Nardone Law Group ("NLG") Summary of Tax Law Changes:

In the early morning hours of January 1, 2013, the Senate, by a vote of 89-8, passed H.R.8, the "American Taxpayer Relief Act" (the "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 Act. The Act, which Obama quickly signed into law, will prevent 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. But, it will also increase income taxes for some high-income individuals and slightly increase transfer tax rates. This article provides an overview of the Act's key provisions.

1. **Tax Rates.** For tax years beginning after 2012, the income tax rates for 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 "Economic Growth Tax Relief Reconciliation Act" (the "EGTRRA") sunset—but with a 39.6% rate applying for income above a certain threshold. The threshold for the 39.6% rate is 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 for married taxpayers filing separately (one-half of the otherwise applicable amount for joint filers). These dollar amounts are inflation-adjusted for tax years after 2013.

   NLG Comment: By having the adjusted inflation kick in, we avoid the debacle and difficulty of having to extend this provision each year, like the alternative minimum tax ("AMT") patch.

2. **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 surviving spouses; $275,000 for heads of household; $250,000 for single filers; and $150,000 for married taxpayers filing separately (one-half of the otherwise applicable amount for joint filers). 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 adjusted gross income ("AGI") exceeds the applicable threshold. These dollar amounts are inflation-adjusted for tax years after 2013.

3. **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 surviving spouses, $275,000 for heads of household, $250,000 for single filers, and $150,000 for married taxpayers filing separately (one-half of the otherwise applicable amount for joint filers). 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 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.

4. **Capital Gain and Dividend Rates.** 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). And, taking into consideration the 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%. This is a significant increase. Under the EGTRRA/"Jobs and Growth Tax Relief Reconciliation Act" ("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 not be taxed. That is, the rate is 0%. 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 surtax.

5. **Estate Tax and Estate Planning.** The Act provides for a permanent exemption level of $5,000,000 for estate, gift, and generation-skipping transfer ("GST") tax—as indexed for inflation. But, the Act also permanently increases the top estate, gift, and GST tax rate from 35% to 40%. The 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.

6. **Permanent AMT Relief.** The Act provides permanent 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%.

   NLG Comment: All I can say is, it is about time.

   Prior to the 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 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.

7. **Miscellaneous Credits**. Prior to the Act, the 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—were to be allowed only to the extent that the individual's regular income tax liability exceeded their tentative minimum tax, determined without regard to the minimum tax foreign tax credit. Retroactively effective for tax years beginning after 2011, the Act permanently allows individuals to offset their entire regular tax liability and AMT liability by the nonrefundable personal credits.

8. **Recovery Act Extenders.** The Act extends, for a period of five years, the following items that were originally enacted as part of the American Recovery and Investment Tax Act of 2009 and were slated to expire:

   a. 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);

b. Eased rules for qualifying for the refundable child credit; and

c. 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.

9. **Historical Individual Extenders.** The Act extends the following items for beyond their prior termination date as shown in the listing below:

a. The deduction for certain expenses of elementary and secondary school teachers, which expired at the end of 2011 and is now revived for 2012, and will continue through 2013;

b. The exclusion for discharge of qualified principal residence indebtedness, which applied for discharges before January 1, 2013 and is now continued to apply for discharges before January 1, 2014;

c. Parity for the exclusions for employer-provided mass transit and parking benefits, which applied before 2012 and is now revived for 2012 and will continue through 2013;

d. The treatment of mortgage insurance premiums as qualified residence interest, which expired at the end of 2011 and is now revived for 2012 and will continue through 2013;

e. The option to deduct state and local general sales taxes, which expired at the end of 2011 and is now revived for 2012 and will continue through 2013;

f. The special rule for contributions of capital gain real property made for conservation purposes, which expired at the end of 2011 and is now revived for 2012 and will continue through 2013;

g. The above-the-line deduction for qualified tuition and related expenses, which expired at the end of 2011 and is now revived for 2012 and will continue through 2013; and

h. Tax-free distributions from individual retirement plans for charitable purposes, which expired at the end of 2011 and is now revived for 2012 and will continue 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 December 31, 2012.

10. **Depreciation Provisions Modified and Extended.** The following depreciation provisions are retroactively extended by the Act through 2014:

    a. 15-year straight line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;

    b. 7-year recovery period for motorsports entertainment complexes;

    c. Accelerated depreciation for business property on an Indian reservation;

    d. Increased expensing limitations and treatment of certain real property as §179 property;

    e. Special expensing rules for certain film and television productions; and

    f. The election to expense mine safety equipment.

The Act also extends and modifies the bonus depreciation provisions with respect to property placed in service after December 31, 2012, in tax years ending after that date.

11. **Business Tax Breaks Extended.** The following business credits and special rules are also extended:

    a. The §41 research credit is modified and retroactively extended for two years through 2013;

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

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

    d. The §45A Indian employment tax credit is retroactively extended for two years through 2013;

    e. The §45D new markets tax credits is retroactively extended for two years through 2013;

    f. The §45G railroad track maintenance credit is retroactively extended for two years through 2013;

    g. The §45N mine rescue team training credit is retroactively extended for two years through 2013;

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

i. The §51 work opportunity tax credit is retroactively extended for two years through 2013;

j. The §54E qualified zone academy bonds are retroactively extended for two years through 2013;

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

l. Allowance of the domestic production activities deduction for activities in Puerto Rico, for the first eight tax years of the taxpayer beginning after December 31, 2005, and before January 1, 2014;

m. 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 §512(b)(13)(E)(iv) is extended through December 31, 2013;

n. Treatment of certain dividends of regulated investment companies ("RIC"s) as "interest-related dividends" is extended through December 31, 2013;

o. Inclusion of RICs in the definition of a "qualified investment entity" under §897(h)(4) is extended through December 31, 2013;

p. 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 §953(e)(10) and §954(h)(9) for tax years of a foreign corporation beginning after December 31, 1998, and before January 1, 2014, for tax years of foreign corporations beginning after December 31, 2005, and before January 1, 2014;

q. Look-through treatment for payments between related controlled foreign corporations ("CFC"s) under the foreign personal holding company rules under §954(c)(6) is extended through January 1, 2014;

r. Exclusion of 100% of gain on certain small business stock acquired before Jan. 1, 2014;

s. Basis adjustment to stock of S corporations making charitable contributions of property under §1367(a) in tax years beginning before December 31, 2013;

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

u. Various empowerment zone tax incentives, including the designation of an empowerment zone and of additional empowerment zones under §1391(d) are extended through December

31, 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 §1202(a)(2) (extended through December 31, 2018);

v. Tax-exempt financing for New York Liberty Zone under §1400L(d)(2) is extended for bonds issued before January 1, 2014;

w. Temporary increase in limit on cover over run excise taxes to Puerto Rico and the Virgin Islands is extended for spirits brought into the U.S. before January 1, 2014; and

x. American Samoa economic development credit, as modified, is extended through January 1, 2014.

12. **Pension Provision.** For transfers after December 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 §408A(e).

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