

Congress Passes Fiscal Cliff Solution; President Signs into Law

What it means to you in 2013

After days of negotiations, fraught with the possibility of deadlock and failure, the terms of a fiscal cliff resolution have finally been successfully negotiated. Early on January 1, 2013, the Senate approved the "American Taxpayer Relief Act" by a vote of 89 to 8. Later in the same day, the House of Representatives followed suit and passed the bill by a vote of 257 to 167. The President quickly signed and enacted the bill into law.

THE MAJOR TAX PROVISIONS ARE AS FOLLOWS:

- The income tax rate increases to 39.6% (up from 35%) for individuals making more than \$400,000 a year (\$450,000 for joint filers; \$425,000 for heads of household)
- The two-percentage-point reduction in payroll taxes for Old Age, Survivors and Disability Insurance (OASDI) tax, commonly known as the Social Security tax, will be allowed to expire. OASDI tax on the first \$113,700 of earned income will increase from 4.2% in 2012 to 6.2% in 2013
- The higher exemption amounts for alternative minimum tax (AMT) of \$50,600 for unmarried and \$78,750 for married taxpayers filing jointly (the so-called "patch") are made permanent, resulting in an estimated 30 million taxpayers escaping being subject to the AMT
- Dividends and capital gains are taxed at 20% (up from 15%) for individuals making at least \$400,000 (\$450,000 for joint returns). This change, combined with the additional 3.8% surtax on investment income, means that many "higher income" taxpayers will pay a 23.8% tax on long-term and a 43.4% tax on short-term capital gains in 2013
- The Personal Exemption Phase-out (PEP), which had previously been suspended, is reinstated with starting thresholds of: \$300,000 for joint filers and a surviving spouse; \$275,000 for heads of household; \$250,000 for single filers; and \$150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. Under the phase-out, the total amount

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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

- The “Pease” limitation on deductions, which had previously been suspended, is reinstated with a threshold of: \$300,000 for joint filers and a surviving spouse; \$275,000 for heads of household; \$250,000 for single filers; and \$150,000 (one-half of the otherwise applicable amount for joint filers) for married taxpayers filing separately. 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
- For estate, gift, and generation-skipping transfer (GST) tax purposes; for individuals dying; and for gifts made after 2012; there is a \$5 million exemption (adjusted for inflation), and the top estate, gift and GST rate is permanently increased from 35% to 40%. (Additionally, “portability” becomes permanent. With portability, a spouse’s estate exemption will be increased by the unused estate tax exemption of their spouse)
- Tax credits for businesses, including the research credit and the domestic production activities deduction, are generally extended through the end of 2013
- A number of individual tax provisions have been retroactively extended through 2013. These include: the adoption credit/assistance, projected

to be \$12,770 for 2013 with a phase-out starting at \$191,530 of modified adjusted gross income; the college tuition credit/deduction, which includes a potential \$2,500 credit per eligible student OR a \$4,000 deduction for taxpayers whose modified AGI does not exceed \$65,000 (\$130,000 for joint filers), and a \$2,000 deduction for taxpayers whose modified AGI does not exceed \$80,000 (\$160,000 for joint filers); the earned income tax credit; and the \$1,000 child tax credit

- Employer provided education assistance exclusion has been permanently extended and the Transit Benefits have been extended through 2013
- Various energy credits are also extended including the \$500 household energy efficiency credit as well as other credit for investments in renewable resources properties
- The 50% bonus depreciation has been extended through 2013, as well as the Section 179 depreciation of up to \$500,000 (as long as capital investment are under \$2,000,000 in any year); in addition to the extension of the 15-year recovery period for qualified leasehold improvements, retail improvements and restaurant property

Another non-tax provision scheduled to go into effect is a “doc fix,” which stops a 27% reduction in payments to Medicare doctors. Unemployment benefits, which were set to expire at the end of 2012, are extended for the long-term unemployed through the end of 2013.

Turn to RotenbergMeril for expert assistance in navigating these new provisions at cpas@rmsbg.com.