2012 and 2013 Tax Planning…..
The American Taxpayer Relief Act of 2012

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Bonus Depreciation

- For assets placed in service beginning January 1, 2012 through December 31, 2013, bonus depreciation is at 50%, with the remaining 50% being depreciated using normal depreciation rules. The Act extended bonus through 2013.

- Currently, there is no provision for bonus depreciation for property placed in service after December 31, 2013

Property Qualifying for Bonus Depreciation

- Modified accelerated cost recovery system (MACRS) property with a recovery period of 20 years or less (business and investment property)
- Computer software
- Qualified leasehold improvement property
- NO binding contract before 1/1/08

Qualified Leasehold Improvement Property

- This is any improvement to an interior part of a building that is nonresidential real property, if ALL the following requirements are met:
  - The improvement is made under or according to a lease by the lessee (or any sublessee) or the lessor of that part of the building
  - That part of the building is to be occupied exclusively by the lessee (or any sublessee) of that part
  - The improvement is placed in service more than 3 years after the date the building was first placed in service by any person
  - The improvement is §1250 property

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Qualified Leasehold Improvement Property

- Qualified leasehold improvement does not include any improvement for which the expenditure is attributable to any of the following:
  – The enlargement of the building
  – Any elevator or escalator
  – Any structural component benefiting a common area
  – The internal structural framework of the building

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Qualified Leasehold Improvement Property

- Generally, a binding commitment to enter into a lease is treated as a lease and the parties to the commitment are treated as the lessor and lessee. However, a lease between related persons is not treated as a lease.

Mechanics of Bonus Depreciation

- Must be new property; used does not qualify
- No taxable income limitation; may create NOL
- Taxpayers must claim bonus depreciation for all qualified property. Can elect out on an asset class basis.
- Does it make sense to elect out of bonus depreciation in 2012?

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Qualified Leasehold/Retail Improvements and Restaurant Property

- Qualified leasehold improvement property, as well as restaurant property and retail property placed in service on or before 12/31/13 is depreciated using a 15-year recovery period. The Act retroactively reinstated this for 2012, through 2013.

§179

- Eligible taxpayers may elect to deduct the cost of certain property placed in service in a tax year rather than depreciate those costs over time

- For tax years beginning in 2012 and 2013, the Section 179 amount is $500,000 with a $2,000,000 purchase limitation. The amount for 2012 was $139,000 but the Act retroactively increased the amount.

- For tax years beginning in 2014, the limit drops to $25,000 with a $200,000 purchase limitation

§179

- History of the deduction/purchase limitation
  - Pre-2003, $25,000/$200,000
  - 2003-2006, $100,000/$400,000
  - 2007, $125,000/$500,000
  - 2008-2009, $250,000/$800,000
  - 2010-2013, $500,000/$2,000,000
  - 2014, back to pre-2003 levels

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§179

- For 2012 and 2013, expensing of real property is now allowed, up to $250,000
- Tax year concept; can be new or used property; CAN'T create a loss

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Business Provisions Extended by the Act

- Research and development credit – Extended through 2013
- Enhanced corporate charitable deductions for contributions of food inventory – Extended through 2013
- Enhanced corporate charitable deductions for contributions of book inventories and computer equipment – Expired after 12/31/11
- Work opportunity tax credit – Extended through 2013
- Energy efficient homes credit – Extended through 2013

Except as noted, all were made retroactive back to 1/1/2012

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Employer Mandate to Provide Health Insurance – Shared Responsibility Payment

- Non-deductible penalty on employers – "assessable payment"
- Assessed to large employers: At least 50 full-time employees for more than 120 business days in the preceding calendar year. Is a FTE concept:
  - Full time is based on at least 30 hours per week
  - Part time: Total hours in month/130
- Penalty is assessed for two reasons:
  - Failing to offer its full time employees the opportunity to enroll in minimum essential coverage
  - Offering minimum essential coverage that is too expensive or does not cover at least 60% of the medical costs

Employer Mandate to Provide Health Insurance – Shared Responsibility Payment

- Penalty for failing to offer health insurance that is considered minimum essential coverage:
  - Only assessed if at least one full-time employee is in an Exchange and is eligible for a Premium Assistance Tax Credit
  - Penalty is $2,000 per full time employee, assessed monthly. So $166.67 per month. 30 full-time employees are exempt from the penalty.
  - Penalty is based on ALL full-time employees (NOT FTES), not just those that are covered on an exchange and receiving a Premium Assistance Tax Credit

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Employer Mandate to Provide Health Insurance – Shared Responsibility Payment

- Penalty for employer that fails to offer affordable coverage or coverage does not meet the 60% test:
  - Assessed when one or more full-time employees are in an Exchange and are receiving a premium tax credit
  - The penalty is $3,000 per year, assessed monthly
  - Penalty is based on only those employees receiving a credit
  - Basically a "too expensive" penalty
  - Affordable: Same definition for premium credit – premium for self coverage only exceeds 9.5% of household income or employer "safe harbor"
  - Safe harbor: Premium for self coverage doesn't exceed more than 9.5% of the employee's Form W-2, box 1 for that year

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Individual Income Tax Rates

- The federal tax bracket rates for 2012 will be 10%, 15%, 25%, 28%, 33% and 35%
- The federal tax bracket rates for 2013 and thereafter will be 10%, 15%, 25%, 28%, 33, 35% and 39.6%
- The 39.6% tax bracket applies to taxpayers with taxable income above $400,000 ($450,000 for married taxpayers, or $425,000 for heads of households).

Capital Gain and Dividend Tax Rates

- Long-term capital gains and qualifying dividends are taxed at a maximum rate of 20% for taxpayers whose income exceeds the thresholds set for the 39.6% rate.

- All other individuals will continue to enjoy a maximum rate of 15% and a special 0% rate for gains and dividends that fall below the top of the 15% tax bracket.

- These rates have been made permanent.

Itemized Deduction Phase Out

- For many years, the amount of itemized deductions that a taxpayer may claim has been phased out to the extent the taxpayer's adjusted gross income (AGI) is above a certain amount

- For 2010-2012, Congress repealed the phase-out on itemized deductions, thereby allowing 100% of claimed deductions

- The phase-out returns for 2013, but using higher applicable thresholds than in years prior to 2010, which now starts at $300,000 MFJ

Personal Exemption Phase Out

- Due to the Personal Exemption Phase Out (PEP), the exemptions were phased out for taxpayers with AGIs above a certain level
- For 2010-2012, Congress repealed PEP, thereby allowing 100% of a taxpayer's personal exemptions
- The phase-out returns for 2013, but using higher applicable thresholds than in years prior to 2010, which now starts at $300,000 for MFJ.

Child Tax Credit

- Generally, taxpayers with income below certain threshold amounts may claim the Child Tax Credit to reduce federal income tax for each qualifying child under the age of 17

- The current Child Tax Credit is $1,000, and may be claimed as a refund in some situations. This was going to drop to $500 in 2013

- The credit has been made permanent by the Act.

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American Opportunity Tax Credit

- The American Opportunity Tax Credit is a maximum credit of up to $2,500 for college tuition and related expenses paid during the taxable year

- Taxpayers receive a credit based on 100% of the first $2,000 of tuition and related expenses (including course materials) paid during the taxable year and 25% of the next $2,000 of tuition and related expenses paid during the taxable year

- 40% of the credit is refundable

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American Opportunity Tax Credit

- The credit is subject to a phase out for taxpayers with AGI in excess of $80,000 ($160,000 for married couples filing jointly)

- The credit has been extended by the Act through 2017. Previously it was to expire as of 1/1/2013.

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Other Education Incentives

- Taxpayers are eligible to take an above-the-line deduction for qualified tuition and related expenses paid on or before 12/31/13. The Act reinstated this retroactive back to 1/1/2012.

- The 60-month limitation for the $2,500 above-the-line student loan interest deduction has been permanently suspended, and the modified adjusted gross income range for phase-out of the deduction has been expanded. This was set to expire 1/1/2013.

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Individual Provisions Extended through 2013

- The deduction for state and local sales tax in lieu of state and local income tax on Schedule A
- The $250 above-the-line deduction for elementary school and secondary school teacher classroom expenses
- Increased contribution limits and carry-forward period for contributions of capital gain property for conservation purposes

Previously these were all expired as for 2012 and future tax years.

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Individual Provisions Extended through 2013

- Tax-free distributions to charitable organizations from IRAs by individuals age 70½ or older (up to $100,000 per year)

- This was made retroactive by the Act to 1/1/2012. Taxpayers may take a distribution in January 2013 and elect to treat it as a December 2012 contribution. Or if they took a distribution in December 2012, they can donate it to charity in January 2013 and it will qualify.

Temporary Employee Payroll Tax Cut

- Under current law, employees pay a 4.2% Social Security tax on all wages earned up to $110,100 (in 2012) and self-employed individuals pay a 10.4% Social Security self-employment tax on all their self-employment income up to the same threshold

- The reduction in the employee tax rate expires as of 12/31/12

Alternative Minimum Tax (AMT)

- The American Taxpayer Relief Act permanently "patches" the AMT for 2012 and subsequent years by increasing the exemption amounts and allowing nonrefundable personal credits to the full amount of the individual's regular tax and AMT.

- For 2012, the exemption amounts are $50,600 for unmarried individuals; $78,750 for married taxpayers filing jointly and surviving spouses; and $39,375 for married taxpayers filing separately. For 2013, the projected amounts are $51,900, $80,750, and $40,375 respectively.

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0.9% Additional Medicare Tax on Earned Income

- Effective January 1, 2013
- Applies to wages and earned income in excess of $200,000 (Single or HOH)/ $250,000 (MFJ)/$125,000 (MFS)
  - In addition to the regular Medicare rate of 1.45%
  - Not indexed for inflation
- Only applies to the employee portion of the Medicare tax
- Applies to all wages that are currently subject to Medicare tax
  - Fringe benefits (e.g. PUA, tax prep fees)
- Applies to income subject to SE tax

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0.9% Additional Medicare Tax on Earned Income

- Employers must begin withholding the additional tax when an employee's wages exceed $200,000 within the calendar year

- Employers do not need to notify the employee when it begins withholding the additional tax

0.9% Additional Medicare Tax on Earned Income

- Amounts Under-withheld
  - Example: Single taxpayer that earns $140,000 of wages from one employer and $105,000 from a separate employer
  - Neither employer will withhold the additional Medicare tax
  - The taxpayer will show an additional tax on the individual income tax return
    - An underpayment penalty could apply

3.8% Medicare Tax on Net Investment Income

- Effective for tax years beginning after December 31, 2012
- Applies to Individuals, Estates and Trusts
- For individuals, applies to the lesser of:
  - Net Investment Income
  - Excess of the taxpayer's MAGI > $200,000 (Single/HOH)/ $250,000 (MFJ)/$125,000 (MFS)
    - Example – Joint return with MAGI of $260,000, $10,000 excess becomes the limitation, even if net investment income is greater than $10,000
- MAGI, modified AGI, the only modification is the net foreign earned income exclusion

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3.8% Medicare Tax on Net Investment Income

- Net Investment Income
  - Taxable interest, dividends, annuities, royalties and rents
  - Income from trades or businesses in which the taxpayer is passive
  - Net gain from the disposition of property held in a passive activity
  - Capital gains and other net gains from the sale of property

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3.8% Medicare Tax on Net Investment Income

- Net Investment Income does not include:
  - Wages or earned income
  - Tax-exempt interest
  - Income from a trade or business in which the taxpayer is active (including gains from the sale of assets)
  - Distributions from IRAs, pensions or qualified plans
  - Life insurance proceeds
  - Social security income

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3.8% Medicare Tax on Net Investment Income

- The IRC does allow for “deductions which are properly allocable to gross investment income.” Investment interest expense? Investment fees? Regs will hopefully provide more guidance.

- Not subject to “kiddie” tax

- Planning: Reduce MAGI or reduce net investment income. One more dollar of MAGI could cause another dollar of NII that is subject to the tax.

3.8% Medicare Tax on Net Investment Income

- Planning Strategies
  - Consider selling appreciated stocks, bonds or real estate before 2013 – harvest gains
  - Consider purchasing tax-exempt securities
  - Real Estate
    - Arrange sales of real estate as an installment sale to potentially keep MAGI less than the threshold amount
    - Defer the gain on the sale of real-estate by arranging a like-kind exchange
  - Passive investors in a flow-through entity could consider meeting the requirements to be considered active in the activity

3.8% Medicare Tax on Net Investment Income

- **Example 2 – Sale of Rental Property**
  - Taxpayers (MFJ) own rental real estate that was purchased years ago for $900,000. $230,000 of depreciation has been taken on the property, leaving an adjusted basis of $670,000. Taxpayers sell the property on January 1, 2013 for $1,100,000. In addition, the taxpayers have combined wages of $140,000 and taxable interest and dividend income of $8,000.

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3.8% Medicare Tax on Net Investment Income

- **Example 2** *(continued)*

Medicare Contribution Tax Calculation	
Earned Income	$ 140,000
Taxable Interest & Dividends	8,000
Gain on Sale of Rental Property	430,000
Adjusted Gross Income	$ 578,000
Excess AGI over $250,000	$ 328,000
Net Investment Income (430,000 + 8,000)	438,000
Medicare Contribution Tax ($328,000 * 3.8%)	**$ 12,464**

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Estate Tax

- The estate tax exemption amount has permanently been set at $5 million per person (adjusted annually for inflation)

- The top estate and gift tax rate is 35% for 2012, and 40% for 2013 and thereafter

- Wisconsin Estate tax has been permanently eliminated

Gift Tax

- The gift tax exemption is unified with the estate tax
- This means that lifetime gifting of $5.12 million per individual or $10.24 million per married couple can be accomplished at this time (Based on 2012 inflation figures)

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Any questions?

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Thank you!

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