

# American Taxpayer Relief Act of 2012

January 3, 2013

Special Report

## HIGHLIGHTS

- 39.6% Tax Rate For Incomes Above \$400,000 (\$450,000 For Families)
- All Other Bush-Era Tax Rates Extended
- 20% Maximum Capital Gains/Dividend Tax Rate
- Maximum 40% Estate/Gift Tax Rate
- Permanent AMT Patch
- Five-Year Extension Of Enhanced Education Credit
- One-Year Extension Of Many Business Tax Extenders
- Over 30 Extenders Retroactive To Start Of 2012

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## President Signs Eleventh-Hour Agreement To Avert Fiscal Cliff

The tax side of the “Fiscal Cliff” has been averted. The U.S. Senate overwhelmingly passed legislation to avert the so-called fiscal cliff on January 1, 2013 by a vote of 89 to 8, sending the American Taxpayer Relief Act of 2012 (HR 8, as amended by the Senate) to the House, where it was similarly approved on January 1, 2013 by a vote of 257 to 167. The American Taxpayer Relief Act allows the Bush-era tax rates to sunset after 2012 for individuals with incomes over \$400,000 and families with incomes over \$450,000; permanently “patches” the alternative minimum tax (AMT); revives many now-expired tax extenders, including the research tax credit and the American Opportunity Tax Credit; and provides for a maximum estate tax of 40 percent with a \$5 million exclusion. The bill also delays the mandatory across-the-board spending cuts known as sequestration. President Obama signed the bill into law on January 2, 2013.

**IMPACT.** *Individuals with incomes above the \$450,000/\$400,000 thresholds will pay more in taxes in 2013 because of a higher 39.6 percent income tax rate and a 20 percent maximum capital gains tax. Nevertheless, all taxpayers will find less in their paychecks in 2013 because of what the American Taxpayer Relief Act did not include: the new law effectively raises taxes for all wage earners (and those self-employed) by not extending the 2012 payroll tax holiday that had reduced OASDI taxes from 6.2 percent to 4.2 percent on earned income up to the Social Security wage base (\$113,700 for 2013).*

**IMPACT.** *The American Taxpayer Relief Act avoids draconian automatic sunset provisions that were scheduled to take effect after 2012 under the Bush-era tax cuts in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) (both as extended by subsequent legislation, including the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act)). Without the American Taxpayer Relief Act, individual tax rates on all income groups would have increased, taxpayer-friendly treatment of capital gains and dividends would have completely disappeared, the child tax credit would have plummeted to \$500, enhancements to education tax incentives would have ended, the federal estate tax would have reverted to a maximum rate of 55 percent, and many other popular but temporary incentives would no longer be available.*

## INDIVIDUAL INCOME TAX RATES

The American Taxpayer Relief Act of 2012 makes permanent for 2013 and beyond the lower Bush-era income tax rates for all, except for taxpayers with taxable income above \$400,000 (\$450,000 for married taxpayers, \$425,000 for heads of households). Income above these levels will be taxed at a 39.6 percent rate.

**IMPACT.** *The 10, 15, 25, 28 and 33 percent marginal rates remain the same after*

2012, as does the 35 percent rate for income between the top of the 33 percent rate (projected to be at \$398,350 for most taxpayers) and the \$400,000/\$450,000 threshold at which the 39.6 percent bracket now begins.

Individual marginal tax rates of 10, 15, 25, 28, 33, and 35 percent at the end of 2012, therefore, are now set going forward at the same 10, 15, 25, 28, 33, and 35 rates, but with an additional 39.6 percent rate carved out from the old 35 percent bracket range. The fiscal cliff agreement also uses the same \$400,000/\$450,000 taxable income threshold to apply a higher capital gains and dividend rate of 20 percent, up from 15 percent (see discussion, at “Capital Gains and Dividends,” below).

**IMPACT.** The bracket ranges for the extension of the 35 percent rate now cover only a relatively small sliver of what had constituted the upper-income range. As projected for annual inflation, the range of the 35 percent tax bracket for 2013 because of the Bush-era rate extensions begins at \$398,350, for all individual brackets, except half (\$199,175) for married taxpayers filing separately. The 35 percent income bracket ranges for 2013, therefore, are:

- \$398,350 - \$400,000 for single filers
- \$398,350 - \$425,000 for heads of household
- \$398,350 - \$450,000 for joint filers.
- surviving spouses
- \$199,175 - \$225,000 for married filing separately

**IMPACT.** Taxpayers who find themselves within the 39.6 percent marginal income tax bracket nevertheless also benefit from extension of all Bush-era rates below that level.

As with all tax bracket ranges, the new law directs that the \$450,000/\$400,000 beginning of the 39.6 percent bracket be adjusted for inflation after 2013 based upon the standard formula of Code Sec. 1(f). Also relevant, however, the new law did not adopt recommendations that had been floated for several years that would lower the inflation-factor ap-

plied annually to all tax bracket ranges, thereby raising slightly more tax revenue each year.

**COMMENT.** Full sunset of the Bush-era tax rates would have replaced the 10, 15, 25, 28, 33 and 35 percent rates with the Clinton-era rate schedule of 15, 28, 31, 36, and 39.6 percent.

“The American Taxpayer Relief Act avoids draconian automatic sunset provisions that were scheduled to take effect after 2012...”

**COMMENT.** President Obama had initially proposed a \$250,000/\$200,000 threshold for higher rates. This proposal had been based upon a modified adjusted gross income (AGI) amount. The new law not only raises the dollar value but also simplifies that proposal by keying the \$450,000/\$400,000 threshold amounts to bottom-line taxable income.

**COMMENT.** Although these rates are now made “permanent,” nothing would stop Congress from reconsidering the entire tax rate structure again in the future, as part of overall tax reform or even earlier as debt ceiling negotiations get under way shortly.

**Trusts and estates.** The American Taxpayer Relief Act similarly retains the Bush-era tax rates for all bracket levels that apply to trusts and estates, except for the highest rate bracket. That top rate increases to 39.6 percent and, as confirmed by a Joint Committee on Taxation Legislation Counsel, applies to what was the entire 35-percent bracket range and, therefore, is projected to begin in 2013 for taxable income in excess of \$11,950.

## Marriage Penalty Relief

The American Taxpayer Relief Act extends all existing marriage penalty relief. Before EGTRRA, married couples experienced the so-called marriage penalty in several areas. EGTRRA gradually increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The 2010 Tax Relief Act extended EGTRRA’s marriage penalty relief through 2012.

**IMPACT.** Without marriage penalty relief, the standard deduction for married couples would be 167 percent of the deduction for single individuals rather than 200 percent. For joint filers in 2013, that would have meant a drop of \$1,950, from \$12,200 to \$10,150.

EGTRRA also gradually increased the size of the 15 percent income tax bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. The 2010 Tax Relief Act extended this treatment through 2012 only. Without that relief, the top of the 15 percent rate bracket in 2013 for married taxpayers filing jointly would be set at a projected \$60,550 rather than \$72,500.

## CAPITAL GAINS/ DIVIDENDS RATES

The American Taxpayer Relief Act raises the top rate for capital gains and dividends to 20 percent, up from the Bush-era maximum 15 percent rate. That top rate will apply to the extent that a taxpayer’s income exceeds the thresholds set for the 39.6 percent rate (\$400,000 for single filers; \$450,000 for joint filers and \$425,000 for heads of households).

All other taxpayers will continue to enjoy a capital gains and dividends tax at a maximum rate of 15 percent. A zero percent rate will also continue to apply to capital

gains and dividends to the extent income falls below the top of the 15 percent income tax bracket—projected for 2013 to be \$72,500 for joint filers and \$36,250 for singles. Qualified dividends for all taxpayers continue to be taxed at capital gains rates, rather than ordinary income tax rates as prior to 2003.

**IMPACT.** *Absent the American Taxpayer Relief Act, the maximum tax rate on net capital gain of all noncorporate taxpayers would have reverted to 20 percent (10 percent for taxpayers in the 15 percent bracket) starting January 1, 2013.*

The 28 and 25 percent tax rates for collectibles and unrecaptured Code Sec. 1250 gain, respectively, continue unchanged after 2012. Also unchanged is the application of ordinary income rates to short-term capital gains; only long-term capital gains, those realized on the sale or disposition of assets held for more than one year, can benefit from the reduced net capital gain rate.

Generally, dividends received from a domestic corporation or a qualified foreign corporation, on which the underlying stock is held for at least 61 days within a specified 121-day period, are qualified dividends for purposes of the reduced tax rate. Certain dividends do not qualify for the reduced tax rates and are taxed as ordinary income. Those include (not an exhaustive list) dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

**CAUTION.** *Installment payments received after 2012 are subject to the tax rates for the year of the payment, not the year of the sale. Thus, the capital gains portion of payments made in 2013 and later is now taxed at the 20 percent rate for higher-income taxpayers.*

**COMMENT.** *Starting in 2013, under the Patient Protection and Affordable Care Act (PPACA), higher income taxpayers must also start paying a 3.8 percent additional tax on net investment income (NII) to the extent certain threshold amounts of income*

*are exceeded (\$200,000 for single filers, \$250,000 for joint returns and surviving spouses, \$125,000 for married taxpayers filing separately). Those threshold amounts stand, despite higher thresholds now set for the 20 percent capital gain rate that previously had been proposed by President Obama to start at the same levels. The NII surtax thresholds are not affected by the American Taxpayer Relief Act. Starting in 2013, therefore, taxpayers within the NII surtax range must pay the additional 3.8 percent on capital gain, whether long-term or short-term. The effective top rate for net capital gains for many "higher-income" taxpayers thus becomes 23.8 percent for long term gain and 43.4 percent for short-term capital gains starting in 2013.*

## PERMANENT AMT RELIEF

The American Taxpayer Relief Act "patches" the AMT for 2012 and subsequent years by increasing the exemption amounts and allowing nonrefundable personal credits to the full amount of the individual's regular tax and AMT. Additionally, the American Taxpayer Relief Act provides for an annual inflation adjustment to the exemption amounts for years beginning after 2012.

The American Taxpayer Relief Act increases the 2012 exemption amounts to \$50,600 for unmarried individuals; \$78,750 for married taxpayers filing jointly and surviving spouses; and \$39,375 for married taxpayers filing separately. The 2013 AMT exemption amounts

## CCH PROJECTED\* TAX RATES FOR 2013

### UNDER AMERICAN TAXPAYER RELIEF ACT OF 2012

#### Single Individuals

If taxable income is:	The tax will be:
Not over \$8,925	10% of taxable income
Over \$8,925 but not over \$36,250	\$892.50 plus 15% of the excess over \$8,925
Over \$36,250 but not over \$87,850	\$4,991.25 plus 25% of the excess over \$36,250
Over \$87,850 but not over \$183,250	\$17,891.25 plus 28% of the excess over \$87,850
Over \$183,250 to \$398,350	\$44,603.25 plus 33% of the excess over \$183,250
Over \$398,350 to \$400,000	\$115,586.25 plus 35% of the excess over \$398,350
Over \$400,000	\$116,163.75 plus 39.6% of the excess over \$400,000

#### Married Couples Filing Jointly

If taxable income is:	The tax will be:
Not over \$17,850	10% of taxable income
Over \$17,850 but not over \$72,500	\$1,785 plus 15% of the excess over \$17,850
Over \$72,500 but not over \$146,400	\$9,982.50 plus 25% of the excess over \$72,500
Over \$146,400 but not over \$223,050	\$28,457.50 plus 28% of the excess over \$146,400
Over \$223,050 but not over \$398,350	\$49,919.50 plus 33% of the excess over \$223,050
Over \$398,350 but not over \$450,000	\$107,768.50 plus 35% of the excess over \$398,350
Over \$450,000	\$125,846 plus 39.6% of the excess over \$450,000

\* The IRS is expected to release official 2013 tax rate tables shortly now that legislation has resolved the uncertainty surrounding the rates.

are projected to be \$80,750 for married filing jointly and qualified widow(er)s, \$51,900 for single and head of household, and \$40,375 for married taxpayers filing separately.

**IMPACT.** *Without the AMT patch, the AMT exemption amounts for 2012 would have been \$33,750 for unmarried individuals; \$45,000 for married taxpayers filing jointly and surviving spouses; and \$22,500 for married taxpayers filing separately, down dramatically from the \$48,450/\$74,450/\$37,225 levels of 2011. The latest patch immediately saves over 60 million taxpayers from being subject to AMT on returns about to be filed for the 2012 tax year.*

**IMPACT.** *The American Taxpayer Relief Act provides that all nonrefundable personal credits are allowed to the full extent of the taxpayer's regular tax and AMT liability, effective for tax years beginning after 2011.*

**COMMENT.** *Acting IRS Commissioner Steven Miller estimated that 80 to 100 million taxpayers may experience a delay in filing their 2012 returns if Congress failed to enact an AMT patch before year-end 2012.*

**COMMENT.** *Although a "permanent" AMT patch is welcomed by many taxpayers, the future of the AMT itself could be decided later this year or next year if Congress tackles comprehensive tax reform. The AMT could, as some lawmakers have proposed, be abolished. President Obama previously proposed to replace at least part of the AMT with the so-called Buffett Rule as a part of comprehensive tax*

*reform. The White House has explained the Buffett Rule in general terms as ensuring that taxpayers making over \$1 million annually would pay an effective tax rate of at least 30 percent. In 2012, the Senate rejected the Paying a Fair Share Act, which would implement the Buffett Rule. It is unclear if Democrats will reintroduce the bill or whether it will be considered within the overall framework of possible tax reform later in 2013.*

## PEASE LIMITATION

The American Taxpayer Relief Act officially revives the "Pease" limitation on itemized deductions, which was eliminated by EG-TRRA as extended by the 2010 Tax Relief Act. However, higher "applicable threshold" levels apply under the new law:

- \$300,000 for married couples and surviving spouses;
- \$275,000 for heads of households;
- \$250,000 for unmarried taxpayers; and
- \$150,000 for married taxpayers filing separately.

**IMPACT.** *The applicable threshold for the Pease limitation for 2013, as adjusted for inflation and as computed under the sunset rules, would have been \$178,150 (\$89,075 for individuals married filing separately). Thus, the American Taxpayer Relief Act does not call for a full revival of the Pease limitation at former levels.*

**COMMENT.** *The dollar amounts are adjusted for inflation for tax years after 2013.*

The Pease limitation, named after the member of Congress who sponsored the original provision, reduces the total amount of a higher-income taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. However, the amount of itemized deductions is not reduced by more than 80 percent. Certain items, such as medical expenses, investment interest, and casualty, theft or wagering losses, are excluded.

**COMMENT.** *President Obama has previously proposed to limit the value of all itemized deductions for "higher-income" taxpayers to 28 percent. Whether this proposal will replace or add to the Pease limitation in future tax proposals remains to be seen.*

## PERSONAL EXEMPTION PHASEOUT

The American Taxpayer Relief Act also officially revives the personal exemption phaseout rules, but at applicable income threshold levels slightly higher than in the past:

- \$300,000 for married couples and surviving spouses;
- \$275,000 for heads of households;
- \$250,000 for unmarried taxpayers; and
- \$150,000 for married taxpayers filing separately.

Under the phaseout, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each \$2,500, or portion thereof (two percent for each \$1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income exceeds the applicable threshold level.

**IMPACT.** *The applicable thresholds for the personal exemption phaseout for 2013 if full sunset had occurred would have been \$178,150 for single taxpayers and \$267,200 for married couples filing a joint return.*

## NO GRAND BARGAIN

The American Taxpayer Relief Act is nowhere close to the grand bargain as envisioned by the President and many lawmakers after the November elections. Effectively, it is a stop-gap measure to prevent the onus of the expiration of the Bush-era tax cuts from falling on middle income taxpayers. Congress must still address sequestration. Congress is likely to revisit tax policy and spending cuts when it tackles the expected increase on the nation's debt limit in February. Slowing the growth of entitlements, such as through a "chained-CPI" is certain to be a controversial topic in upcoming debates.



## FEDERAL ESTATE, GIFT AND GST TAXES

The American Taxpayer Relief Act permanently provides for a maximum federal estate tax rate of 40 percent with an annually inflation-adjusted \$5 million exclusion for estates of decedents dying after December 31, 2012.

**IMPACT.** *The maximum estate tax rate for estates of decedents dying after December 31, 2010 and before January 1, 2013 is 35 percent with a \$5 million exclusion (indexed for inflation for 2012 at \$5.12 million). Effective January 1, 2013, the maximum federal estate tax rate was scheduled to revert to 55 percent with an applicable exclusion amount of \$1 million (not indexed for inflation), its levels before enactment of estate tax reform in 2001 and subsequent legislation.*

**COMMENT.** *The federal estate tax almost appeared to be a deal-breaker in the Senate. Republicans wanted complete repeal while the President insisted on a 45 percent rate with a \$3.5 million exemption.*

**COMMENT.** *The most recent estate tax legislation, the 2010 Tax Relief Act, provided for a complicated application of the tax depending on the year in which the decedent died. First, the 2010 Tax Relief Act provided for a maximum estate tax rate of 35 percent for decedents dying after December 31, 2009 and before January 1, 2013, and an applicable exclusion amount of \$5 million for decedents dying after December 31, 2009 and before January 1, 2013. Second, the 2010 Tax Relief Act allowed estates of decedents dying in 2010 to opt out of the revived estate tax. Estates of decedents dying after December 31, 2009 and before January 1, 2011 had the option to elect*

*not to apply the estate tax regime under the 2010 Tax Relief Act. Such estates could have elected to apply either (1) the estate tax based on the 2010 Tax Relief Act's 35 percent top rate and \$5 million applicable exclusion amount, with stepped-up basis or (2) no estate tax and modified carryover basis rules under EGTRRA.*

### Portability

The American Taxpayer Relief Act makes permanent "portability" between spouses. Prior to the permanent extension, portability was only available to the estates of decedents dying after December 31, 2010 and before January 1, 2013.

**IMPACT.** *Portability 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 (the deceased spousal unused exclusion amount (DSUE)) to the surviving spouse's own transfers during life and at death.*

## H.R. 8: SELECTED ESTIMATED REVENUE EFFECTS

### Expenditures\*

Retention of 10, 25 and 28% Brackets	\$654.8 billion
Child Tax Credit	\$354.4 billion
Tax Dividends with 0/15/20% Rate Structure	\$231 billion
American Opportunity Tax Credit	\$67.2 billion
Marriage Penalty Relief	\$55.6 billion
Earned Income Credit	\$29 billion
Energy Tax Incentives	\$18.1 billion
Research Tax Credit	\$14.3 billion
Partial Repeal Of Pease Limitation/Personal Exemption Phaseout	\$10.5 billion

### Revenue Raisers\*

Transfers Of Amounts In Applicable Retirement Plans To Roth Accounts	\$12.1 billion
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### Other Provisions

Sunset Of Payroll Tax Holiday	\$93.2 billion**
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\* Over 10 years (revenue scoring is mandated for 10 years. Certain provisions are permanent, others expire after 2013 or subsequent years) (JCX-13-1).

\*\*Over 10 years as projected in 2012 by the Joint Committee on Taxation (JCX-17-12).

**Note.** According to the Congressional Budget Office, the overall estimate of the budgetary effects of H.R. 8 over 10 years is \$-3.63 trillion in revenues.

### State Death Tax Credit/Deduction

The American Taxpayer Relief Act extends the deduction for state estate taxes.

**IMPACT.** *Before 2005, a credit was allowed against the federal estate tax for state estate, inheritance, legacy, or succession taxes. EGTRRA repealed the state death tax credit for decedents dying after 2004 and replaced the credit with a deduction.*

### More Estate Tax Provisions

The American Taxpayer Relief Act extends a number of provisions affecting qualified conservation easements, qualified family-owned business interests (QFOBIs), the installment payment of estate tax for closely-held businesses for purposes of the estate tax, and repeal of the five percent surtax on estates larger than \$10 million.

### Gift Tax

The American Taxpayer Relief Act provides a 40 percent tax rate and a unified estate

and gift tax exemption of \$5 million (inflation adjusted) for gifts made after 2012.

**COMMENT.** *The 2010 Tax Relief Act provided that for gifts made after December 31, 2010, the gift tax was reunified with the estate tax, with a tax rate through 2012 of 35 percent and an applicable lifetime unified exclusion amount of \$5 million (adjusted annually for inflation).*

### GST Tax

The American Taxpayer Relief Act provides for a 40 percent GST tax rate with a \$5 million exemption and extends a number of GST tax-related provisions scheduled to expire after 2012. They include the GST deemed allocation and retroactive allocation provisions; clarification of valuation rules with respect to the determination of the inclusion ratio for GST tax purposes; provisions allowing for a qualified severance of a trust for purposes of the GST tax; and relief from late GST allocations and elections.

### RETIREMENT SAVINGS

The American Taxpayer Relief Act makes a valuable change to the treatment of retirement savings and opens up an important planning opportunity. Generally, participants with 401(k)s and similar plans have been allowed to roll over funds to designated Roth accounts in the same plan subject to certain qualifying events or age restrictions. The American Taxpayer Relief Act lifts most restrictions, and now allows participants in 401(k) plans with in-plan Roth conversion features to make transfers to a Roth account at anytime. Congress made this change because conversion is a taxable event and will raise revenue.

### STATE AND LOCAL SALES TAX DEDUCTION

The American Taxpayer Relief Act extends through 2013 the election to claim an itemized deduction for state and local general sales taxes in lieu of state and local income taxes.

**IMPACT.** *Because of the extension, taxpayers in states without income taxes continue to be able to elect to claim an itemized deduction for state (and local) general sales taxes.*

### CHILD TAX CREDIT

The American Taxpayer Relief Act extends permanently the \$1,000 child tax credit. Certain enhancements to the credit under Bush-era legislation and subsequent legislation are also made permanent.

**IMPACT.** *Absent the American Taxpayer Relief Act, the child tax credit was scheduled to revert after 2012 to \$500 per qualifying child (dependents under age 17 at the close of the year). The child tax credit has been set at the \$1,000 level since 2003 and is not adjusted each year for inflation. The American Taxpayer Relief Act keeps the child tax credit at the \$1,000 level, still without inflation adjustments, for future years.*

**IMPACT.** *Bush-era and subsequent legislation modified the refundable component of the child tax credit, provided that the refundable portion of the credit does not constitute income, provided that the credit is allowable against regular income tax and AMT, repealed the AMT offset against the additional child tax credit for families with three or more children; and eliminated the supplemental child tax credit. The American Taxpayer Relief Act extends all these modifications as well.*

**COMMENT.** *The current provision that reduces the earnings threshold for the refundable portion of the child tax credit to \$3,000 is extended through 2017.*

### EARNED INCOME CREDIT

The American Taxpayer Relief Act makes permanent or extends through 2017 enhancements to the earned income credit (EIC) in Bush-era and subsequent legislation. The enhancements to the EIC made by Bush-era and subsequent legislation include (not an exhaustive list) a simplified definition of earned income, reform of the relationship test and modification of the tie-breaking rule. The IRS also has additional authority with respect to mathematical errors.

**IMPACT.** *Expiration of the EIC enhancements would result in the credit phaseout being determined by reference to modified adjusted gross income rather than adjusted gross income. The Bush-era legislation substituted adjusted gross income to reduce the number of calculations necessary to compute EIC.*

### OTHER CHILD-RELATED TAX RELIEF

#### Adoption Credit/Assistance

The American Taxpayer Relief Act extends permanently Bush-era enhancements to the adoption credit and the income exclusion for employer-paid or reimbursed adoption expenses up to \$10,000 (indexed for inflation).

### TAX REFORM SOLUTION?

Since passage of the 2010 Tax Relief Act, several proposals for comprehensive tax reform have been unveiled in Washington that may hold promise for a more permanent solution. A presidential panel developed the so-called Simpson-Bowles plan. The GOP has put forward several proposals for comprehensive tax reform, also calling for reduced individual income tax rates, while both parties have struggled to strike a "grand bargain." Later in 2013, a broader, more permanent solution may be found.

tion) both for non-special needs adoptions and special needs adoptions.

**COMMENT.** *The adoption credit phases out for taxpayers above specified inflation-adjusted levels of modified adjusted gross income. The phase-out level for 2012 started at \$189,710. For 2013, the beginning point for phasing out the adoption credit is projected to be \$191,530. The limit on the adoption credit is projected to be \$12,770 for 2013.*

### Child And Dependent Care Credit

The American Taxpayer Relief Act extends permanently Bush-era enhancements to the child and dependent care credit. The current 35 percent credit rate is made permanent along with the \$3,000 cap on expenses for one qualifying individual and the \$6,000 cap on expenses for two or more qualifying individuals.

**COMMENT.** *Expenses qualifying for the child and dependent care credit must be reduced by the amount of any dependent care benefits provided by the taxpayer's employer that are excluded from the taxpayer's gross income. For 2012, total expenses qualifying for the credit are capped at \$3,000 in cases of one qualifying individual or at \$6,000 in cases of two or more qualifying individuals subject to income thresholds. For 2013, absent extension, these monetary amounts would have decreased to \$2,400 in cases of one qualifying individual or \$4,800 in cases of two or more qualifying individuals, subject to income thresholds.*

**COMMENT.** *The amount of the credit under the American Taxpayer Relief Act continues to be adjusted gross income (AGI) sensitive. The credit is reduced by one percentage point for each \$2,000 of AGI, or fraction thereof, above \$15,000 through \$43,000. Taxpayers with AGI over \$43,000 are allowed a credit equal to 20 percent of employment-related expenses. Absent the American Taxpayer Relief Act, the AGI range would have been reduced to \$10,000 through \$28,000.*

**COMMENT.** *The child and dependent care credit is intended to help individuals pay child and dependent care expenses so the taxpayer (if married, a joint return must be filed) can work or look for work. A child, for purposes of this tax benefit, must be under 13 years of age at the close of the tax year. A qualifying dependent who is disabled, however, may be of any age if he or she is a dependent, or spouse, who lives with the taxpayer for more than half the year. EGTRRA and subsequent legislation increased the maximum amount of eligible employment-related expenses for purposes of the dependent care credit and made other enhancements. The 2010 Tax Relief Act had extended these enhancements through 2012.*

### Employer-Provided Child Care Credit

The American Taxpayer Relief Act extends permanently the Bush-era credit for employer-provided child care facilities and services.

### American Opportunity Tax Credit

The American Taxpayer Relief Act extends through 2017 the American Opportunity Tax Credit (AOTC). The AOTC is an enhanced, but temporary, version of the permanent HOPE education tax credit.

**IMPACT.** *The AOTC rewards qualified taxpayers with a tax credit of 100 percent of the first \$2,000 of qualified tuition and related expenses and 25 percent of the next \$2,000, for a total maximum credit of \$2,500 per eligible student. Additionally, the AOTC applies to the first four years of a student's post-secondary education. The HOPE credit, in contrast, is less generous and applies to the first two years of a student's post-secondary education.*

**COMMENT.** *The AOTC was one of the signature pieces in President Obama's American Recovery and Reinvestment Act of 2009 and the President has often urged Congress to make the AOTC permanent.*

## OTHER EDUCATION INCENTIVES

The American Taxpayer Relief Act makes permanent or extends a number of enhancements to tax incentives designed to promote education. Many of these enhancements were made in Bush-era legislation, extended by subsequent legislation and are scheduled to expire after 2012. Some enhancements, notably the American Opportunity Tax Credit, had been made in President Obama's first term.

### Deduction For Qualified Tuition And Related Expenses

The American Taxpayer Relief Act extends until December 31, 2013 the above-the-line deduction for qualified tuition and related expenses. The bill also extends the deduction retroactively for the 2012 tax year.

**COMMENT.** *The above-the-line deduction for higher education tuition and related expenses expired after 2011. The higher education tuition deduction was created by EGTRRA and extended by subsequent laws, most recently by the 2010 Tax Relief Act, but only through the end of 2011.*

**IMPACT.** *In 2011, the last year in which the deduction was available under current law, the deduction reached a maximum of \$4,000 for taxpayers whose modified AGI did not exceed \$65,000 (\$130,000 for joint filers), and \$2,000 for taxpayers whose modified AGI exceeded \$65,000 but did not exceed \$80,000 (\$160,000 for joint filers)*

**COMMENT.** *Taxpayers cannot claim the higher education tuition deduction in the same tax year that they claim the AOTC or the Lifetime Learning credit. A taxpayer also cannot claim the higher education tuition deduction if anyone else claims the AOTC or the Lifetime Learning credit for the student in the same tax year.*

### Student Loan Interest Deduction

The American Taxpayer Relief Act permanently suspends the 60-month rule for the

\$2,500 above-the-line student loan interest deduction. The American Taxpayer Relief Act also expands the modified adjusted gross income range for phaseout of the deduction permanently and repeals the restriction that makes voluntary payments of interest non-deductible permanently.

**IMPACT.** *Absent the American Taxpayer Relief Act, the 60-month limitation on the number of months during which interest paid on the student loan is deductible was scheduled to be revived after 2012.*

### Coverdell Education Savings Accounts

The American Taxpayer Relief Act extends permanently Bush-era enhancements to Coverdell education savings accounts (Coverdell ESAs). These enhancements include a \$2,000 maximum contribution amount and treatment of elementary and secondary school expenses as well as post-secondary expenses as qualified expenditures.

**IMPACT.** *Absent the American Taxpayer Relief Act, the maximum contribution amount to a Coverdell ESA was scheduled to decrease from \$2,000 to \$500 after 2012.*

**COMMENT.** *Under the American Taxpayer Relief Act, qualified educational expenses continue to include expenses incurred while attending an elementary, secondary or post-secondary school.*

### Employer-Provided Education Assistance

The American Taxpayer Relief Act extends permanently the exclusion from income and employment taxes of employer-provided education assistance up to \$5,250.

**COMMENT.** *The employer may also deduct up to \$5,250 annually for qualified education expenses paid on behalf of an employee.*

### Federal Scholarships

The American Taxpayer Relief Act makes permanent the exclusion from income for the National Health Service Corps Scholarship Program and the Armed Forces Scholarship Program.

## MORE INDIVIDUAL TAX EXTENDERS

### Teachers' Classroom Expense Deduction

The American Taxpayer Relief Act extends through 2013 the teacher's classroom expense deduction. The deduction, which expired after 2011, allows primary and secondary education professionals to deduct (above-the-line) qualified expenses up to \$250 paid out-of-pocket during the year.

"Congress is likely to revisit tax policy and spending cuts when it tackles the expected increase on the nation's debt limit in February."

**COMMENT.** *Qualified expenses must be reduced by any reimbursements.*

### Exclusion Of Cancellation Of Indebtedness On Principal Residence

Cancellation of indebtedness income is includible in income, unless a particular exclusion applies. This provision excludes from income cancellation of mortgage debt on a principal residence of up to \$2 million. The American Taxpayer Relief Act extends the provision for one year, through 2013.

**IMPACT.** *Homeowners have struggled to keep up with their mortgage payments*

*and have also faced declines in the value of their principal residence. This provision avoids further financial penalties.*

### Transit Benefits

The American Taxpayer Relief Act extends parity in transit benefits through December 31, 2013. These benefits are a tax-free fringe benefit to employees. Parity in the exclusion limit expired after 2011.

### Mortgage Insurance Premiums

This provision treats mortgage insurance premiums as deductible interest that is qualified residence interest. The American Taxpayer Relief Act extends this provision through December 31, 2013. The provision originally expired after 2011.

**IMPACT.** *This provision provides an additional itemized deduction by treating mortgage insurance premiums as deductible qualified residence interest.*

### Contribution of Capital Gains Real Property for Conservation

The Act extends for two years, through December 31, 2013, the special rule for contributions of capital gain real property for conservation purposes. The special rule allows the contribution to be taken against 50 percent of the contribution base. The Act also extends for two years the special rules for contributions by certain corporate farmers and ranchers.

**IMPACT.** *The special rule thus allows a larger charitable contribution.*

### IRA Distributions to Charity

The American Taxpayer Relief Act extends for two years, through December 31, 2013, the provision allowing tax-free distributions from individual retirement accounts to public charities, by individuals age 70½ or older, up to a maximum of \$100,000 per taxpayer each year.

**IMPACT.** *The Act provides special transition rules. One rule allows taxpayers*



to recharacterize distributions made in January 2013 as made on December 31, 2012. The other rule permits taxpayers to treat a distribution from the IRA to the taxpayer made in December 2012 as a charitable distribution, if transferred to charity before February 1, 2013.

## BUSINESS TAX PROVISIONS

Many popular but temporary tax extenders relating to businesses are included in the American Taxpayer Relief Act. Among them are Code Sec. 179 small business expensing, bonus depreciation, the research tax credit, and the Work Opportunity Tax Credit.

**IMPACT.** *Despite predictions by some lawmakers that Congress would allow some of the tax extenders to permanently expire after 2012 (or, for some provisions, like the research credit, to expire after 2011), the American Taxpayer Relief Act extends many extenders, albeit through 2013. Ultimately, the fate of many of the extenders thereafter may be decided if Congress takes up comprehensive tax reform.*

### Code Sec. 179 Small Business Expensing

The American Taxpayer Relief Act extends through 2013 enhanced Code Sec. 179 small business expensing. The Code Sec. 179 dollar limit for tax years 2012 and 2013 is \$500,000 with a \$2 million investment limit. The rule allowing off-the-shelf computer software is also extended.

**IMPACT.** *Without the American Taxpayer Relief Act, the Code Sec. 179 dol-*

*lar limit for tax years beginning in 2012 would have been \$125,000 (subject to inflation adjustment) with a \$500,000 investment limit (again, subject to inflation adjustment). In tax years after 2012, the dollar limit would have reverted to \$25,000 with a \$200,000 investment limit. This significant decrease in the value of the incentive has now been postponed to tax years after 2013.*

### Bonus Depreciation

The American Taxpayer Relief Act extends 50 percent bonus depreciation through 2013. Some transportation and longer period production property is eligible for 50 percent bonus depreciation through 2014.

**IMPACT.** *Bonus depreciation has been used as an economic stimulus in many tax bills in recent years. One hundred percent bonus depreciation generally expired at the end of 2011 (with certain transportation and longer period production property eligible for 100 percent bonus depreciation through 2012).*

**IMPACT.** *Bonus depreciation also relates to the vehicle depreciation dollar limits under Code Sec. 280F, which imposes dollar limitations on the depreciation deduction for the year in which a taxpayer places a passenger automobile in service within a business, and for each succeeding year. If bonus depreciation had not been extended, 2012 would have been the final year in which substantial first-year writeoffs for the purchase of a business automobile may be available.*

**COMMENT.** *To be eligible for bonus depreciation, qualified property must be*

*depreciable under the Modified Accelerated Cost Recovery System (MACRS) and have a recovery period of 20 years or less. These requirements encompass a wide variety of assets. The property must be new and placed in service before January 1, 2014 (January 1, 2015 for certain longer production period property and certain transportation property). Subject to the investment limitations, Code Sec. 179 expensing remains a viable alternative, especially for small businesses. Property qualifying under Code Sec. 179 expensing may be used or new, in contrast to bonus depreciation's "first-use" requirement.*

### Research Tax Credit

The American Taxpayer Relief Act extends through 2013 the Code Sec. 41 research tax credit, which expired after 2011. The incentive rewards taxpayers that engage in qualified research activities with a tax credit.

**IMPACT.** *The research tax credit, which had expired at the end of 2011, enjoys significant bipartisan support in Congress and President Obama has called for making permanent the credit. One obstacle to its extension is its cost, which the Joint Committee on Taxation has estimated to be \$14.3 billion over 10 years.*

**COMMENT.** *Commonly called the research or research and development credit, the incremental research credit may be claimed for increases in business-related qualified research expenditures and for increases in payments to universities and other qualified organizations for basic research. The credit applies to excess of qualified research expenditures for the tax year over the average annual qualified research expenditures measured over the four preceding years.*

### Work Opportunity Tax Credit

The American Taxpayer Relief Act extends through 2013 the Work Opportunity Tax Credit (WOTC), which rewards employers that hire individuals from targeted groups with a tax credit.

## SEQUESTRATION DELAYED TWO MONTHS

The Budget Control Act of 2011 imposed sequestration (across-the-board spending cuts), effective after 2012. The American Taxpayer Relief Act temporarily postpones sequestration for two months. Approximately one-half of the delay will be paid for by allowing and taxing rollovers of funds from applicable retirement accounts (such as 401(k)s) to Roth IRAs. This treatment is estimated to raise \$12.1 billion over 10 years.

**IMPACT.** Under the revived WOTC, employers hiring an individual within a targeted group (generally, otherwise hard-to-employ workers) are eligible for a credit generally equal to 40 percent of first-year wages up to \$6,000. The WOTC is part of the general business credit.

**COMMENT.** The Vow to Hire Heroes Act of 2011 (Heroes Act) extended the WOTC for unemployed veterans and unemployed veterans with service-connected disabilities through 2012. The WOTC for qualified veterans can be as high as \$9,600. The Heroes Act did not extend the non-veteran WOTC provisions. The American Taxpayer Relief Act extends the WOTC for qualified veterans as well as for those within prior targeted groups.

### Qualified Leasehold/Retail Improvements, Restaurant Property

The American Taxpayer Relief Act extends through 2013 the 15-year recovery period for qualified leasehold improvements, qualified retail improvements and qualified restaurant property.

## MORE BUSINESS TAX EXTENDERS

A number of other business tax extenders expired after 2011 and they are extended through 2013 under the American Taxpayer Relief Act. They include, among others:

- New Markets Tax Credit;
- Employer wage credit for activated military reservists;
- Subpart F exceptions for active financing income;
- Look through rule for related controlled foreign corporation payments;
- Railroad track maintenance credit;
- Seven-year recovery period for motorsports entertainment complexes;
- 100 percent exclusion for gain on sale of qualified small business stock;

- Reduced recognition period for S corporation built-in gains tax;
- Enhanced deduction for charitable contributions of food inventory;
- Tax incentives for empowerment zones;
- Indian employment credit;
- Accelerated depreciation for business property on Indian reservations;
- Special expensing rules for qualified film and television productions;
- Mine rescue team training credit;
- Election to expense advanced mine safety equipment;
- Qualified zone academy bonds;
- Low-income tax credits for non-federally subsidized new buildings;
- Low-income housing tax credit treatment of military housing allowances;
- Treatment of dividends of regulated investment companies (RICs);
- Treatment of RICs as qualified investment entities;
- S corporations making charitable donations of property;
- New York Liberty Zone tax-exempt bond financing; and
- Economic development credit for American Samoa.

**Not extended.** Certain business provisions were not extended by the American Taxpayer Relief Act. These include:

- Enhanced deduction for corporate charitable contributions of book inventory;

- Enhanced deduction for corporate charitable contributions of computers;
- Tax incentives for the District of Columbia; and
- Expensing of brownfields remediation costs

## ENERGY INCENTIVES

The American Taxpayer Relief Act extends a number of energy tax incentives, primarily business-related credits. The Act also extends the Code Sec. 25C non-business energy property credit.

### Energy Credits For Individuals

The Code Sec. 25C credit is available to individuals who make energy efficiency improvements to their existing residence. The lifetime credit limit is \$500 (\$200 for windows and skylights) under the 2010 Tax Relief Act. The American Taxpayer Relief Act extends the credit at the \$500 level through December 31, 2013.

### Renewable Resources

The American Taxpayer Relief Act extends through 2013, the Code Sec. 45 production tax credit for facilities that produce energy from wind facilities. The Act also excludes recycled paper from the definition of municipal solid waste.

## CONGRESS ALLOWS IRS TO LEVY ON THRIFT SAVINGS FUND ACCOUNTS

On January 1, 2013, the Senate approved by unanimous consent HR 4365, which clarifies that Thrift Savings Fund accounts are subject to federal tax levy. The House passed HR 4365 in July 2012.

The Federal Employees Retirement System Act of 1986 (FERSA) protects assets in Thrift Savings Fund accounts from levy, subject to certain exceptions. HR 4365 clarifies that the IRS can levy on Thrift Savings Fund accounts to collect unpaid taxes.

HR 4365 requires any revenue generated to be used solely for deficit reduction. In 2012, the Congressional Budget Office (CBO) estimated that HR 4365 would raise \$24 million over 10 years.

**Other energy tax incentives** extended by the American Taxpayer Relief Act through 2013, include:

- Credits for alternative fuel vehicle refueling property;
- Credits for cellulosic biofuel production;
- Credits for biodiesel and renewable diesel;
- Production credits for Indian coal facilities;
- Credit for energy-efficient new homes;
- Credit for energy-efficient appliances;
- Allowance for cellulosic biofuel plant property;
- Special rules for sales of electric transmission property; and
- Tax credits and outlay payments for ethanol.

**No extension.** Certain incentives have not been extended by the American Taxpayer Relief Act:

- Credits for refined coal facilities;
- Percentage depletion for oil and gas from marginal wells (no longer suspended); and
- Grants for certain energy property in lieu of tax credits.

## AFFORDABLE CARE ACT

The American Taxpayer Relief Act amends several provisions of the Patient Protection and Affordable Care Act. The

American Taxpayer Relief Act repeals the CLASS Program (a national voluntary insurance program) and reduces certain loan funding for the Consumer Operated and Oriented Plan program (CO-OP program).

**IMPACT.** *In 2011, HHS announced that it was suspending implementation of the CLASS program. The American Taxpayer Relief Act formally repeals the CLASS program. The American Taxpayer Relief Act authorizes the creation of a special commission to explore development of a long term care program.*



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