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CONGRESS PULLS AMERICA OUT OF THE PRECIPICE

NEW LAW IS BETTER LATE THAN NEVER

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CONGRESS PULLS AMERICA OUT OF THE PRECIPICE

In what has become an all too familiar scenario, Congress went beyond the last minute in enacting the necessary changes to prevent America from plummeting over the fiscal cliff. Actually, Congress did allow us to slip over the edge, but grabbed us and pulled us back up before we suffered irreparable injury.

We take a look at the major provisions of the newly approved law and how it will affect your life...

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So how did Congress accomplish this amazing feat? They met in a rare New Year's Day session (actually, two of them) and voted for the compromise that was negotiated by President Obama and the Senate Republicans. The Senate approved the measure shortly after 2:00 a.m. on January 1 and the House approved it shortly before midnight on the same day.

So, what are the major provisions of this law and how will it affect your life? Looking at a 30,000 foot overview, the law does the following:

- **Makes many provisions, that were previously temporary, permanent,**
- **Extends other provisions on a temporary basis, and**
- **Adds one or two new provisions.**

One thing this law does not do is to implement any spending cuts, which rankled most of the House Republicans. Also, among the tax items not addressed by the act was the temporary lower 4.2% rate for employees' portion of the Social Security payroll tax, which was not extended and has reverted to 6.2%.

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What follows is a summary of the major provisions of the law:

- **The Bush Tax Cuts, originally enacted in 2001, have been made permanent for most Americans.** However, the law imposes a top bracket of 39.6% on individuals with taxable income above $400,000 and married couples above $450,000. The thresholds at which the top bracket kicks in will be indexed for inflation beginning in 2014.

- **The phase-out of itemized deductions and personal exemptions will be reinstated for individuals with Adjusted Gross Income (AGI) over $250,000 and married couples over $300,000.** These thresholds, too, will be indexed for inflation beginning in 2014.

- **There were some significant developments affecting the Estate Tax:**
    - The lifetime exemption of $5,000,000 has been made permanent and will be adjusted for inflation, and
    - The "portability" provisions of one's unused exemption amount have also been made permanent.
    - However, the top Estate Tax rate was increase from 35% to 40%.

- **Three provisions that were originally enacted in 2003, affecting capital gains and dividend tax rates have been made permanent, with modifications.** A new capital gains tax rate of 20% is adopted for individuals with taxable income above $400,000 and married couples above $450,000. All other taxpayers will be subject to a capital gains tax rate of either 0% or 15%, depending on taxable income.

In a classic case of closing the barn door after the horse has run out, the Tax-free Distributions from IRAs for Charitable Purposes was reinstated through 2013. Since this was enacted in 2013, how can this possibly apply to 2012?

- **Three provisions, originally enacted in 2009, have been extended for five more years, expiring at the end of 2017, including:**
  - The American Opportunity Tax Credit
  - The Child Tax Credit, and
  - The Earned Income Tax Credit.

- **In a major change, the so-called AMT Patch has been made permanent.**
  - For 2012, the AMT exemption for individuals is $50,600 and married couples is $78,750.
  - The exemption amounts will be indexed for inflation beginning in 2013, and
  - The AMT may be offset by nonrefundable tax credits.

- **A few of the individual tax provisions that have been extended temporarily are:**
  - The teachers' $250 above the line deduction for classroom expenses (through 2013)
  - The exclusion from Cancellation of Debt Income on Qualified Residence Debt (through 2013)
  - Mortgage Insurance Premium deduction (through 2013)
  - Sales Tax Deduction (through 2013)
  - Deduction for Qualified Tuition and Related Expenses (through 2013)

- **In a classic case of closing the barn door after the horse has run out, the Tax-free Distributions from IRAs for Charitable Purposes was reinstated through 2013.** Since this was enacted in 2013, how can this possibly apply to 2012?
  - First, a qualifying taxpayer who elects to make a direct transfer before February 1, 2013 can elect to treat that contribution as having been made on December 31, 2012,
    - *Thus, a taxpayer could make two separate transfers of $100,000 in 2013, with one being treated as a 2012 contribution and the other as a 2013 contribution.*

    - Second, a qualifying taxpayer who took a distribution in December 2012 can make a cash contribution up to the amount of that distribution before February 1, 2013 and have that amount treated as if it had been a direct transfer to that charity.
        - *So, what happens if a taxpayer took their distribution before December 2012? Unfortunately, there is no provision allowing them any ability to avail themselves to the second option, above.*

In a new provision, Qualified Plan participants will be allowed to transfer funds into a designated Roth IRA account, even if that participant is not otherwise eligible to receive a distribution.

- **A few of the Business Tax Provisions that were extended temporarily are:**
    - The Research Credit (through 2013)
    - Employer Wage Credit for Employees Who are Active Duty Members of the Military (through 2013)
    - Work Opportunity Credit (through 2013)
    - 15 Year Straight Line Cost Recovery for Qualified Leasehold Improvements, Restaurant Buildings and Retail Improvements (placed in service before 2014)
    - Increased limits for §179 property and treatment of certain Real Property as §179 property (through 2013)
    - Reduction of S Corporation Recognition Period for Built-in Gains Tax to 5 years (through 2013)
    - 50% Bonus Depreciation (placed in service before 2014

- In a new provision, Qualified Plan participants will be allowed to transfer funds into a designated Roth IRA account, even if that participant is not otherwise eligible to receive a distribution. The amount transferred will be treated as if it was distributed and then rolled over into the designated Roth IRA account in the Plan. This provision applies to transfers after December 31, 2012.

As you can see, there are many changes to be aware of. Many of these changes will affect you, but others will not. As has become the rule, rather than the exception, over recent years, the American public is left to figure out how this all affects them at the 11th hour, or, in this case, the 13th hour!

If you would like help in understanding how this will affect you, contact one of the professionals at Zinner & Co. LLP.

Have questions regarding how the law may affect you?

Contact **Howard Kass** at Zinner & Co.
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Howard J. Kass has over 30 years experience and has cultivated particular expertise in individual and business income taxes, tax aspects of real estate investment, gift and estate taxes and tax exempt organizations. Howard applies his extensive knowledge and experience to a diverse client base of individuals and companies including closely held businesses in a variety of industries and ownership structures such as C Corporations, S Corporations, Partnerships, and LLCs. Industries served include real estate, manufacturing, retail establishments, insurance agencies, distributors and service companies.