ICS Insurance Consulting Services, Inc

DUE CARE BULLETIN

January 2013

# A Summary of the American Taxpayer Relief Act of 2012

*Life insurance due care requires an understanding of the factors that impact policy performance and drive product selection.*

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On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (the Act). The legislation increases federal income tax rates on higher income Americans, preserves the unification of the federal gift and estate tax, extends unemployment benefits, and addresses a wide range of other tax and spending measures. In addition, the bill delays for two months the automatic spending cuts that were originally scheduled to take effect January 1, 2013.

Below is a summary of the key provisions of the Act.

## Transfer Taxes

The Act permanently unifies the federal gift and estate tax systems, as was the case in 2011 and 2012. The top federal tax rate has been increased to 40%. The exemption level remains at $5,000,000 ($10,000,000 for couples), indexed annually for inflation since 2011, expected to result in a $5.25 million exemption for gifts made in 2013 and estates of descendents dying in 2013.

The Generation-Skipping Tax (GST) exemption is expected to also be $5.25 million for 2013.

## Alternative Minimum Tax (AMT)

The Act provides permanent changes to the AMT and provides that the exemption amount used in its calculation will be adjusted in future years for inflation.

Alternative Minimum Taxable Income is calculated by taking taxable income, modifying it with various adjustments, and then subtracting an AMT exemption amount. Alternative Minimum Taxable Income is subject to tax at a rate of 26% or 28%.

The Act retroactively increases the AMT exemption for 2012 as follows:

- $50,600 for unmarried filers (up from $33,750)
- $78,750 for joint filers (up from $45,000)
- $39,375 for married persons filing separately (up from $22,500)

These amounts are indexed for inflation for tax years beginning after 2012.

In addition, the Act permanently allows an individual to offset the entire regular tax liability and AMT liability by certain nonrefundable personal credits.

## Income Tax Rates

For tax years beginning after 2012, a new top income tax rate of 39.6% will be introduced, and will apply to:

- Joint filers and surviving spouses with income of $450,000 and above
- Heads of Household with income of $425,000 and above
- Single filers with income of $400,000 and above
- Married taxpayers filing separately with income of $225,000 and above

These dollar amounts are inflation adjusted for tax years after 2013.

Income tax rates will stay at 10%, 15%, 25%, 28%, 33%, and 35% for taxpayers with income under these threshold amounts.

In addition, the Affordable Care Act instituted a new 0.9% Medicare surtax that will be imposed on wages in excess of $200,000 of income for individuals and $250,000 for couples, bringing the total Medicare Tax on such wages to 2.35%.

## Personal Phase-out Exemption and Pease Limitations

Personal Exemption Phase-out (PEP) and "Pease" limitations are reinstated for "high earners," defined as follows:

- Joint filers and surviving spouses with Adjusted Gross Income (AGI) of $300,000 and above
- Heads of Household with AGI of $275,000 and above
- Single filers with AGI of $250,000 and above
- Married taxpayers filing separately with AGI of $150,000 and above

These dollar amounts are inflation adjusted for tax years after 2013.

Under the PEP, the total amount of exemptions a taxpayer may claim is reduced by 2% for each $2,500 by which the taxpayer's AGI exceeds these thresholds.

Under the "Pease" limitations, the total amount of itemized deductions a taxpayer may claim is reduced by 3% of the amount by which the taxpayer's AGI exceeds the thresholds, with the reduction not to exceed 80% of otherwise allowable itemized deductions.

## Capital Gains and Dividend Rates

Capital Gains and Dividend Taxes will be assessed at a rate commensurate with taxpayers' ordinary income.

- Taxpayers whose ordinary income is generally taxed below 25% will not be subject to taxes on capital gains and dividends
- Taxpayers who are taxed at a 25% or greater rate on ordinary income, but whose income is below $400,000 ($450,000 for married taxpayers) will continue to be taxed at a 15% rate
- Taxpayers whose ordinary income exceeds $400,000 ($450,000 for married taxpayers) will be taxed at a 20% rate

In addition, the previously instituted Affordable Care Act included a 3.8% Medicare surtax that will apply on investment-type income and gains.  This taxed is assessed on the lesser of the following two amounts:

- The individual's net investment income, or
- The excess of the individual's modified adjusted gross income over the applicable threshold ($200,000 for individuals; $250,000 for joint filers)

## Social Security Payroll Tax

The 2% cut that applied for 2011 and 2012 will lapse, restoring the Social Security payroll tax to 6.2%.

## Tax Extenders Affecting Individuals and Families

The Act also provides for various extensions of exclusions, deductions, and credits impacting individuals and families, including:

- An exclusion for the discharge of qualified principal residence indebtedness will continue to apply for discharges before January 1, 2014
- A five-year extension of the American Opportunity tax credit, which provides a maximum $2,500 tax credit for college tuition and related expenses
- A five-year extension of the Child Tax Credit qualification rules that were eased as part of the American Recovery and Investment Tax Act of 2009
- A five-year extension of various Earned Income Tax Credit (EITC) provisions related to taxpayers with three or more children; the income threshold phase amounts for these credits will also be increased

## A Summary of the American Taxpayer Relief Act of 2012 (continued)

In addition, the following items are retroactively reinstated for 2012 and continue through 2013:

- An above-the-line deduction for qualified tuition and related expenses
- An option to deduct State and local general sales taxes
- Treatment of mortgage insurance premiums as qualified residence interest
- Extension of the Charitable IRA Rollover, which permits donors age 70½ to make a tax-free transfer of up to $100,000 from an Individual Retirement Account to a public charity, resulting in a 100% charitable deduction not subject to the normal charitable giving limit of 50% of AGI

### Tax Extenders Affecting Businesses

Among a wide range of business-specific credits, exclusions, deductions, and special rules extensions, the following will impact many businesses:

- Accelerated "bonus" depreciation treatment of business investments in equipment and new property will be extended for one year
- Tax credits for certain research and development costs will be extended for one year
- Section 179 asset expensing is continued for one year at $500,000
- The exclusion for employer provided mass transit benefits has been increased from $125 to $240 month for one year
- Employer provided education assistance is permanently extended to allow for up to $5,250 per year in assistance to be excluded from an employee's gross income

### Other Important Provisions

- **401(k) Plan In-Plan Roth Conversions:** Participants in 401(k) plans with a Roth feature may transfer their pre-tax 401(k) accounts to Roth accounts within the plan even if the account is not otherwise available for a distribution from the 401(k) plan. Such transfers could occur even if the plan participant is still an active employee of the plan sponsor and prior to age 59½. Transfer of a pre-tax deferral account to a Roth account is a taxable event.
- **CLASS Act Repeal:** The federal CLASS Act Program is discontinued and replaced with a federal Commission on Long Term Care that will study and recommend to Congress ways to address Americans' long-term care needs. Plans are for the Commission to include 15 representatives from federal and state agencies, providers of long-term care insurance and services, and consumers.
- **Medicare Reimbursements to Doctors:** The Act blocks a 27% cut in Medicare payments to doctors for one year.
- **Unemployment Benefits:** Jobless benefits for the long-term unemployed are extended for one year.
- **Sequestration Delay:** $109 billion worth of automatic across-the-board spending cuts have been deferred until March 1, 2013. Absent additional legislation, which is likely to come, these spending cuts will impact a wide sector of government and non-government institutions.

## For More Information

To learn more, please contact:

Jim Pittman
Insurance Consulting Services, Inc.
jim@icspdx.com
503.542.4085
www.icspdx.com