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CONGRESS AVOIDS THE FISCAL CLIFF AND PASSES THE AMERICAN TAXPAYER RELIEF ACT

The U.S. Senate and the U.S. House of Representatives approved the American Taxpayer Relief Act of 2012 (the "Act") on January 1, 2013, which President Obama is expected to sign. The Act averts the tax side of the so-named fiscal cliff.

This article briefly outlines the highlights of the Act. It is not intended to be a full description of all provisions in the Act.

Individual Provisions

- For married couples earning less than $450,000 and for singles earning less than $400,000, the individual and capital gains tax rates in existence prior to December 31, 2012, (commonly referred to as the "Bush tax rates") are made permanent.
- The top individual income tax rate for married couples earning more than $450,000 and for singles earning more than $400,000 is increased to 39.6 percent. The income amounts will be indexed for inflation in future years. These taxpayers still benefit from the Bush tax rates at amounts below that amount.
- The tax rate on long-term capital gains and qualifying dividends is increased to 20 percent for taxpayers in the new 39.6 percent tax bracket. Capital gains and dividends for these taxpayers could also be subject to the 3.8 percent Medicare tax that is also applicable starting January 1, 2013.
- Reinstates the personal exemption phase-out ("PEP") and the limitation on itemized deductions ("Pease limitation") at the following income levels: more than $300,000 for married couples and more than $250,000 for singles.
- Patches the Alternative Minimum Tax ("AMT") for 2012 by increasing the exemption amounts and allowing non-refundable personal credits to the full amount of the individual's regular tax and AMT. The patch is now permanent, and the Act also adjusts the exemption amount for inflation going forward.
- Extends through 2013 the following individual tax benefits:
    - relief from cancellation of debt income for principal residences;
    - deduction for mortgage insurance premiums as interest;
    - the election to deduct state and local sales taxes in lieu of deduction state income taxes;
    - tax-free distributions from an IRA account for charitable purposes;
    - the option to deduct general sales and use taxes;
    - adds five year extension of Work Opportunity Tax Credit and Earned Income Credit.

NOTE: The payroll tax holiday, which reduced the employee's share of social security taxes from 6.2 percent to 4.2 percent, was allowed to expire, so that the employee's share of social security taxes will rise to 6.2 percent again.

Business Provisions

- Extends 50 percent bonus depreciation through 2013.
- Extends through 2013 certain business provisions that expired at the end of 2011, including:
    - the increased section 179 expense limit of $500,000;
    - the section 1202 stock exclusion at 100 percent;
    - the research credit;

  - the new markets credit;
  - work opportunity credit;
  - empowerment zone incentives;
  - reduced recognition period for S corporation built-in gains tax.
- Extends through 2013 the five-year built-in gain period for S corporations.

Energy Tax Incentives

- Extends through 2013 certain energy tax incentives that expired at the end of 2011, including:
  - the energy efficient credit for existing homes;
  - the energy efficient credit for new homes;
  - the credit for manufacturing energy efficient appliances;
  - the alternative fuel vehicle refueling property credit;
  - the biodiesel and renewable diesel incentives;
  - the wind credit.

Estate Tax Provisions

- The estate tax rate will be set at 40 percent with a $5 million exemption, which will be indexed to inflation.
- The gift tax rate is set at 40 percent and a unified estate and gift tax exemption is created for gifts made after 2012.
- A number of generation skipping tax provisions scheduled to expire at the end of 2012 are extended.
- Portability between spouses is made permanent. This allows the estate of a decedent who is survived by a spouse to make a portability election to permit the surviving spouse to apply the decedent's unused exclusion amount to the surviving spouse's own transfers during life and at death.

—Louis S. Nunes, III

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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