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Dear Clients and Friends:

On January 1, 2013, the Senate passed the "American Taxpayer Relief Act" (the Act). The Act was later passed by the House of Representatives and has now been signed into law by the President. The Act will prevent many of the tax rate hikes that were set to expire at the end of 2012 and will retain many of the favorable tax breaks that were also set to expire. However, it will also increase income taxes for some high-income individuals and slightly increase transfer (estate and gift) tax rates. A key benefit not extended by the Act is the payroll tax holiday that has been in effect for the prior two years which effectively reduced social security taxes on employees and self-employed individuals by 2%. This will cause an immediate tax increase on all employees and self-employed individuals. If you are an employer you should confirm that you adjust your employee payroll tax withholding amounts accordingly for this change. Discussed below are some highlights of the Act as well as brief synopsis on the taxes imposed in 2013 and later under the Patient Protection and Affordable Care Act.

Income tax rates for individuals will stay at the prior year levels of 10%, 15%, 25%, 28%, 33% and 35%, but with a 39.6% rate applying for income above a certain threshold. 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. These dollar amounts are inflation-adjusted for tax years after 2013.

For tax years beginning after 2012, the Act provides that the top rate for long term capital gains and qualified dividends will permanently rise to 20% (up from 15%) for taxpayers with incomes **exceeding** $400,000 ($450,000 for married taxpayers). When accounting for The Patient Protection and Affordable Care Act's 3.8% surtax on investment-type income and gains for tax years beginning after 2012 (discussed later), the overall rate for higher-income taxpayers could be as high as 23.8% on long term capital gains and qualified dividends.

The Act will also affect those with incomes below the thresholds noted above via the phase-out for personal exemptions and the limitation on itemized deductions, which were both previously suspended. The **threshold** for these two indirect tax increases will start at $300,000 for joint filers and a surviving spouse; $275,000 for heads of household; $250,000 for single filers; and $150,000 for married taxpayers filing separately.

The Act 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 2012 Taxpayer Relief Act also permanently increases the top estate and gift tax rate from 35% to 40%. The 2012 Taxpayer Relief 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.

The Act provides permanent alternative minimum tax (AMT) relief. The Act also extends many of the enactments in the American Recovery and Investment Tax Act of 2009 as well as many of the historical individual tax extenders that were set to expire at the end of 2012. Some of these items include the American Opportunity tax credit for education, the deduction for certain expenses of elementary and secondary school teachers, and the exclusion for discharge of certain qualified principal residence indebtedness. The Act will extend many business tax breaks as well as extend certain beneficial depreciation provisions applicable to businesses.

The Patient Protection and Affordable Care Act (PPACA) has some key tax provisions in it that are set to go into effect for tax years after 2012. There will be an additional medicare tax of 0.9% on wages earned in **excess** of $250,000 (joint return), $125,000 (married taxpayer filing a separate tax return), or $200,000 (all other cases). An analogous provision applies to self-employed persons and their net earnings from self-employment. Also, there is an additional medicare tax on unearned income (or investment income) for individuals, estates and trusts. The tax is 3.8% of the **lesser** of net investment income (generally income from interest, dividends, capital gains, etc.) for the tax year, or the excess (if any) of the modified adjusted gross income for such taxable year over the threshold amount. For these purposes the **threshold** amount means $250,000 (joint return), $125,000 (married taxpayer filing a separate tax return), or $200,000 (all other cases). For net investment income purposes please note this will also include income from a trade or business that is a passive activity with respect to the taxpayer.

If you have questions regarding any of the items noted in this newsletter or any other concerns related to your business or tax related needs please contact our office at your convenience. We look forward to working with you in the future and wish all of our clients, friends and family a very prosperous New Year!

Very truly yours,

Gero & Evaul

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