BURR ALERT

THE OTHER SIDE OF THE "FISCAL CLIFF"

January 2013

Congress began 2013 by passing "The American Taxpayer Relief Act of 2012" (the "Act") reflecting a plan negotiated by Vice President Biden and Senate Minority Leader Mitch McConnell (R-Ky.) to avoid a series of tax hikes scheduled to take effect upon the expiration of the "Bush tax cuts."

Some of the more significant features of the Act are as follows:

Income tax rates. The Act maintains the "Bush" tax rates for individuals with taxable income under $400,000 ($450,000 for married individuals, $425,000 for those filing as a head of household). Taxable income over and above these thresholds is taxed at the pre-Bush maximum rate of 39.6 percent.

Capital gains and dividends. Long term capital gains and dividend income of taxpayers having taxable income below the $400,000/$450,000 levels would continue to be taxed at the 15 percent rate while individual taxpayers above those income thresholds would be subject to 20 percent rate on long term capital gains and dividends. In addition, the higher income taxpayers will be subject to tax at the rate of 23.8 percent because of an additional 3.8 percent tax that was part of the included in the 2010 "Obamacare" health care legislation.

Phase out of deductions for high-income individuals. The Act would reinstate the Clinton-era limitations on the deductions for personal exemptions and itemized deductions for taxpayers exceeding certain income thresholds. As a consequence, taxpayers whose adjusted gross income (AGI) exceeds certain thresholds ($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 amount for joint filers) for married taxpayers filing separately), will have their itemized deductions reduced by 3% of the amount by which the taxpayer's AGI exceeds the applicable threshold, subject to a maximum reduction of 80 percent of the otherwise allowable itemized deductions. The threshold amounts are inflation-adjusted for tax years after 2013.

AMT fix. The Act "permanently" patches the alternative minimum tax in an attempt to prevent the tax from being applied to a growing number of middle class taxpayers by indexing the income exemption threshold that must be exceeded for the tax to be applicable. Prior to the Act, the individual AMT exemption amounts for 2012 were to have been $33,750 for unmarried taxpayers, $45,000 for married couples filing jointly, and $22,500 for married persons filing separately. The Act retroactively, effective for tax years beginning after 2011, increases these exemption amounts to $50,600 for unmarried taxpayers, $78,750 for married couples filing jointly, and $39,375 for married persons filing separately. In addition, these amounts are indexed for inflation for tax years beginning after 2012.

Estate, gift and GST taxes. The Act maintains the estate, gift and generation-skipping transfer (GST) tax exemption amounts at their 2012 level of $5,000,000. These exemptions would have fallen to $1,000,000 effective January 1, 2013.) In addition, beginning in 2014, these exemption amounts will be indexed for inflation. The Act does, however, permanently increase the top estate, gift and GST rates to 40 percent (an increase from 35 percent. The Act 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.

Individual extenders. The Act extends a number of provisions applicable to individual taxpayers, including the deduction for state and local general sales taxes, and the above-the-line deduction for qualified tuition and related expenses.

Depreciation provisions extended. The Act extends the following depreciation provisions retroactively through 2014:

- 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 Indian reservations
- increased expensing limitations and treatment of certain real property as Code Sec. 179 property
- special expensing rules for certain film and television productions
- the election to expense mine safety equipment
- the Act also extends the "bonus" depreciation provisions with respect to property placed in service after December 31, 2012, in tax years ending after that date

Business tax breaks extended. A number of business credits and special rules are extended by the Act, including:

- The research credit of Code Section 41 is modified and retroactively extended for two years through 2013.
- The new markets tax credits in Code Section 45D is retroactively extended for two years through 2013.
- The employer wage credit for employees who are active duty members of the armed services is retroactively extended for two years through 2013.
- The work opportunity tax credit in Code Section 51 is retroactively extended for two years through 2013.
- The deduction for charitable contributions of food inventory is retroactively extended for two years through 2013.
- The exclusion from a tax-exempt organization's unrelated business taxable income of interest, rent, royalties, and annuities paid to it from a controlled entity is extended through December 31, 2013.
- The exclusion from gross income of the gain on certain small business stock acquired before Jan. 1, 2014.
- The adjustment to the basis of stock in S corporations making charitable contributions of property in tax years beginning before December 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.

Other items. The Act includes a one-year extension of emergency unemployment benefits as well as a one-year extension of provisions to prevent a reduction in payments to doctors from Medicare. The Act also extends many health and energy-related provisions, as well as extending farm legislation.

Payroll taxes. One thing not included in the Act, however, is any extension of the existing 2 percent cut in individual payroll taxes.

Sequestration. The Act kicks the sequestration can down the road for a few months by including a two-month delay in the automatic spending cuts. The Act does not address the debt ceiling.

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