Willson & Pechacek, P.L.C. Newsletter

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THE EFFECT OF THE 2012 AMERICAN TAXPAYER RELIEF ACT ON INDIVIDUAL INCOME TAXES

The recently enacted 2012 American Taxpayer Relief Act signed by President Obama on January 2, 2013 includes, among many other items, "permanent" extension of the Bush-era tax cuts for most taxpayers, revised tax rates on ordinary and capital gain income for high-income individuals, modification of the estate tax, "permanent" relief from the AMT for individual taxpayers, limits on the deductions and exemptions of high-income individuals, and a host of retroactively resuscitated and extended tax breaks for individual and businesses. When you hear that these tax provisions are "permanent", do not be fooled into thinking that these tax provisions cannot be changed. The 2012 Act simply eliminated the provision in the previous Bush-era tax cuts that call for the tax provisions to sunset or revert back to the previous tax provisions. Therefore, the provisions of the Bush-era tax cuts were made "permanent" and no longer automatically sunset in future years. Here's a look at the some of the key provisions of the tax bill:

• *Tax rates*. For tax years beginning after 2012, the 10%, 15%, 25%, 28%, 33% and 35% tax brackets from the Bush tax cuts will remain in place and are made permanent. This means that for most Americans, the tax rates will stay the same.

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Differences in Federal and Iowa Tax Laws due to 2012 Taxpayer Relief Act

At the time of this publication, the Iowa Department of Revenue had the following to say with regards to potential changes in the Iowa Tax law and 2012 tax forms as a result of the federal 2012 Taxpayer Relief Act.

The federal legislation passed on January 1, 2013 to avert the "fiscal cliff" included provisions for what are commonly referred to as the federal "extenders." The federal "extenders" are not currently reflected on Iowa tax forms for 2012 and will require approval by the Iowa legislature before being allowed for Iowa tax purposes. Should legislative approval be given, Iowa online forms will be updated accordingly. The federal extender provisions include:

* Educator Expenses (Line 24; IA 1040)

* Tuition and Fees (Line 24; IA 1040)

* Itemized Deduction for State Sales / Use Tax Paid (Line 4; IA Schedule A)

* The federal section 179 expensing limit of $500,000 for 2012 and 2013

* Treatment of mortgage insurance premiums as qualified residence interest (line 11, Schedule A)

Iowa income tax returns must be filed based upon current Iowa law. Therefore, the extenders should not be included on Iowa returns at this time.

Due to the fact there may or may not be Iowa approval of these federal tax law changes, there could be a substantial delay before 2012 Iowa tax forms are finalized. In addition to the IRS changing the necessary federal tax forms, there could be a substantial delay in filing returns for 2012.

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However, there will be a new 39.6% rate, which will begin at the following thresholds: $400,000 (single), $425,000 (head of household), $450,000 (joint filers and qualifying widow(er)s), and $225,000 (married filing separately. These dollar amounts will be inflation-adjusted for tax years after 2013.

- ***Estate tax***. The new law prevents steep increases in estate, gift and generation-skipping transfer (GST) tax that were slated to occur for individuals dying and gifts made after 2012 by permanently keeping the exemption level at $5,000,000 (as indexed for inflation). However, the new law also permanently increases the top estate, gift, and GST rate from 35% to 40% It 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.

- ***Capital gains and qualified dividends rates***. The new law retains the 0% tax rate on long-term capital gains and qualified dividends, modifies the 15% rate, and establishes a new 20% rate. Beginning in 2013, the rate will be 0% if income falls below the 25% tax bracket; 15% if income falls at or above the 25% tax bracket but below the new 39.6% rate; and 20% if income falls in the 39.6% tax bracket. It should be noted that the 20% top rate does not include the new 3.8% surtax on investment-type income and gains for tax years beginning after 2012, which applies on investment income above $200,000 (single) and $250,000 (joint filers) in adjusted gross income. So actually, beginning in 2013, the top rate for capital gains and dividends will be 23.8% if income falls in the 39.6% tax bracket. For lower income levels, the tax will be 0%, 15%, or 18.8%.

- ***Personal exemption phaseout***. Beginning in 2013, personal exemptions will be phased out (i.e., reduced) for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers). Taxpayers claim exemptions for themselves, their spouses and their dependents. Last year, each exemption was worth $3,800.

- ***Itemized deduction limitation.*** Beginning in 2013, itemized deductions will be limited for adjusted gross income over $250,000 (single), $275,000 (head of household) and $300,000 (joint filers).

- ***Pension provisions.*** For transfers after Dec. 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.

- ***AMT relief***. The new law provides permanent alternative minimum tax (AMT) relief. 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 new law 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.

- ***Tax credits for low to middle wage earners.*** The new law extends for five years the following items that were originally enacted as part of the 2009 stimulus package and were slated to expire at the end of 2012: (1) the American Opportunity tax credit, which provides up to $2,500 in refundable tax credits for undergraduate college education; (2) eased rules for qualifying for the refundable child credit; and (3) various earned income tax credit (EITC) changes.

- **Payroll tax cut is no more.** The 2% payroll tax cut was allowed to expire at the end of 2012.

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BUSINESS CHANGES OF 2012 AMERICAN TAXPAYER RELIEF ACT

The 2012 American Taxpayer Relief Act includes an array of tax changes affecting both individuals and business. For businesses, two of the most significant changes provide incentives to invest in machinery and equipment by allowing for faster cost recovery of business property.

Enhanced small business expensing (Section 179 expensing). Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is "capitalized" and depreciation deductions are allowed for most property (other than land), but are spread out over a period of years. However, to help small businesses quickly recover the cost of capital outlays, small business taxpayers can elect to write off these expenditures in the year they are made instead of recovering them through depreciation. The expense election is made available, on a tax year by tax year basis, under Section 179 of the Internal Revenue Code, and is often referred to as the "Section 179 election". The new law makes three important changes to the Code Section 179 expense election.

First, the new law provides that for tax years beginning in 2012 or 2013, a small business taxpayer will be allowed to write off up to $500,000 of capital expenditures subject to a phaseout (i.e., gradual reduction) once capital expenditures exceed $2,000,000. For tax years beginning after 2013, the maximum expensing amount will drop to $25,000 and the phaseout level will drop to $200,000. Before this law was passed, the Section 179 allowable was going to be $139,000 for 2013 and $25,000 for 2013.

Second, the new law extends the rule which treats off-the-shelf computer software as qualifying property through 2013.

Finally, the new law extends through 2013 the provision permitting a taxpayer to amend or irrevocably revoke an election for a tax year under Section 179 without IRS' consent.

Extension of additional first-year depreciation.

Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, by permitting an additional first year write off of the cost. For qualified property acquired and placed in service after December 31, 2011 and before January 1, 2013 (before January 1, 2014 for certain longer-lived and transportation property), the additional first-year depreciation was 50% of the cost. The new law extends this additional first-year depreciation for investments placed in service before January 1, 2014 (before January 1, 2015 for certain longer-lived and transportation property).

The new law also extends for one year the election to accelerate the AMT credit instead of claiming additional first-year depreciation.

The new law leaves in place the existing rules as to what kinds of property qualify for additional first-year depreciation. Generally, the property must be (1) depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified leasehold improvements. Also, the original use of the property must commence with the taxpayer—used machinery doesn't qualify.

As a reminder, at this time, the Iowa tax rules do not allow the use of the 50% bonus depreciation nor have they been coupled with the federal law raising the Section 179 expensing limit from $139,000 in 2012 and $25,000 in 2013 to the federal limit of $500,000.

Please contact us if you have any questions regarding how the 2012 American Taxpayer Relief Act will impact your 2012 income tax return or your 2013 income tax planning.

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- **Child Tax Credit**. The new law extends the $1,000 child tax credit that was scheduled to revert back to $500.

- **Tax break extenders.** Many of the "traditional" tax extenders are extended for two years, retroactively to 2012 and through the end of 2013. Among many others, the extended provisions include the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes, the $250 above-the-line deduction for certain expenses of elementary and secondary school teachers and the itemized deduction for mortgage insurance premiums as deductible interest that is qualified residence interest.

CLARINDA OFFICE

The firm continues to staff an office in Clarinda, Iowa, located at 101 East Main, phone number 712-542-1070. Lee Rankin of the firm will be in the Clarinda office on Tuesdays and Fridays.

2012 TAX RETURN PREPARATION

If you haven't already made your appointment for tax preparation, please call our office and schedule an appointment today. We look forward to assisting you in the preparation and filing of your 2012 income tax returns.