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American Taxpayer Relief Act

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After months of proposals and counter-proposals, seemingly endless negotiations and down-to-the-wire drama, Congress has passed legislation to avert the tax side of the so-called "fiscal cliff." The American Taxpayer Relief Act permanently extends the Bush-era tax cuts for lower and moderate income taxpayers, permanently "patches" the alternative minimum tax (AMT), provides for a permanent 40% federal estate tax rate, renews many individual, business and energy tax extenders, and more. In one immediately noticeable effect, the American Taxpayer Relief Act does not extend the 2012 employee-side payroll tax holiday.

The American Taxpayer Relief Act is intended to bring some certainty to the Tax Code. At the same time, it sets the stage for comprehensive tax reform, possibly in 2013. Moreover, the new law creates important planning opportunities for taxpayers.

INDIVIDUALS

Unlike the two-year extension of the Bush-era tax cuts enacted in 2010, the debate in 2012 took place in a very different political and economic climate. If Congress did nothing, tax rates were scheduled to increase for all taxpayers at all income levels after 2012. President Obama made it clear that he would veto any bill that extended the Bush-era tax cuts for higher-income individuals. The President's veto threat gained weight after his re-election. Both the White House and the GOP realized that going over the fiscal cliff would jeopardize the economic recovery, and the American Taxpayer Relief Act is, for the moment, their best compromise.

Tax rates: The American Taxpayer Relief Act permanently extends the Bush-era income tax rates for all taxpayers except for taxpayers with taxable income above certain thresholds:

- $400,000 for single individuals,
- $450,000 for married couples filing joint returns, and
- $425,000 for heads of households.

For 2013 and beyond, the federal income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent. In comparison, the top rate before 2013 was 35 percent. The IRS is expected to issue revised income tax withholding tables to reflect the 2013 rates as quickly as possible and provide guidance to employers and self-employed individuals.

Itemized Deductions and Personal Exemptions: The new law revives the Pease limitation on itemized deductions and personal exemption phase-out (PEP) for higher-income individuals, but at revised thresholds. The new thresholds for both the Pease limitation and PEP after 2012 are:

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

For tax years beginning after 2012, the Pease limitation on itemized deductions, which had previously been suspended, is reinstated for those with adjusted gross income (AGI) in excess of the aforementioned thresholds. 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 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.

For tax years beginning after 2012, the Personal Exemption Phaseout (PEP), which had previously been suspended, is reinstated for those with adjusted gross income (AGI) in excess of the aforementioned thresholds. Under the phase-out, 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.

Capital gains and qualified dividends: The taxpayer-friendly Bush-era capital gains and dividend tax rates are modified by the American Taxpayer Relief Act. Generally, the new law increases the top rate for qualified capital gains and dividends to 20 percent (the Bush-era top rate was 15 percent). The 20-percent rate will apply to the extent that a taxpayer's income exceeds the $400,000/$425,000/$450,000 thresholds discussed above. The 15-percent Bush-era tax rate will continue to apply to all other taxpayers (as will the zero percent for qualified taxpayers within the 15-percent-or-lower income tax brackets).

The new 3.8% surtax on net investment income that takes effect in 2013 as a result of the 2010 health care legislation will impact the overall rate for higher income taxpayers. This new surtax will apply to the *lesser* of:

- Net investment income for the tax year, *or*
- The excess, if any, of modified adjusted gross income over the threshold amount.

The applicable threshold amounts for this surtax are:

- $250,000 for taxpayers filing a joint return or surviving spouses
- $125,000 for married taxpayers filing separate returns, and
- $200,000 for all other taxpayers

Thus the top rate for capital gains for higher income taxpayers will be 18.8% or 23.8%, depending upon modified AGI. Despite these changes, many planning opportunities are still available to take advantage of the tax advantaged rates on qualified dividends and capital gains.

Payroll taxes: The employee-side payroll tax holiday is not extended. Before 2013, the employee-share of OASDI taxes was reduced by two percentage points from 6.2 percent to 4.2 percent up to the Social Security wage base (with a similar tax break for self-employed individuals). For 2013, the two-percent reduction is no longer available and the employee-share of OASDI taxes reverts to 6.2 percent. The employer-share of OASDI taxes remains at 6.2 percent. In 2012, the payroll tax holiday could have saved a taxpayer up to $2,202 (taxpayers earning at or above the Social Security wage base for 2012). As a result of the expiration of the payroll tax holiday, everyone who receives a paycheck or self-employment income will see an increase in taxes in 2013.

Employers should implement the 6.2 percent employee OASDI tax rate as soon as possible, but not later than February 15, 2013. After implementing the 6.2 percent rate, employers should make an adjustment in a subsequent pay period to correct any under-withholding of OASDI tax as soon as possible, but not later than March 31, 2013.

While not part of the American Taxpayer Relief Act, it is important to note that an additional 0.9% surtax will take effect in 2013 as a result of the 2010 health care legislation. This surtax increases the employee share of Medicare tax for wages and self-employment income. The surtax tax is not imposed until an individual's covered wages, compensation and/or self-employment income exceed the threshold amount for the taxpayer's filing status. The threshold amounts are:

- $250,000 for married couples filing a joint return,
- $125,000 for married individuals filing separate returns, and
- $200,000 for all other taxpayers.

Despite the above thresholds and filing statuses, employers must begin to withhold the surtax in any pay period in which year-to-date wages in excess of $200,000 are paid to an employee in a calendar year. This amount is withheld as federal income tax withholding, not Medicare withholding. If both spouses work or if a taxpayer has wage or self-employment income from two sources, taxpayers may be under withheld for this new tax. We would be glad to assist you in determining the appropriate withholding and/or estimated tax payments for 2013 and beyond.

Permanent AMT Relief: In recent years, Congress routinely "patched" the alternative minimum tax (AMT) exemption amount to prevent its encroachment on middle-income taxpayers. The American Taxpayer Relief Act permanently patches the AMT by giving taxpayers higher exemption amounts and other targeted relief. This relief is available beginning in 2012 and going forward. The permanent patch is expected to provide some certainty to planning for the AMT.

Prior to the Act, the individual AMT exemption amounts for 2012 were scheduled to be $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 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, the Act indexes these exemption amounts for inflation.

No single factor automatically triggers AMT liability, but some common factors are itemized deductions for state and local income taxes; itemized deductions for miscellaneous expenses; itemized deductions on home equity loan interest (not including interest on a loan to build, buy, or improve a residence); and significant changes in income. We can help determine if you may be liable for the AMT in 2013 or future years and assist you in taking steps to minimize your exposure to this tax.

Child tax credit and related incentives: The popular $1,000 child tax credit was scheduled to revert to $500 per qualifying child after 2012. Additional enhancements to the child tax credit also were scheduled to expire after 2012. The American Taxpayer Relief Act makes permanent the $1,000 child tax credit. Most of the Bush-era enhancements are also made permanent or extended. Along with the child tax credit, the new law makes permanent the enhanced adoption credit/and income exclusion; the enhanced child and dependent care credit, and the Bush-era credit for employer-provided child care facilities and services.

Education incentives: A number of popular education tax incentives are extended or made permanent by the American Taxpayer Relief Act. The American Opportunity Tax Credit (an enhanced version of the Hope education credit) is extended through 2017. Enhancements to Coverdell education savings accounts, such as the $2,000 maximum contribution, are made permanent. The student loan interest deduction is made more attractive by the permanent suspension of its 60-month rule (which had been scheduled to return after 2012). The new law also extends permanently the exclusion from income and employment taxes of employer-provided education assistance up to $5,250 and the exclusion from income for certain military scholarship programs. In additional, the above-the-line higher education tuition deduction is extended through 2013, as is the teachers' classroom expense deduction. Qualifying for educational incentives can sometimes be tricky, but we can assist you in maximizing the educational benefits that are available to you.

Charitable giving: Congress has long used the tax laws to encourage charitable giving. The American Taxpayer Relief Act extends a popular charitable giving incentive through 2013: tax-free IRA distributions to charity by individuals age 70½ and older up to a maximum of $100,000 per qualified taxpayer per year. The Act provides special transition rules. One such rule allows individuals to recharacterize distributions made in January 2013 as made on December 31, 2012. The other rule permits individuals to treat a December 2012 distribution from the IRA to the individual as a charitable distribution, if transferred to a qualified charity before February 1, 2013. The new law also extends for businesses the enhanced deduction for charitable contributions of food inventory. Many other charitable planning opportunities also remain viable under the Act.

Estate and gift tax: Few issues have complicated family wealth planning in recent years as has the federal estate tax. Recent laws have changed the maximum estate tax rate multiple times. Most recently, the 2010 Tax Relief Act set the maximum estate tax rate at 35 percent with an inflation-adjusted exclusion of $5 million for estates of decedents dying before 2013.
Effective January 1, 2013, the maximum federal estate tax will rise to 40 percent, but will continue to apply an inflation-adjusted exclusion of $5 million (projected to be $5.25 million in 2013). The new law also makes permanent portability between spouses, which effectively raises their combined exemption amount to $10 million, as well as some Bush-era technical enhancements to the estate and generation-skipping transfer taxes.

As a result of the permanent changes to the federal estate tax, Wisconsin's estate tax has been eliminated. Please contact us if you have questions about the applicability of estate taxes in other states.

For those taxpayers who have used their lifetime gift tax exclusion, the annual inflation adjustment to the exclusion amount will provide additional opportunities to gift in the future. Although not part of the American Taxpayer Relief Act, it is important to note that the annual gift tax exclusion has increased to $14,000 for 2013.

BUSINESSES

The business tax incentives in the new law, while not receiving as much press as the individual tax provisions, are valuable. Two very popular incentives – bonus depreciation and small business expensing – are extended, as are many business "tax extenders."

Bonus depreciation/small business expensing: The new law renews 50-percent bonus depreciation through 2013 (2014 in the case of certain longer period production property and transportation property). IRC Section 179 small business expensing is also extended through 2013 with a generous $500,000 expensing allowance and a $2 million investment limit. Without the new law, the expensing allowance was scheduled to plummet to $25,000 with a $200,000 investment limit.

It is important to note that many states, Wisconsin included, have not adopted bonus depreciation and permit Section 179 expensing but at much lower limits.

Also of note, the Act retroactively extends certain depreciation provisions through 2014, including the 15-year straight line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements to name a few.

Small business stock: To encourage investment in small businesses, the tax laws in recent years have allowed non-corporate taxpayers to exclude a percentage of the gain realized from the sale or exchange of small business stock held for more than five years. The American Taxpayer Relief Act extends the 100-percent exclusion from the sale or exchange of small business stock through 2013.

Tax extenders: A host of business tax incentives are extended through 2013. They include the research tax credit, Work Opportunity Tax Credit (WOTC), Indian employment credit, New Markets Tax Credit, tax incentives for empowerment zones, and more.

ENERGY

For individuals and businesses, the new law extends some energy tax incentives. The IRC Section 25C credit, which rewards homeowners who make energy efficient improvements, with a tax credit is extended through 2013. Businesses benefit from the extension of the IRC Section 45 production tax credit for wind energy, credits for biofuels, credits for energy-efficient appliances, and many more.

LOOKING AHEAD

The negotiations and passage of the new law are likely a dress rehearsal for comprehensive tax reform during President Obama's second term. Both the President and the GOP have called for making the Tax Code more simple and fair for individuals and businesses. The many proposals for tax reform include consolidation of the current individual income tax brackets, repeal of the AMT, moving the United States from a worldwide to a territorial system of taxation, and a reduction in the corporate tax rate.

Congress and the Obama Administration also must tackle sequestration, which is an automatic form of spending cutbacks. The American Taxpayer Relief Act delayed sequestration for two months. All this and more is expected to keep federal tax policy in the news in 2013. We will keep you posted on developments.

We have provided you with a synopsis of the most popular tax law changes resulting from the American Taxpayer Relief Act. If you would like to discuss any other aspect of the American Taxpayer Relief Act or if you have any questions about tax savings opportunities that may apply to your specific tax situation, please do not hesitate to contact us.

OTHER TAX UPDATES FOR 2013

Standard Mileage Rate:	
Business	$0.565
Section 179 – Federal:	
Current Depreciation Expense	$500,000
Asset Purchases	$2,000,000
Federal Bonus Depreciation	50%
Health Savings Account Maximum Contribution:	
Self	$3,250
Family	$6,450
Age 55 Catch-Up	$1,000
Retirement Contribution Limits:	
401(k), 403(b), 457, SARSEP	
Under Age 50	$17,500
Age 50+ (w/ catch-up)	$5,500
Simple IRA	
Under Age 50	$12,000
Age 50+ (w/ catch-up)	$2,500
Traditional & Roth IRA	
Under Age 50	$5,500
Age 50+ (w/ catch-up)	$1,000

Payroll Tax Updates

PAYROLL TAX RATES AND LIMITS FOR 2013

Social Security (OASDI) Wage Base	$113,700
Medicare Wage Base	No limit
OASDI Percentage	
- Employer	6.2%
- Employee	6.2%
Maximum OASDI Withholding	
- Employer	$7,049.40
- Employee	$7,049.40
Medicare Percentage	1.45%
Medicare Surtax on wages Over $200,000	0.9%
Maximum Medicare Withholding	No limit
Maximum Federal Unemployment Compensation Wage Base	$7,000
Maximum State Unemployment Compensation Wage Base	$14,000

2013 Wisconsin
Unemployment Tax Rates

Firms with less than $500,000 taxable payroll:

- ❖ Minimum rate - .27%
- ❖ New employer (construction industry) - 6.6%
- ❖ All other new employers - 3.6%

SOCIAL SECURITY TAX

For 2013, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 expired so the two percentage point payroll tax cut for employees is no longer valid and their Social Security tax withholding rate is now 6.2 percent of wages paid. The employer tax rate for social security remains unchanged at 6.2 percent.

The IRS recognizes that the late enactment of these changes makes it difficult for many employers to quickly update their withholding systems. For that reason, the agency asks employers to adjust their payroll systems as soon as possible, but not later than February 15, 2013.

For any Social Security tax over withheld during January, employers should make an offsetting adjustment in workers' pay as soon as possible but not later than March 31, 2013.

The additional 0.9% surtax increases the employee share of Medicare tax for wages. Employers must begin to withhold the surtax in any pay period in which year-to-date wages in excess of $200,000 are paid to an employee. This amount is withheld as federal income tax withholding, not Medicare withholding.

FEDERAL UNEMPLOYMENT TAX (FUTA)

The FUTA tax rate will remain at 6.0%.

- ❖ No deposit is required if the FUTA tax liability for the quarter is $500 or less.
- ❖ If payment is not required for the quarter, the liability incurred is added to the following quarter's liability.
- ❖ If the FUTA tax liability for the quarter is greater than $500 (including any unpaid liability from the previous quarter), a deposit is due the last day of the first month following the end of the quarter.

WISCONSIN UNEMPLOYMENT TAX

Effective January 1, 2013, the unemployment wage base will be increased from $13,000 to $14,000. This means that the first $14,000 of wages earned by each employee for each calendar year will be subject to Wisconsin unemployment taxes.

- Wisconsin unemployment tax payments must be *received* on or before the due date to be considered on time. The latest date an EFT payment can be made and still have a settlement date of the due date, is 4:00 P.M. one business day before the tax due date.

***Remember to update the Wisconsin unemployment wage base and tax rate in your payroll system.**

FEDERAL TAX DEPOSITS REMINDER

As of January 1, 2011, you must use electronic funds transfer to make all federal employment tax deposits. Forms 8109 and 8109-B, Federal Tax Deposit Coupon, cannot be used after December 31, 2010.

Generally, electronic fund transfers are made using the Electronic Federal Tax Payment System (EFTPS). If you do not want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make deposits on your behalf. Also, you may arrange for your financial institution to initiate a same-day tax wire payment on your behalf.

EFTPS is a free service provided by the Department of Treasury. To get more information about EFTPS or to enroll in EFTPS, visit **www.eftps.gov**.

NEW HIRING REMINDERS

All employers must use Form I-9 for new employees. Within three days of being hired, the employee's identity and employment eligibility must be verified. If copies of documents are made, they must be retained with Form I-9. Employers must retain the completed forms for three years after the date of hire or one year after the date employment ends, *whichever is later*.

Form I-9 can be obtained from the internet website at **www.uscis.gov**. These forms can be reproduced, provided both sides are copied. Instructions must be available to all employees completing this form.

Employers are required to report each newly hired employee to the State of Wisconsin within 20 days after the employee starts work. State Form WT-4 or Federal Form W-4 can be used to report via mail or fax. Internet reporting can be completed at **www.dwd.state.wi.us/uinh**.

The WT-4 form can be obtained from the Wisconsin Department of Revenue website at **www.dor.state.wi.us**. The Federal W-4 can be obtained from the internet website at **www.irs.gov**.

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