to Coverdell ESAs such as the increased (to $2,000) annual contribution amounts and allowing qualified distributions to be used for elementary and secondary school expenses.
- **Student loan interest deduction** - The above-the line deduction for up to $2,500 of qualified student loan interest is made permanent. The restriction that interest may be deducted for only the first 60 months of a loan is permanently repealed.
- **American Opportunity Tax Credit** – The new law temporarily extends the provisions of the American Opportunity Tax Credit (a credit of up to $2,500 for tuition and fees for the first four years of higher education) for five years, 2013 through 2017.
- **Above-the-line tuition deduction** – Extends to 2012 and 2013 the above-the-line deduction for up to $4,000 of qualified tuition and related higher-education expenses.

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- **Section 179 expensing** – Extends the expanded expense deduction allowed to taxpayers under IRC Sec. 179 to 2012 and 2013. For these two years, the deduction is subject to a maximum dollar limitation of $500,000 and a maximum investment limitation of $2 million.
- **Bonus depreciation** – Extends for one year, 2013 (2014 for certain long-lived and transportation property) the 50% bonus depreciation allowance for qualifying new property.
- **Research tax credit** – Retroactively extends the research tax credit to 2012 and further extends it to 2013.

Other Notable Tax Changes Taking Effect in 2013

Although not part of the ATRA 2012, the following items will take effect in 2013:

- **Social Security Payroll Taxes** – The employee portion of OASDI returns to 6.2% of covered wages, up to the 2013 wage base of $113,700. For self-employed individuals, the OASDI rate returns to 12.4% of covered wages, up to the wage base. The payroll tax "holiday" in effect in 2011 and 2012 was not extended by ATRA 2012.
- **Additional 0.90% Medicare Hospital Insurance (HI) Tax** - Taxpayers with incomes above certain thresholds will pay an additional HI tax of 0.9%. For an employee, the additional 0.90% increases the HI tax from 1.45% to 2.35%. For self-employed taxpayers, the additional tax of .90% raises the HI tax rate to 3.80% of net self-employment income.
- **3.80% Unearned Income Medicare Contribution** - A 3.80% Medicare tax on "net investment income" will apply beginning in 2013. This new tax is applicable to individuals, estates, and trusts whose "modified adjusted gross income" exceeds certain limits.