We will continue to expand on the provisions of the taxpayer relief act as more information becomes available. If you have any questions please feel free to contact us.

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

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 is expected to quickly 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 article provides an overview of the 2012 Taxpayer Relief Act's key provisions.

Highlights of the 2012 Taxpayer Relief Act include the following:

Elimination of EGTRRA sunsetting. The 2012 Taxpayer Relief Act eliminates the sunsetting provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16). 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. (Sec. 901 of EGTRRA) The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act, P.L. 111-312) 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.

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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 Code Sec. 1411's 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%. (Under the EGTRRA/JGTRRA sunset provisions, long-term capital gain was to be taxed at a maximum rate of 20%, with an 18% rate for assets held more than five years, and dividends paid to individuals were to be taxed at the same rates that apply to ordinary income.)

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. (Under the EGTRRA/JGTRRA sunset provisions, long-term capital gain of lower-income taxpayers was to be taxed at a maximum rate of 10%, with an 8% rate for assets held more than five years, and dividends were to be subject to ordinary income rates.) 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).

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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:

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... 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;

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... 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 also 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).

Business tax breaks extended. The following business credits and special rules are also extended:

... The Code Sec. 41 research credit is modified and retroactively extended for two years through 2013.

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... The temporary minimum low-income tax credit rate for nonfederally subsidized new buildings under Code Sec. 42(b)(2)(A) is extended to apply to housing credit dollar amount allocations made before Jan. 1, 2014.

... The housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds is extended two years.

... The Code Sec. 45A Indian employment tax credit is retroactively extended for two years through 2013.

... The Code Sec. 45D new markets tax credits is retroactively extended for two years through 2013.

... The Code Sec. 45G railroad track maintenance credit is retroactively extended for two years through 2013.

... The Code Sec. 45N mine rescue team training credit is retroactively extended for two years through 2013.

... The Code Sec. 45P employer wage credit for employees who are active duty members of the uniformed services is retroactively extended for two years through 2013.

... The Code Sec. 51 work opportunity tax credit is retroactively extended for two years through 2013.

... Code Sec. 54E qualified zone academy bonds are retroactively extended for two years through 2013.

... The enhanced charitable deduction for contributions of food inventory under Code Sec. 174(e) is retroactively extended for two years through 2013.

... Allowance of the domestic production activities deduction for activities in Puerto Rico, for the first eight tax years of the taxpayer beginning after 2005, and before 2014.

... The exclusion from a tax-exempt organization's unrelated business taxable income (UBTI) of interest, rent, royalties, and annuities paid to it from a controlled entity under Code Sec. 512(b)(13)(E)(iv) is extended through 2013.

... The treatment of certain dividends of regulated investment companies (RICs) as “interest-related dividends” is extended through 2013.

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... The inclusion of RICs in the definition of a “qualified investment entity” under Code Sec. 897(h)(4) is extended through 2013.

... The exception under subpart F for active financing income (i.e., certain income from the active conduct of a banking, financing, insurance, or similar business) under Code Sec. 953(e)(10) and Code Sec. 954(h)(9) for tax years of a foreign corporation beginning after '98, and before 2014, for tax years of foreign corporations beginning after 2005, and 2014.

... Look-through treatment for payments between related controlled foreign corporations (CFCs) under the foreign personal holding company rules under Code Sec. 954(c)(6) is extended through 2013.

... The exclusion of 100% of gain on certain small business stock acquired before 2014.

... The basis adjustment to stock of S corporations making charitable contributions of property under Code Sec. 1367(a) is extended to apply to tax years beginning in 2013.

... The reduction in S corporation recognition period for built-in gains tax under Code Sec. 1374(d)(7) is extended through 2013, with a 5-year period instead of a 10-year period.

... Various empowerment zone tax incentives are extended, including the designation of an empowerment zone and of additional empowerment zones under Code Sec. 1391(d) (through 2013) and the period for which the percentage exclusion for qualified small business stock of a corporation which is a qualified business entity is 60% under Code Sec. 1202(a)(2) (through 2018).

... Tax-exempt financing for the New York Liberty Zone under Code Sec. 1400L(d)(2) is extended for bonds issued before 2014.

... The temporary increase in the limit on cover over run excise taxes to Puerto Rico and the Virgin Islands is extended for spirits brought into the U.S. before 2014.

... The American Samoa economic development credit, as modified, is extended through 2014.

Energy-related tax breaks extended. Various energy credits are extended. These include:

- The nonbusiness energy property credit under Code Sec. 25C for energy-efficient existing homes is retroactively extended for two years through 2013. A taxpayer can claim a 10% credit on the cost of: (1) qualified energy efficiency improvements, and (2) residential energy property expenditures, with a lifetime credit limit of $500 ($200 for windows and skylights).
- The alternative fuel vehicle refueling property credit under Code Sec. 30C is retroactively extended for two years through 2013 so that taxpayers can claim a 30% credit for qualified alternative fuel vehicle refueling property placed in service through 2013, subject to the $30,000 and $1,000 thresholds.
- The credit for 2- or 3-wheeled plug-in electric vehicles under Code Sec. 30D is modified and retroactively extended for two years through 2013.
- The cellulosic biofuel producer credit under Code Sec. 40(b) is modified and extended one year through 2013.
- The credit for biodiesel and renewable diesel under Code Sec. 40A is retroactively extended for two years through 2013.
- The production credit for Indian coal facilities placed in service before 2009 under Code Sec. 45(e)(10) is extended one year. The credit applied to coal produced by the taxpayer at an Indian coal production facility during the 8-year period beginning on Jan. 1, 2006, and sold by the taxpayer to an unrelated person during such 8-year period and the tax year.
- The credits with respect to facilities producing energy from certain renewable resources under Code Sec. 45 is modified and extended one year. A facility using wind to produce electricity will be a qualified facility if it is placed in service before 2014.
- The credit for energy-efficient new homes under Code Sec. 45L is retroactively extended for two years through 2013.
- The credit for energy-efficient appliances under Code Sec. 45M is retroactively extended for two years through 2013.

- The additional depreciation deduction allowance for cellulosic biofuel plant property under Code Sec. 168(l)(2) is modified and extended one year.
- The special rule for sales or dispositions to implement Federal Energy Regulatory Commission (FERC) or State electric restructuring policy for qualified electric utilities is retroactively extended for two years through 2013.
- The alternative fuels excise tax credits under Code Sec. 6426(d)(5) and Code Sec. 6426(e)(3) for sales or use of alternative fuels or alternative fuel mixtures is retroactively extended for two years through 2013.

Pension provision. For transfers after Dec. 31, 2012, in tax years ending after that date, plan provisions in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution under Code Sec. 408A(e).