Congress Enacts Taxpayer Relief Act

By Arthur M. Seltzer, CPA

The American Taxpayer Relief Act of 2012, the much-discussed measure to avoid the "fiscal cliff," was enacted by Congress and signed by President Obama in early January. A summary of the Act's highlights, prepared by CCH and released shortly after the passage of the Act, is posted at *www.mocpa.org/economicnews* as an appendix to this article, which attempts to highlight some of the Act's provisions that have not been highly publicized.

Unlike other phase-outs, which are based on adjusted gross income (AGI), the newly reenacted 39.6 percent tax rate is measured by taxable income. Beginning in 2014, the amount will be indexed for inflation; for 2013 the higher bracket applies to taxable income in excess of $400,000 for single taxpayers, $425,000 for heads of households and $450,000 for couples filing jointly.

The tax rate on qualifying dividends and long-term capital gains will be increased from 15 percent to 20 percent for income in excess of the threshold for the 39.6 percent rate. The current 15 percent and zero rates will otherwise continue to apply, as will the 25 percent rate for depreciation recapture and the 28 percent rate for collectibles.

The 2 percent reduction in employees' FICA taxes was not extended, and the additional withholding has been reflected in employees' paychecks since January.

A major concern was whether the so-called "AMT patch" would be extended. If not, the exemption would have been significantly decreased for 2012 returns, millions of additional taxpayers would have been subject to the AMT, and it would have taken the IRS months to reprogram its computers so it could process 2012 returns. The Act permanently (definition: forever or until Congress changes its mind, whichever comes first) continues to index the exemption for inflation and allows personal tax credits to offset the AMT. For 2012, the exemption is $50,600 for single taxpayers, $78,750 for couples filing jointly, and $39,375 for married taxpayers filing separate returns.

The "PEP" phase-out of personal exemptions and "Pease" phase-out of itemized deductions are back. Exemptions will be reduced by 2 percent for each $2,500 (or fraction thereof) of adjusted gross income in excess of $250,000 for singles, $275,000 for heads of household, and $300,000 for couples filing jointly. The Pease adjustment will be 3 percent of the AGI in excess of these amounts. These amounts will be indexed for inflation, beginning in 2014.

The maximum estate, gift and GST tax rate is fixed at 40 percent. The exemption will be $5 million, indexed for post-2012 inflation. Portability between spouses has been made permanent.

A significant change eliminates many restrictions on participants in 401(k) plans who wish to make Roth conversions, and essentially permits participants in plans with Roth features to make Roth conversions at any time.

The option of deducting sales taxes instead of state and local income taxes has been extended for 2012 and 2013.

The Child Tax Credit, Earned Income Credit, Child and Dependent Care Credit and various tax incentives designed to encourage adoption, including their refundable features, have been extended.

The American Opportunity Tax Credit, a temporary enhancement of the Hope education credit, has been extended through 2017. The above-the-line deduction for tuition expenses has been extended for 2012 and 2013. Enhancements to Coverdell Education Savings Accounts, the exclusion for employer-provided educational assistance and the deduction for student loan interest have also been permanently extended.

The provision treating mortgage premium insurance as deductible mortgage interest has been extended for 2012 and 2013.

The provision permitting tax-free distributions from IRAs to charity has been extended for 2012 and 2013.

Enhanced Sec. 179 small business expensing, 50 percent bonus depreciation and the 15-year recovery period for qualifying improvements have been extended for 2012 and 2013.

The Work Opportunity Tax Credit, which rewards employers who employ individuals from targeted groups with a tax credit, has been extended for 2012 and 2013.

There have also been a number of provisions extending energy tax incentives, primarily tax credits.

For more details on these and other provisions contained in the Act, please refer to the online appendix as mentioned at the top of the article.

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