DIASCIK
CERTIFIED PUBLIC ACCOUNTANTS

Main / 804-527-1815
Toll Free / 866-527-1815
Fax / 804-527-1816
Innsbrook Corporate Center
4470 Cox Road, Suite 250
Glen Allen, Virginia 23060

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Mr. Smith

Congress passes 2012 Taxpayer Relief Act and averts fiscal cliff tax consequences

Dear Mr. Smith:

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**" (the **2012** Taxpayer Relief Act). 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. The 2012 Taxpayer Relief Act, which the President has now sign into law, prevents many of the tax hikes that were scheduled to go into effect this year and retain many favorable tax breaks that were scheduled to expire. However, it also increases income taxes for some high-income individuals and slightly increases transfer tax rates. This letter provides an overview of the 2012 Taxpayer Relief Act's key provisions.

Highlights of the 2012 Taxpayer Relief Act:

Elimination of EGTRRA sunsetting. The 2012 Taxpayer Relief Act eliminates the sunsetting provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001. The provisions in EGTRRA, other than those made permanent or extended by subsequent legislation, were set to sunset and no longer apply to tax or limitation years beginning after 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the EGTRRA provisions for two additional years. Thus, under pre-2012 Taxpayer Relief Act law, beginning in 2013, the EGTRRA sunset would have wiped out a host of favorable tax rules, such as: favorable income tax rate structure for individuals; marriage penalty relief; and liberal education-related deduction rules. The 2012 Taxpayer Relief Act amends EGTRRA so that its provisions are made **permanent and no longer automatically sunset in future years.**

Tax rates. For tax years beginning after 2012, the income tax rates for most individuals will stay at 10%, 15%, 25%, 28%, 33% and 35% (instead of moving to 15%, 28%, 31%, 36% and 39.6% as would have occurred under the EGTRRA sunset). However, a 39.6% rate applying for income above a certain threshold (specifically, income in excess of the "applicable threshold" over the dollar amount at which the 35% bracket begins). The applicable threshold is $450,000 for joint filers and surviving spouses; $425,000 for heads of household; $400,000 for single filers; and $225,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. These dollar amounts are inflation-adjusted for tax years after 2013.

Capital gain and dividend rates rise for higher-income taxpayers. For tax years beginning after 2012, the top rate for capital gains and dividends will permanently rise to 20% (up from 15%) for taxpayers with incomes exceeding $400,000 ($450,000 for married taxpayers). When accounting for the Healthcare 3.8% surtax on investment-type income and gains for tax years beginning after 2012, the overall rate for higher-income taxpayers will be 23.8%.

For taxpayers whose ordinary income is generally taxed at a rate below 25%, capital gains and dividends will permanently be subject to a 0% rate. Taxpayers who are subject to a 25%-or-greater rate on ordinary income, but whose income levels fall below the $400,000/$450,000 thresholds, will continue to be subject to a 15% rate on capital gains and dividends. The rate will be 18.8% for those subject to the 3.8% surtax (i.e, those with modified adjusted gross income (MAGI) over $250,000 for joint filers or surviving spouses, $125,000 for a married individual filing a separate return, and $200,000 in any other case).

PEP limitations to apply to "high-earners." For tax years beginning after 2012, the Personal Exemption Phaseout (PEP), which had previously been suspended, is reinstated with a starting threshold of $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. Under the phaseout, the total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by 2% for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. These dollar amounts are inflation-adjusted for tax years after 2013.

Pease limitations to apply to "high-earners." For tax years beginning after 2012, the "Pease" limitation on itemized deductions, which had previously been suspended, is reinstated with a starting threshold of $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. Thus, for taxpayers subject to the "Pease" limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income (AGI) exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions. These dollar amounts are inflation-adjusted for tax years after 2013.

Permanent AMT relief. The 2012 Taxpayer Relief Act provides permanent alternative minimum tax (AMT) relief. The AMT is the excess, if any, of the tentative minimum tax for the year over the regular tax for the year. In arriving at the tentative minimum tax, an individual begins with taxable income, modifies it with various adjustments and preferences, and then subtracts an exemption amount (which phases out at higher income levels). The result is alternative minimum taxable income (AMTI), which is subject to an AMT rate of 26% or 28%.

Prior to the 2012 Taxpayer Relief Act, the individual AMT exemption amounts for 2012 were to have been $33,750 for unmarried taxpayers, $45,000 for joint filers, and $22,500 for married persons filing separately. Retroactively effective for tax years beginning after 2011, the 2012 Taxpayer Relief Act permanently increases these exemption amounts to $50,600 for unmarried taxpayers, $78,750 for joint filers and $39,375 for married persons filing separately. In addition, for tax years beginning after 2012, it indexes these exemption amounts for inflation.

Prior to the 2012 Taxpayer Relief Act, for 2012, nonrefundable personal credits—other than the adoption credit, the child credit, the savers' credit, the residential energy efficient property credit, the non-depreciable property portions of the alternative motor vehicle credit, the qualified plug-in electric vehicle credit, and the new qualified plug-in electric drive motor vehicle credit—would have been allowed only to the extent that the individual's regular income tax liability exceeded his tentative minimum tax, determined without regard to the minimum tax foreign tax credit. Retroactively effective for tax years beginning after 2011, the 2012 Taxpayer Relief Act permanently allows an individual to offset his entire regular tax liability and AMT liability by the nonrefundable personal credits.

Transfer tax provisions kept intact with slight rate increase. The 2012 Taxpayer Relief Act prevents steep increases in estate, gift and generation-skipping transfer (GST) tax that were slated to occur for individuals dying and gifts made after 2012 by permanently keeping the exemption level at $5,000,000 (as indexed for inflation). However, the 2012 Taxpayer Relief Act also permanently increases the top estate, gift and rate from 35% to 40%. The 2012 Taxpayer Relief 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.

Recovery Act extenders. The 2012 Taxpayer Relief 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 expired 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 phaseout amounts for singles, surviving spouses, and heads of households.

Historical individual extenders. The 2012 Taxpayer Relief 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;

-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. 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.

Depreciation provisions modified and extended. The following depreciation provisions are retroactively extended by the 2012 Taxpayer Relief 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 2012 Taxpayer Relief Act extends and modifies the 50% bonus depreciation provisions for one year so that it applies to qualified property placed in service before 2014 (before Jan. 1, 2015 for certain aircraft and long-production-period property).

Finally, the 2012 Taxpayer Relief Act extends numerous business and energy tax credits and incentives such as the research credit, work opportunity tax credit, exclusion of 100% of gain on certain small business stock acquired before 2014 and more. We have highlighted many in this letter but not all of the changes brought on by the 2012 Taxpayer Relief Act.

If you have any questions on these topics, we would be happy to personally go over all of these rules with you or other tax-savings strategies that your financial situation may suggest – will work for you. PIASCIK provides premier tax, business, and financial services to a broad range of clients throughout the United States, Canada, UK, Germany and abroad. For more information, please visit www.piascik.com, or call Ryan L. Losi directly at (804) 228-4179.

Very truly yours,
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Ryan L. Losi, CPA
Executive Vice President