PATRICK J. RUBEY & COMPANY, LTD.
CERTIFIED PUBLIC ACCOUNTANTS

American Taxpayer Relief Act

January 1, 2013

Here are the act's main tax features:

Individual tax rates

All the individual marginal tax rates under EGTRRA and JGTRRA are retained (10%, 15%, 25%, 28%, 33%, and 35%). A new top rate of 39.6% is imposed on taxable income over $400,000 for single filers, $425,000 for head-of-household filers, and $450,000 for married taxpayers filing jointly ($225,000 for each married spouse filing separately).

Phaseout of itemized deductions and personal exemptions

The personal exemptions and itemized deductions phaseout is reinstated at a higher threshold of $250,000 for single taxpayers, $275,000 for heads of household, and $300,000 for married taxpayers filing jointly.

Capital gains and dividends

A 20% rate applies to capital gains and dividends for individuals above the top income tax bracket threshold; the 15% rate is retained for taxpayers in the middle brackets. The zero rate is retained for taxpayers in the 10% and 15% brackets.

Alternative minimum tax

The exemption amount for the AMT on individuals is permanently indexed for inflation. For 2012, the exemption amounts are $78,750 for married taxpayers filing jointly and $50,600 for single filers. Relief from AMT for nonrefundable credits is retained.

Estate and gift tax

The estate and gift tax exclusion amount is retained at $5 million indexed for inflation ($5.12 million in 2012), but the top tax rate increases from 35% to 40% effective Jan. 1, 2013. The estate tax "portability" election, under which, if an election is made, the surviving spouse's exemption amount is increased by the deceased spouse's unused exemption amount, was made permanent by the act.

Permanent extensions

Various temporary tax provisions enacted as part of EGTRRA were made permanent. These include:

- Marriage penalty relief (i.e., the increased size of the 15% rate bracket (Sec. 1(f)(8)) and increased standard deduction for married taxpayers filing jointly (Sec. 63(c)(2));
- The liberalized child and dependent care credit rules (allowing the credit to be calculated based on up to $3,000 of expenses for one dependent or up to $6,000 for more than one) (Sec. 21);
- The exclusion for National Health Services Corps and Armed Forces Health Professions Scholarships (Sec. 117(c)(2));
- The exclusion for employer-provided educational assistance (Sec. 127);
- The enhanced rules for student loan deductions introduced by EGTRRA (Sec. 221);
- The higher contribution amount and other EGTRRA changes to Coverdell education savings accounts (Sec. 530);
- The employer-provided child care credit (Sec. 45F);
- Special treatment of tax-exempt bonds for education facilities (Sec 142(a)(13));
- Repeal of the collapsible corporation rules (Sec. 341);
- Special rates for accumulated earnings tax and personal holding company tax (Secs. 531 and 541); and
- Modified tax treatment for electing Alaska Native Settlement Trusts (Sec. 646).

Individual credits expired at the end of 2012

The American opportunity tax credit for qualified tuition and other expenses of higher education was extended through 2018. Other credits and items from the American Recovery and Reinvestment Act of 2009, P.L. 111-5, that were extended for the same five-year period include enhanced provisions of the child tax credit under Sec. 24(d) and the earned income tax credit under Sec. 32(b). In addition, the bill permanently extends a rule excluding from taxable income refunds from certain federal and federally assisted programs (Sec. 6409).

Individual provisions expired at the end of 2011

The act also extended through 2013 a number of temporary individual tax provisions, most of which expired at the end of 2011:

- Deduction for certain expenses of elementary and secondary school teachers (Sec. 62);
- Exclusion from gross income of discharge of qualified principal residence indebtedness (Sec. 108);
- Parity for exclusion from income for employer-provided mass transit and parking benefits (Sec. 132(f));
- Mortgage insurance premiums treated as qualified residence interest (Sec. 163(h));
- Deduction of state and local general sales taxes (Sec. 164(b));
- Special rule for contributions of capital gain real property made for conservation purposes (Sec. 170(b));
- Above-the-line deduction for qualified tuition and related expenses (Sec. 222); and
- Tax-free distributions from individual retirement plans for charitable purposes (Sec. 408(d)).

Business tax extenders

The act also extended many business tax credits and other provisions. Notably, it extended through 2013 and modified the Sec. 41 credit for increasing research and development activities, which expired at the end of 2011. The credit is modified to allow partial inclusion in qualified research expenses and gross receipts those of an acquired trade or business or major portion of one. The increased expensing amounts under Sec. 179 are extended through 2013. The availability of an additional 50% first-year bonus depreciation (Sec. 168(k)) was also extended for one year by the act. It now generally applies to property placed in service before Jan. 1, 2014 (Jan. 1, 2015, for certain property with longer production periods).

Other business provisions extended through 2013, and in some cases modified, are:

- Temporary minimum low-income tax credit rate for non-federally subsidized new buildings (Sec. 42);
- Housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds (Section 3005 of the Housing Assistance Tax Act of 2008);
- Indian employment tax credit (Sec. 45A);
- New markets tax credit (Sec. 45D);
- Railroad track maintenance credit (Sec. 45G);
- Mine rescue team training credit (Sec. 45N);
- Employer wage credit for employees who are active duty members of the uniformed services (Sec. 45P);
- Work opportunity tax credit (Sec. 51);
- Qualified zone academy bonds (Sec. 54E);
- Fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (Sec. 168(e));
- Accelerated depreciation for business property on an Indian reservation (Sec. 168(j));
- Enhanced charitable deduction for contributions of food inventory (Sec. 170(e));
- Election to expense mine safety equipment (Sec. 179E);
- Special expensing rules for certain film and television productions (Sec. 181);
- Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (Sec. 199(d));
- Modification of tax treatment of certain payments to controlling exempt organizations (Sec. 512(b));
- Treatment of certain dividends of regulated investment companies (Sec. 871(k));
- Regulated investment company qualified investment entity treatment under the Foreign Investment in Real Property Act (Sec. 897(h));
- Extension of subpart F exception for active financing income (Sec. 953(e));
- Lookthrough treatment of payments between related controlled foreign corporations under foreign personal holding company rules (Sec. 954);
- Temporary exclusion of 100% of gain on certain small business stock (Sec. 1202);
- Basis adjustment to stock of S corporations making charitable contributions of property (Sec. 1367);
- Reduction in S corporation recognition period for built-in gains tax (Sec. 1374(d));
- Empowerment Zone tax incentives (Sec. 1391);
- Tax-exempt financing for New York Liberty Zone (Sec. 1400L);
- Temporary increase in limit on cover-over of rum excise taxes to Puerto Rico and the Virgin Islands (Sec. 7652(f)); and

- American Samoa economic development credit (Section 119 of the Tax Relief and Health Care Act of 2006, P.L. 109-432, as modified).

Energy tax extenders

The act also extends through 2013, and in some cases modifies, a number of energy credits and provisions that expired at the end of 2011:

- Credit for energy-efficient existing homes (Sec. 25C);
- Credit for alternative fuel vehicle refueling property (Sec. 30C);
- Credit for two- or three-wheeled plug-in electric vehicles (Sec. 30D);
- Cellulosic biofuel producer credit (Sec. 40(b), as modified);
- Incentives for biodiesel and renewable diesel (Sec. 40A);
- Production credit for Indian coal facilities placed in service before 2009 (Sec. 45(e)) (extended to an eight-year period);
- Credits with respect to facilities producing energy from certain renewable resources (Sec. 45(d), as modified);
- Credit for energy-efficient new homes (Sec. 45L);
- Credit for energy-efficient appliances (Sec. 45M);
- Special allowance for cellulosic biofuel plant property (Sec. 168(l), as modified);
- Special rule for sales or dispositions to implement Federal Energy
- Regulatory Commission or state electric restructuring policy for qualified electric utilities (Sec. 451); and
- Alternative fuels excise tax credits (Sec. 6426).

Foreign provisions

The IRS's authority under Sec. 1445(e)(1) to apply a withholding tax to gains on the disposition of U.S. real property interests by partnerships, trusts, or estates that are passed through to partners or beneficiaries that are foreign persons is made permanent, and the amount is increased to 20%.

New taxes

In addition to the various provisions discussed above, some new taxes also took effect Jan. 1 as a result of 2010's health care reform legislation.

Additional hospital insurance tax on high-income taxpayers. The employee portion of the hospital insurance tax part of FICA, normally 1.45% of covered wages, is increased by 0.9% on wages that exceed a threshold amount. The additional tax is imposed on the combined wages of both the taxpayer and the taxpayer's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

For self-employed taxpayers, the same additional hospital insurance tax applies to the hospital insurance portion of SECA tax on self-employment income in excess of the threshold amount.

Medicare tax on investment income. Starting Jan. 1, Sec. 1411 imposes a tax on individuals equal to 3.8% of the lesser of the individual's net investment income for the year or the amount the individual's modified adjusted gross income (AGI) exceeds a threshold amount. For estates and trusts, the tax equals 3.8% of the lesser of undistributed net investment income or AGI over the dollar amount at which the highest trust and estate tax bracket begins.

For married individuals filing a joint return and surviving spouses, the threshold amount is $250,000; for married taxpayers filing separately, it is $125,000; and for other individuals it is $200,000.

Net investment income means investment income reduced by deductions properly allocable to that income. Investment income includes income from interest, dividends, annuities, royalties, and rents, and net gain from disposition of property, other than such income derived in the ordinary course of a trade or business. However, income from a trade or business that is a passive activity and from a trade or business of trading in financial instruments or commodities is included in investment income.

Medical care itemized deduction threshold. The threshold for the itemized deduction for unreimbursed medical expenses has increased from 7.5% of AGI to 10% of AGI for regular income tax purposes. This is effective for all individuals, except, in the years 2013–2016, if either the taxpayer or the taxpayer's spouse has turned 65 before the end of the tax year, the increased threshold does not apply and the threshold remains at 7.5% of AGI.

Flexible spending arrangement. Effective for cafeteria plan years beginning after Dec. 31, 2012, the maximum amount of salary reduction contributions that an employee may elect to have made to a flexible spending arrangement for any plan year is $2,500.