

### If Everyone is Dissatisfied, It Must Mean There Was a Compromise

January 2, 2013

Just before midnight on January 1, 2013, the House of Representatives adopted the *American Taxpayer Relief Act of 2012*. There were few surprises except, perhaps, the extent to which numerous deduction and credit provisions remain intact. While the Act is expected to raise approximately \$650 billion over the next 10 years, Congress must now contend with a February deadline to address spending reductions and the debt ceiling.

#### Significant Provisions Resulting From the American Taxpayer Relief Act of 2012

- Social Security tax withholding reverts to 6.2 percent from 4.2 percent in 2012 on wages up to \$110,100. This will increase taxes for all wage earners in an amount up to \$2,202.
- A new 39.6 percent tax bracket on “taxable income” in excess of \$400,000 (\$450,000 for married couples). “Taxable income” is calculated after all allowed deductions and exemptions. A separate rate applies to long-term capital gains and qualified dividends.
- A rate increase from 15 to 20 percent on long-term capital gains and qualified dividends for persons in the highest tax bracket (39.6 percent).
  - The Health Insurance High-Income surcharge continues to apply to investment income of individuals with adjusted gross income in excess of \$250,000, effectively raising the rate on long-term capital gains and qualified dividends for higher income individuals to 23.8 percent.
  - For persons taxed at a rate below 25 percent, capital gains and qualified dividends will permanently be subject to a zero percent rate.
- Permanent solution for the Alternative Minimum Tax in that it will now apply only to a person with AMT taxable income in excess of \$50,600 (\$78,750 per married couple). Indexed annually for inflation, the AMT rate for 2013 is 26 or 28 percent, depending on income.
- Reinstatement of the “Pease” limitation on itemized deductions and the Personal Exemption Phaseout.
  - To the extent an individual has adjusted gross income in excess of the threshold (\$250,000 for individuals and \$300,000 for married couples), the amount of itemized deductions is reduced by the lesser of either (a) 3 percent of the excess of adjusted gross income over the threshold or (b) 80 percent of the itemized deductions otherwise allowable. The threshold amount will be adjusted annually for inflation. The limitation does not apply to deductions for medical expenses, investment interest or casualty loss.
  - A taxpayer will have his personal exemption reduced by 2 percentage points for each \$2,500 by which the taxpayer’s adjusted gross income exceeds \$250,000. This income limitation will be adjusted annually for inflation.

- The estate, gift and generation skipping transfer tax exemption amount is \$5,000,000, indexed annually for inflation from 2011 forward. The exemption amount for 2013 is \$5,250,000. Assets in excess of \$5,250,000 (\$10,500,000 per married couple) will be subject to a 40 percent estate tax.
- Portability of the estate tax exemption between spouses is now permanent, allowing a surviving spouse to aggregate the unused estate tax exemption of a deceased spouse with the surviving spouse's exemption.

### Charitable Deductions Favored

The income tax deduction for charitable gifts remains intact, subject to the itemized deduction limitations. In addition, Congress has reinstated the ability by taxpayers over age 70 ½ to make gifts directly to charity from an IRA (thus avoiding income tax).

- To address 2012 charitable gifts:
  - During the month of January 2013, a taxpayer over age 70 ½ may pay an aggregate of up to \$100,000 to one or more public charities directly from his IRA, and the taxpayer may elect to treat such withdrawals as made on December 31, 2012.
  - If a taxpayer withdrew from his IRA during December 2012, the taxpayer may elect to treat up to \$100,000 of the December withdrawal as a direct payment to charity if the taxpayer:
    - paid the amount in cash to a public charity in December 2012 or,
    - pays the cash amount to a public charity by January 31, 2013.
- For 2013, aggregate charitable gifts up to \$100,000 may be made directly from an IRA to a public charity by a person older than age 70 ½. We suggest taxpayers wait until February 2013, to make such gifts to avoid any potential confusion about the tax year.

### Taxpayer-Friendly Deductions and Credits Retained

Despite the call for an overhaul of the tax code, particularly complex deductions and credits, the Act essentially left such matters untouched. In particular, the Act extends the following through 2013:

- Extensions of 2009 Tax Relief
  - 5-year extension of the American Opportunity Credit, Child Tax Credit and Earned Income Tax Credit.
- Individual Tax Extenders through 2013
  - Deduction for state sales tax (continuing a taxpayer's ability to choose either state sales tax or state income tax as an itemized deduction)
  - Deduction above the line for school teacher expenses (\$250)
  - Extension of employer-provided mass transit and parking benefits
  - Exclusion from income of up to \$2 million of forgiven debt on a taxpayer's principal residence if the discharged debt is the result of declining value or the taxpayer's declining financial condition.
  - Non-business energy property credit for energy-efficient homes

## Business Tax Extenders Retained Through 2013

- Research and Development Tax Credit
- Domestic Production Activities Deduction
- New Markets Tax Credit
- Work Opportunity Tax Credit
- Renewable Electricity Production Tax Credit
- Other energy related credits

## New Provision to Permit Transfer of Funds from a Retirement Plan to a Roth IRA

A qualified retirement plan may permit participants to contribute to a Roth account within the retirement plan (not all retirement plans include this flexibility). Roth accounts are funded with taxable dollars. Upon retirement, distributions from Roth accounts are not subject to income tax. If a qualified retirement plan contains this Roth provision, plan participants are now permitted to transfer amounts from the pre-tax portion of the qualified retirement plan to the designated Roth accounts. The transfer will be treated as a taxable qualified rollover contribution to the new Roth retirement account.

## Increased Income Tax Planning Complexity

The Act continues the Congressional pattern of increasing complexity, particularly as it applies to income tax planning. Different thresholds and limitations refer to terms of art such as "adjusted gross income," "ordinary income," "taxable income," "investment income," and "AMT taxable income." No single definition applies universally, each is computed differently. Income tax advisors must be familiar with the exact character of each item of income and deduction in order to plan effectively for taxpayers.

## Important Rates

	IRC Section 7520 Rate	Minimum Applicable Federal Rate Short-term (Monthly)	Minimum Applicable Federal Rate Mid-term (Monthly)	Minimum Applicable Federal Rate Long-term (Monthly)
December	1.2%	0.24%	0.95%	2.38%
January	1.0%	0.21%	0.87%	2.29%
	Rate for determining present value for QPRTs and split-interest time-valued transfers; hurdle rate for new GRATs	Minimum rate to avoid treatment as a below-market loan for intra-family loans for up to 3 years	Minimum rate to avoid treatment as a below-market loan for 3-9 year intra-family loans	Minimum rate to avoid treatment as a below-market loan for intra-family loans for more than 9 years

Wealth Strategy Overview represents a review of issues or topics of possible interest to Glenmede's clients and not personalized tax or investment advice. It contains Glenmede's opinions, which may change after date of publication. Information gathered from third-party sources is assumed reliable but is not guaranteed. Federal tax advice (if any) contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.