INTRODUCTION TO THE "AMERICAN TAXPAYER RELIEF ACT of 2012"

OVERVIEW

In the early morning hours of Jan. 1, 2013, the Senate, by a vote of 89-8, passed H.R.8, ***the "American Taxpayer Relief Act of 2012" (ATRA)***. Late on that same day—hours after the government had technically gone over the "fiscal cliff"—the House of Representatives, by a vote of 257 to 167, also passed the bill.

ATRA, which the President signed into law on 1/3/13, prevents many of the tax hikes that were scheduled to go into effect this year. The 157-page act permanently extends a number of tax provisions that had already expired at the end of 2011 and 2012, revises tax rates on ordinary and capital gain income, modifies the estate tax, and extends unemployment benefits, Medicare payments and farm subsidies. Some tax provisions, however, are extended only temporarily. It also delays most scheduled automatic spending reductions for two months.

Among the individual tax provisions *ATRA* extends is the 2009 expansion of tax breaks for low-income Americans: the Earned Income Tax Credit, the Child Tax Credit, and the American Opportunity Tax Credit.

Almost all of the temporary business tax breaks — benefiting everything from R&D and wind energy to racecar track owners — will be extended for another year.

Unfortunately, *ATRA* does not address the debt-ceiling which means another confrontation is likely to take place in February when the nation's ability to pay its bills runs out.

Tax Increases in *ATRA.* The Tax Policy Center estimates the fiscal cliff deal would raise income taxes by an average of about $364, but nearly all of it would be paid by households in the top 0.7 percent of income. ATRA does not include an extension of the 2% "payroll tax holiday" which will add an average of about another $740 to every worker's 2013 tax bill.

Alternative Minimum Tax. One key provision makes permanent the Alternative Minimum Tax "patch" that until now has been extended only one year at a time. That patch would keep about 28 million households off the AMT in 2013 alone. The act also extends for five years some refundable tax credits that were intended as temporary stimulus in 2009 and 2010.

Non-tax Items. *ATRA* also includes a number of non-tax items as well. Among them are:

- The sequester will be delayed for two months. Half the cost of the delay will be offset by discretionary cuts, split between defense and non-defense. The other half will be offset by revenue raised by the voluntary transfer of traditional IRAs to Roth IRAs, resulting in a tax retirement savings when they're moved over.
- The pay freeze on members of Congress, which Obama had lifted this week, will be re-imposed .
- Scheduled cuts to doctors under Medicare would be avoided for a year through spending cuts that haven't been specified.
- Federal unemployment insurance will be extended for another year, benefiting those unemployed for longer than 26 weeks. This $30 billion provision won't be offset.

SUMMARY OF ATRA's MAJOR TAX PROVISIONS

Individual Income Tax Rates. Tax rates will permanently rise to 39.6% for families with income above $450,000 and individuals above $400,000. All income below the threshold will permanently be taxed at Bush-era rates. In other words, ATRA permanently retains the 10%, 15%, 25%, 28%, and 33% income tax brackets. The 35% tax bracket will now end at the following thresholds.

- Married Filing Jointly: $450,000 of taxable income,
- Qualifying Widow(er): $450,000 of taxable income,
- Head of Household: $425,000 of taxable income,
- Single: $400,000 of taxable income, and
- Married Filing Separately: $225,000 of taxable income.

Taxable income above these thresholds will be taxed at 39.6%.

Long-term Capital Gains Rates. The tax on capital gains and dividends will be permanently set at 20 percent for those with income above the $450,000/$400,000 threshold. ATRA permanently retains the 0% and 15% tax rates on qualified dividends and long-term capital gains for everyone else. Which capital gains tax rate will apply depends on what tax bracket a person is in.

The new capital gains tax rates for 2013 and future years will be:

- 0% applies to capital gain income if a person is in the 10% and 15% tax brackets,
- 15% applies to capital gain income if a person is in the 25%, 28%, 33%, or 35% tax brackets, and
- 20% applies to capital gain income if a person is in the 39.6% tax bracket.

Alternative Minimum Tax. The Alternative Minimum Tax will be permanently patched to avoid raising taxes on the middle-class. ATRA provides the following AMT exemption amounts for 2012, and provides that these amounts will be indexed for inflation annually:

- Married Filing Jointly: $78,750
- Qualifying Widow(er): $78,750
- Single: $50,600
- Head of Household: $50,600
- Married Filing Separately: $39,375

Estate Tax Rates. The estate tax will be set at 40 percent for those at the $450,000/$400,000 threshold, with a $5 million exemption. ATRA permanently extends the $5 million exclusion, indexed to inflation, and unified exemption amount with portability. The new top tax rate for estates is 40%.

Limitations on Deductions. Two limits on tax exemptions and deductions for higher-income Americans will be reimposed.

- The **total amount of itemized deductions** that are allowable as a deduction will be reduced by the lesser of 3% of the taxpayer's adjusted gross income (AGI) over the threshold amount or by 80% of otherwise allowable itemized deductions. The threshold amounts at which itemized deductions would start to be reduced are:
    - Married Filing Jointly: $300,000 of AGI
    - Qualifying Widow(er): $300,000 of AGI
    - Head of Household: $275,000 of AGI
    - Single: $250,000 of AGI Married Filing Separately: $150,000 of AGI

  These threshold amounts would be indexed for inflation for years after 2013.

- Similarly, **personal exemptions** will be limited. Taxpayers would see their total personal exemptions reduced by two percent for each $2,500 (or fraction thereof) by which adjusted gross income exceeds the threshold. The threshold amounts at which personal exemptions would start to be reduced are the same as for itemized deductions, namely:
    - Married Filing Jointly: $300,000 of AGI
    - Qualifying Widow(er): $300,000 of AGI
    - Head of Household: $275,000 of AGI
    - Single: $250,000 of AGI
    - Married Filing Separately: $150,000 of AGI

These threshold amounts would also be indexed for inflation for years after 2013.

Recovery Act Extenders. The Act extends for five years the following items that were originally enacted as part of the American Recovery and Investment Tax Act of 2009 and that were slated to expire at the end of 2012:

- The American Opportunity tax credit, which permits eligible taxpayers to claim a credit equal to 100% of the first $2,000 of qualified tuition and related expenses, and 25% of the next $2,000 of qualified tuition and related expenses (for a maximum tax credit of $2,500 for the first four years of post-secondary education);
- Eased rules for qualifying for the refundable child credit; and
- Various earned income tax credit (EITC) changes relating to higher EITC amounts for eligible taxpayers with three or more children, and increases in threshold phase out amounts for singles, surviving spouses, and heads of households.

Other Individual Extenders. The Act extends the following items for the period indicated beyond their prior termination date as shown in the listing:

- The deduction for certain **expenses of elementary and secondary school teachers,** which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

- The exclusion for **discharge of qualified principal residence indebtedness** , which applied for discharges before Jan. 1, 2013 and which is now continued to apply for discharges before Jan. 1, 2014;

- The **student loan interest deduction** is permanently extended. ATRA eliminates the rule that the deduction can be claimed only during the first 60 months of repayment.

- Parity for the exclusions for **employer-provided mass transit and parking benefits** , which applied before 2012 and which is now revived for 2012 and continued through 2013;

- The treatment of **mortgage insurance premiums** as qualified residence interest, which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

- The **option to deduct State and local general sales taxes** , which expired at the end of 2011 and which is now revived for 2012 and continued through 2013.

- The **special rule for contributions of capital gain real property made for conservation purposes** , which expired at the end of 2011 and which is now revived for 2012 and continued through 2013;

- The **above-the-line deduction for qualified tuition and related expenses** , which expired at the end of 2011 and which is now revived for 2012 and continued through 2013; and
- **Tax-free distributions from individual retirement plans for charitable purposes,** which expired at the end of 2011 and which is now revived for 2012 and continued through 2013.

Observation. Because 2012 has already passed, a special rule permits distributions taken in 2012 to be transferred to charities for a limited period in 2013. Another special rule permits certain distributions made in 2013 as being deemed made on Dec. 31, 2012.

- The **child tax credit** remains unchanged and is permanently extended. The maximum amount of the child tax credit is $1,000, and the credit is partially refundable. However, the provision that reduces the earnings threshold for the refundable portion of the child tax credit to $3,000 will expire at the end of 2017.

- The **dependent care tax credit** remains unchanged and is permanently extended. Daycare expenses up to $3,000 for one child and $6,000 for two or more children qualify for the tax credit, and these amounts are not indexed for inflation.

- The **adoption credit** is permanently extended. The credit is worth up to $10,000 (indexed for inflation).

- Also permanently extended is the **earned income tax credit** for families with three or more dependents.

Tax-Advantaged Savings Accounts:

- ATRA permanently extends the $2,000 annual contribution limit to **Coverdell Education Savings Accounts**.

- The tax-free **charitable distribution from IRAs** of up to $100,000 per year is temporarily extended through the end of 2013. ATRA provides rules for handling IRA distributions made in December 2012 and January 2013 so as to enable IRA beneficiaries to make charitable distributions for the 2012 tax year.

Depreciation provisions modified and extended. The following depreciation provisions are retroactively extended by the Act 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 an Indian reservation** ;

- **Increased expensing limitations and treatment of certain real property as Code Sec. 179 property;**

- **Special expensing rules for certain film and television productions** ; and

- The election to **expense mine safety equipment.**

The Act also extends and modifies the **bonus depreciation provisions** with respect to property placed in service after Dec. 31, 2012, in tax years ending after that date. **Business tax breaks extended.** The following business credits and special rules are also extended:

- The **Code Sec. 41 research credit** is modified and retroactively extended for two years through 2013.

- The temporary **minimum low-income tax credit rate** for non-federally subsidized new buildings under Code Sec.

42(b) (2) (A) is extended to apply to housing credit dollar amount allocations made before Jan. 1, 2014.

- The **housing allowance exclusion** for determining area median gross income for qualified residential rental project exempt facility bonds is extended two years.

- The Code Sec. 45A **Indian employment tax credit** is retroactively extended for two years through 2013.

- The Code Sec. 45D **new markets tax credits** is retroactively extended for two years through 2013.

- The Code Sec. 45G **railroad track maintenance credit** is retroactively extended for two years through 2013.

- The Code Sec. 45N **mine rescue team training credit** is retroactively extended for two years through 2013.

- The Code Sec. 45P **employer wage credit for employees who are active duty members of the uniformed services** is retroactively extended for two years through 2013.

- The Code Sec. 51 **work opportunity tax credit** is retroactively extended for two years through 2013.

- Code Sec. 54E **qualified zone academy bonds** are retroactively extended for two years through 2013.

- The **enhanced charitable deduction for contributions of food inventory** under Code Sec. 174(e) is retroactively extended for two years through 2013.

- Allowance of the **domestic production activities deduction for activities in Puerto Rico,** for the first eight tax years of the taxpayer beginning after Dec. 31, 2005, and before Jan. 1, 2014.

- **Exclusion from a tax-exempt organization's unrelated business taxable income** (UBTI) of interest, rent, royalties, and annuities paid to it from a controlled entity under Code Sec. 512(b)(13)(E)(iv) is extended through Dec. 31, 2013.

- Treatment of **certain dividends of regulated investment companies** (RICs) as "interest-related dividends" is extended through Dec. 31, 2013.

- **Inclusion of RICs in the definition of a "qualified investment entity"** under Code Sec. 897(h)(4) is extended through Dec. 31, 2013.

- The **exception under subpart F for active financing income** (i.e., certain income from the active conduct of a banking, financing, insurance, or similar business) under Code Sec. 953(e)(10) and Code Sec. 954(h)(9) for tax years of a foreign corporation beginning after Dec. 31, 1998, and before Jan. 1, 2014, for tax years of foreign corporations beginning after Dec. 31, 2005, and before Jan. 1, 2014 Look-through treatment for **payments between related controlled foreign corporations** (CFCs) under the foreign personal holding company rules under Code Sec. 954(c)(6) is extended through Jan. 1, 2014.

- **Exclusion of 100% of gain on certain small business stock** acquired before Jan. 1, 2014.

- Basis adjustment to stock of S corporations making charitable contributions of property under Code Sec. 1367(a) in tax years beginning before Dec. 31, 2013.

- The **reduction in S corporation recognition period for built-in gains tax** under Code Sec. 1374(d)(7) is extended through 2013, with a 10-year period instead of a 5-year period.

- **Various empowerment zone tax incentives,** including the designation of an empowerment zone and of additional empowerment zones under Code Sec. 1391(d) (extended through Dec. 31, 2013) and the period for which the percentage exclusion for qualified small business stock (of a corporation which is a qualified business entity) is 60%Code Sec. 1202(a)(2) (extended through Dec. 31, 2018).

- **Tax-exempt financing for New York Liberty Zone** under Code Sec. 1400L(d)(2) is extended for bonds issued before Jan. 1, 2014.

- Temporary increase in limit on cover over **rum excise taxes to Puerto Rico and the Virgin Islands** is extended for spirits brought into the U.S. before Jan. 1, 2014.

- **American Samoa economic development credit,** as modified, is extended through Jan. 1, 2014.

Energy-related tax breaks extended. Various energy credits are extended. These include:

- The **nonbusiness energy property credit under Code Sec. 25C** for energy-efficient existing homes is retroactively extended for two years through 2013. A taxpayer can claim a 10% credit on the cost of: (1) qualified energy efficiency improvements, and (2) residential energy property expenditures, with a lifetime credit limit of $500 ($200 for windows and skylights).

- **The alternative fuel vehicle refueling property credit** under Code Sec. 30C is retroactively extended for two years through 2013 so that taxpayers can claim a 30% credit for qualified alternative fuel vehicle refueling property placed in service through Dec. 31, 2013, subject to the $30,000 and $1,000 thresholds.

- **The credit for 2- or 3-wheeled plug-in electric vehicles** under Code Sec. 30D is modified and retroactively extended for two years through 2013.

- **The cellulosic biofuel producer credit** under Code Sec. 40(b) is modified and extended one year through 2013.

- **The credit for biodiesel and renewable diesel** under Code Sec. 40A is retroactively extended for two years through 2013.

- **The production credit for Indian coal facilities** placed in service before 2009 under Code Sec. 45(e)(10) is extended one year. The credit applied to coal produced by the taxpayer at an Indian coal production facility during the 8-year period beginning on Jan. 1, 2006, and sold by the taxpayer to an unrelated person during such 8-year period and the tax year.

- The **credits with respect to facilities producing energy from certain renewable resources** under Code Sec. 45 is modified and extended one year. A facility using wind to produce electricity will be a qualified facility if it is placed in service before 2014.

- **The credit for energy-efficient new homes** under Code Sec. 45L is retroactively extended for two years through 2013.

- The **credit for energy-efficient appliances** under Code Sec. 45M is retroactively extended for two years through 2013.

- The **additional depreciation deduction allowance for cellulosic biofuel plant property** under Code Sec. 168(l)(2) is modified and extended one year.

- The **special rule for sales or dispositions** to implement Federal Energy Regulatory Commission (FERC) or State electric restructuring policy for qualified electric utilities is retroactively extended for two years through 2013.

- The **alternative fuels excise tax credits** under Code Sec. 6426(d)Code Sec. (5) and Code Sec. 6426(e)(3) for sales or use of alternative fuels or alternative fuel mixtures is retroactively extended for two years through 2013.

Pension Provision. For transfers after Dec. 31, 2012, in tax years ending after that date, plan provisions in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution under Code Sec. 408A(e).

Employee Benefits:

- Employer provided **educational assistance** is permanently extended. Employers are permitted to reimburse employees for undergraduate and graduate level courses.

- **Mass transit and parking benefits** set at maximum of $175 per month, which is temporarily extended through the end of 2013.

Exclusions from Income:

    - **National Health Service Corps Scholarship** program and **F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program** are granted permanent tax-free status for recipients.

    - **Alaska Native Settlement Trusts** are permitted to tax income to the Trust and not to the beneficiaries, a provision made permanent by ATRA.

    - **Federal tax refund** s are now permanently disregarded in determining income and asset eligibility factors for federal assistance programs.

- The tax-free exclusion for **cancellation of debt income** relating to a principal residence is temporarily extended through the end of 2013.