The Senate passed the American Taxpayer Relief Act last night. We will see what the House does. I will not give a 100 percent accuracy guarantee for the following. If this is correct, we can put estate tax relief in the “done column” if the House follows through.

**INCOME TAX RATES**

Prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”), the rate brackets were 15, 28, 31, 36, and 39.6 percent. The 2001 Act created a new 10-percent regular income tax bracket for a portion of taxable income that was previously taxed at 15 percent. The EGTRRA also reduced the tax rates in excess of 15 percent to 25, 28, 33, and 35 percent, respectively.

Based on the new legislation, on January 1, 2013, the rates and brackets will be configured something like this with a new 39.6 bracket with the lower brackets adjustment to inflation and the top bracket fixed by the new legislation (in later years it is indexed as well). Since the income levels are adjusted for inflation, the exact numbers are not yet available so consider these estimates only

<table>
<thead>
<tr>
<th>If taxable income is:</th>
<th>Then income tax equals:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $8,900:</td>
<td>10% of the taxable income</td>
</tr>
<tr>
<td>Over $8,900 but not over $36,150:</td>
<td>$890 plus 15% of the excess over $8,900</td>
</tr>
<tr>
<td>Over $36,150 but not over $87,550:</td>
<td>$4,978 plus 25% of the excess over $36,150</td>
</tr>
<tr>
<td>Over $87,550 but not over $182,600:</td>
<td>$17,828 plus 28% of the excess over $87,550</td>
</tr>
<tr>
<td>Over $182,600 but not over $397,000:</td>
<td>$44,442 plus 33% of the excess over $182,600</td>
</tr>
<tr>
<td>Over $397,000 but not over $400,000:</td>
<td>$115,194 plus 35% of the excess over $397,000</td>
</tr>
<tr>
<td>Over $400,000:</td>
<td>$116,244 plus 39.6 of the excess over $400,000</td>
</tr>
</tbody>
</table>

There is a phase out of itemized deductions based on hitting a certain income threshold.

**CAPITAL GAINS RATES**

Under present “temporary” law, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate.

Based on the new legislation, for taxable years beginning January 1, 2013, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent for individual taxpayers with taxable income over $400,000 ($450,000 for married couples). It would remain at 15 percent for incomes below that level except any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate.

**DIVIDENDS RATES**

Under the present “temporary” law, an individual’s qualified dividend income is taxed at the same rates that apply to net capital gain. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, an individual’s qualified dividend income is taxed at rates of zero and 15 percent. The zero-percent rate applies to qualified dividend income which otherwise
would be taxed at a 10- or 15-percent rate if the special rates did not apply.

The new legislation continues the dividends rates link to the capital gains rates, so for taxable years beginning January 1, 2013, an individual’s qualified dividend income is taxed at rates of zero, 15 percent or 20 percent depending on income levels.

**ESTATE TAX**

Under the new legislation the exemption will be $5 million inflation adjusted (It is $5.12 million for 2012). Spousal portability of the exemption (unused exemption of a deceased spouse can be used by the surviving spouse) and other revisions made by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The top marginal rate will be 40 percent.

Effective January 1, 2013, the tax schedule for the estate tax will be:

Not over $10,000: 18 percent of such amount.

Over $10,000 but not over $20,000: $1,800, plus 20 percent of the excess of such amount over $10,000.

Over $20,000 but not over $40,000: $3,800, plus 22 percent of the excess of such amount over $20,000.

Over $40,000 but not over $60,000: $8,200 plus 24 percent of the excess of such amount over $40,000.

Over $60,000 but not over $80,000: $13,000, plus 26 percent of the excess of such amount over $60,000.

Over $80,000 but not over $100,000: $18,200, plus 28 percent of the excess of such amount over $80,000.

Over $100,000 but not over $150,000: $23,800, plus 30 percent of the excess of such amount over $100,000.

Over $150,000 but not over $250,000: $38,800, plus 32 percent of the excess of such amount over $150,000.

Over $250,000 but not over $500,000: $70,800, plus 34 percent of the excess of such amount over $250,000.

Over $500,000 but not over $750,000: $155,800, plus 37 percent of the excess of such amount over $500,000.

Over $750,000 but not over $1,000,000: $248,300, plus 39 percent of the excess of such amount over $750,000.

Over $1,000,000: $345,800, plus 40 percent of the excess of such amount over $1,000,000.

**DIRECT EXPENSING**

Internal Revenue Code Section 179 allows business to write off small amount of annual investment in capital assets such as machinery in the year of purchase in lieu of depreciating the investment over a number of years. While it commonly referred to as a small business provision, there is no size limitation on business eligibility. The allowance is reduced and eliminated completely the more capital assets a business buys during the year.

The bill “saved” the provision from reverting to pre-2001 levels of $25,000 as the amount that can be written off and $200,000 as the purchase amount “cap”. Unfortunately, the amounts will revert to those pre-2001 levels without indexing, in 2014.

Under the new legislation, for 2013, the amounts are increased back to what they were in 2011, $500,000 as the amount that can be written off in a year and a taxpayer cannot use the provision if more than $2,000,000 of equipment and machinery is purchased in the year. Neither amount is inflation indexed.

**BONUS DEPRECIATION**

Under the new legislation, the 50 percent depreciation bonus that was set to expire would be extended for another year through 2013.

**ALTERNATIVE MINIMUM TAX**

A creation of the 60’s, the alternative minimum tax (AMT) was designed to make sure the wealthy paid taxes. The AMT applied if taxpayers had income over certain levels. The income levels were not inflation indexed. Over the years, Congress applied “patches” to the income levels,
adjusting them for inflation. The last patch actually expired at the end of 2011. As a result, the lower income levels were scheduled to apply to 2012 income.

The new legislation applies a permanent patch with inflation indexing.

The levels that apply to your 2012 income are $78,750 for married couples filing jointly and $50,600 for individuals.

**PAYROLL TAXES**

A refresher on terminology is necessary for the first two tax increases for 2013.

Under the Federal Insurance Contributions Act (FICA), employers pay a tax based on the amount of wages paid to an employee during the year. The tax imposed is composed of two parts: the Old Age, Survivors, and Disability Insurance ((OASDI) and sometimes referred to as the (“Social Security tax”) tax equal to 6.2 percent of covered wages up to the taxable wage base ($113,700 for 2013); and the Medicare Hospital Insurance (HI) tax amount equal to 1.45 percent of covered wages.

In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer (the “employee portion”). The employee portion of FICA taxes is withheld and remitted to the Federal government by the employer. The same wage base rules apply.

**SOCIAL SECURITY TAX HOLIDAY OVER**

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reduced the OASDI rate by two percentage points to 4.2 percent for the employee portion of the FICA tax. Similarly, for taxable years beginning in 2011, two percentage points to 10.4 percent reduced the OASDI rate for a self-employed individual. The Temporary Payroll Tax Cut Continuation Act of 2011 extended that two-percentage point reduction through the end of February 2012. In 2012, the Middle Class Tax Relief and Job Creation Act of 2012 (MCTRJCA) extended the temporary two-percentage point payroll tax “holiday” for employees (and to the same extent, to the self-employed) through the end of 2012.

Effective January 1, 2013, the OASDI tax rate for employees returns to 6.2 percent (and comparable return in the self-employment tax).

**NEW TAXES**

The health care reform law, the Patient Protection and Affordable Care Act (PPACA) included two tax increases that take effect on January 1, 2013.

**NEW HI TAX INCREASE**

The first of those two is also a “payroll tax” increase. Effective January 1, 2013, the Hospital Insurance (HI) trust portion) of the payroll tax increases to 2.35 percent from 1.45 percent (i.e. a 0.9 increase) on the wages or self-employment income over $200,000 for an individual return and $250,000 for a joint return. There is no limit on the amount of wages or self-employment income that is subject to the tax (unlike the social security portion of the FICA tax, which has a wage cap). This is an increase in the employee’s share only. The employer will continue to pay its 1.45 percent rate share on the employee’s wages. In the case of the self-employed, they will pay “only” the additional 0.9 percent on the income above the $200,000/$250,000 threshold.
The second tax new tax effective January 1, 2013, that comes to us courtesy of PPACA, is a bit more complicated.

PPACA established a new “Unearned Income Medicare Contribution” (UIMC) tax. The IRS is calling it the “Net Investment Income Tax” or the “NIIT.” This tax applies to “net investment income” which is interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). The rate is 3.8 percent. The NIIT on net investment income will not apply if modified adjusted gross income is less than $250,000 in the case of a joint return, or $200,000 in the case of a single return.

The tax is paid when you file your tax return for the year. Since the tax is effective on January 1, 2013, the first time most taxpayers will include the tax will be in 2014 when they file their returns for tax year 2013. However, if you pay estimated taxes during the year the IRS observes, taxpayers “should adjust their income tax withholding or estimated payments to account for the tax increase in order to avoid underpayment penalties.”

The IRS has a page that is a good starting point for information on this new tax: http://www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs