

EYE ON CONGRESS

The Advanced Planning Group
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Congress Acts, President Obama Signs Bill into Law

On Wednesday, January 2nd, 2013, H.R. 8, the American Taxpayer Relief Act of 2012 (ATRA) was signed into law. The Act generally extends pre-existing tax levels for most Americans, and temporarily extends many popular tax breaks. The following is a brief overview of ATRA. Some of the primary planning opportunities created by this legislation will be discussed in a future *Eye on Congress*.

Income and Investment Tax Rates: *Bottom line is that income tax rates are higher therefore tax deferred strategies may be preferred, especially by wealthy clients. Gains in tax deferred products are not subject to the higher tax rates until gains are recognized.*

ATRA raises income tax rates on taxable income over \$400,000 for individuals and \$450,000 taxable income for couples, and sets no expiration date for the current or new rates. Below is a chart that reflects the changes from 2012 and 2013 for married joint filers. The changes in bracket amounts are the result of inflation adjustments. Inflation adjustments will continue into the future.

Rates:*	Taxable Income			
	2012 Married Joint Filers		2013 Married Joint Filers	
	Over-	but not over:	Over-	but not over:
10%	\$0	\$17,400	\$0	\$17,900
15%	\$17,400	\$70,700	\$17,900	\$72,500
25%	\$70,700	\$142,700	\$72,500	\$146,400
28%	\$142,700	\$217,450	\$146,400	\$223,050
33%	\$217,450	\$388,350	\$223,050	\$398,350
35%	\$388,350	--	\$398,350	\$450,000
39.6%	Not applicable		\$450,000	--

* Each bracket will be adjusted for inflation in future years.
Rates for 2013 are as projected by CCH Tax Brief published 1/2/13

- › The current long term capital gains and dividend maximum tax rate of 15% has been extended to filers earning below the \$400,000/\$450,000 income levels discussed above. For filers making above the \$400,000/\$450,000 income level, the tax rate on long term capital gains and dividends has been increased to 20%. In addition, investment income may also be subject to the new Medicare surtax discussed below.

- › The Medicare surtax of 3.8% on investment income (enacted under previous legislation with surtax starting in 2013) applies to **investment income**, including dividends and long term capital gains, of taxpayers with modified adjusted gross income (AGI) above \$200,000 (individual)/\$250,000 (married).^{*} This means that the combined rates for taxpayers in the top bracket may be as high as 23.8%. The chart below gives a rough estimate.

Maximum Tax Rates on Long Term Capital Gains and Dividends

	2012	2013 & future
LONG TERM CAPITAL GAINS		
Below \$400/\$450k Adjusted Gross Income	0 to 15%	0 to 18.8%
Above \$400/\$450k Adjusted Gross Income	15%	23.8%
DIVIDENDS		
Below \$400/\$450k Adjusted Gross Income	0 to 15%	0 to 18.8%
Above \$400/\$450k Adjusted Gross Income	15%	23.8%

- › The Personal Exemption Phaseout (PEP) and itemized deduction limitation (temporarily enacted under previous legislation) will **not** apply to reduce deductions for taxpayers making \$250,000 (individual)/\$300,000 (married filing jointly) or less. However, starting in 2013, the PEP and itemized deduction limits (known as the “Pease limitation”) will apply to taxpayers with AGI in excess of \$250,000 (individual)/\$300,000 (married filing jointly).

Estate, Gift and GST Taxes: *Bottom Line is that the new estate tax rates are higher by 5% with no expiration date. Wealthy clients should prepare now for future estate tax liquidity needs.*

- › The federal estate and gift tax exemption equivalent of \$5 million, indexed for inflation, has been made permanent. This unified credit exemption equivalent for 2013 is now at \$5.25 million, after indexing for inflation. Couples can therefore exempt up to \$10.5 million from estate taxes for 2013.
- › The estate tax exemption amount will remain “portable”, meaning that an unused exemption of a first-to-die spouse may be used by the surviving spouse’s estate.
- › The reunification of the estate and gift tax unified credit (\$5,000,000 exemption equivalent with indexing) has also been made permanent.
- › The GST tax exemption is also \$5,000,000, indexed for inflation, (\$5.25 million in 2013).
- › The estate, gift and GST tax rate has increased from 35% to 40% for taxable estates greater than the applicable exemption.

^{*} 3.8% Medicare surtax will be imposed on the lesser of a taxpayer’s (i) net investment income and (ii) the excess of the taxpayer’s modified adjusted gross income over \$200,000 for single taxpayers, \$125,000 for married taxpayers filing separately and \$250,000 for married taxpayers filing jointly. Net investment income includes dividends, interest, passive rental income, income from passive activities, royalties, capital gains and taxable nonqualified annuity distributions.



Income Tax Patches, Extenders and Other Changes: *Bottom line is that AMT relief is here; marriage penalty relief stays intact; and 2% payroll tax holiday is NOT extended.*

The following lists several other income tax provisions that have been enacted under the new law:

- › Provisions Extended with No Expiration Date:
 - Alternative Minimum Tax. For tax years after 2011, ATRA increases the alternative minimum tax exemption to \$50,600 (individual) and \$78,750 (married filing jointly). Significantly, the AMT exemption will be indexed for inflation moving forward.
 - Marriage penalty relief was extended.
- › Provisions Extended for 2012 and 2013:
 - Deduction for state and local general sales taxes.
 - Increased contribution limits and carry-forward period for contributions of appreciated real property for conservation purposes.
 - Tax free distributions from individual retirement plans for charitable purposes (rollovers during January 2013 can count towards 2012).
 - Increase in maximum deduction limit (\$500,000) and phase-out threshold under IRC §179 deduction for purchase of qualifying business equipment.
 - Exclusion on gain of qualified small business stock acquired before January 1, 2014 and held for more than five years.
 - Basis adjusted for stock of S corporations making charitable contributions of property.
 - The five year holding period to avoid built in gains on property sold in 2012 and 2013 by S corporations previously converted from C corporations.

Lastly, other notable developments occurring as part of this legislative process, as well as arising this year pursuant to the Patient Protection and Affordable Care Act include:

- › The 2.0% payroll tax holiday enjoyed by all income earners for the last two years will expire, resulting in an increase in taxes of approximately \$200 per month for those earning the maximum 2013 cap of \$113,700 or more.
- › A .9% surcharge will apply to the employee share of Medicare payroll tax for taxpayers with income over the \$200,000(single)/\$250,000(married filing jointly) thresholds.
- › Roth conversions for all amounts within a 401(k), 403(b) or 457(b) are now permitted, not just amounts distributable to participants.
- › Emergency Unemployment Compensation Program has been continued for one year.

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