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THE AMERICAN TAXPAYER RELIEF ACT AND ITS IMPACT

As most people were ringing in the New Year, the Senate was voting on legislation to retain the Bush tax cuts for 98% of Americans. The American Taxpayer Relief Act ("ATRA") was passed by the House on January 1, 2013 and was signed into law by the President.

Although the most publicity about ATRA surrounds the tax rates there are several other important provisions and extensions that will likely affect both you and your business. Below we summarize several of the most relevant changes.

BUSINESS PROVISIONS

- **Research Credit** – The research credit which was scheduled to expire as of December 31, 2011 is retroactively extended through December 31, 2013.
- **15-Year Straight-Line Cost Recovery for Qualified Retail Improvements**[1] - This provision which originally expired for property placed in service **before** January 1, 2012 was retroactively extended for property placed in service before January 1, 2014. ***Observation:*** *This means that tax provisions and estimated payments for 2012 taxes could be overstating your current tax liability.*
- **Extension of Expensing Limitations (Section 179 Property)** – The cost of property that may be expensed in 2012 and 2013 remains at the 2011 amount of $500,000 which is not reduced until the cost of 179 property placed in service exceeds $2,000,000.[2]
- **Extension of Bonus Depreciation** – Bonus depreciation which allows a deduction equal to 50 percent of the adjusted basis of qualified property was scheduled to expire at the end of 2012. This provision is extended one year for property acquired prior to January 1, 2014.

INDIVIDUAL PROVISIONS

- **Individual Income Tax Rates** – Taxpayers who earn less than $400,000 (single) or $450,000 (married filing joint status) (the "threshold") will not see a change in either their income tax rate or the 15% rate on capital gains. Those having taxable income exceeding these limits will see their top tax rate rise to 39.6% on ordinary income in excess of the threshold and to 20% for capital gains and qualified dividends.
- **Threshold Amounts for Phase-Out of Itemized Deductions and Personal Exemptions Are Back** – Once adjusted gross income equals a "threshold amount" (reflected in the table below) both itemized deductions and personal exemptions are reduced. The Bush tax cuts eliminated this provision for 2010 and 2011. Although the provision is back, ATRA **increases** the "threshold amounts" which are as follows:

Status	Amount
Married filing joint	$300,000
Single	$250,000

Itemized deductions are reduced by the **lesser** of:

- 3% of the excess of adjusted gross income over the applicable amount, or
- 80% of the amount of the itemized deductions otherwise allowable.

The personal exemption is reduced by 2 percentage points for each $2,500 (or fraction thereof) by which adjusted gross income exceeds the threshold amount.

Example *– Assume a married couple that files a joint tax return have $400,000 of adjusted gross income and $50,000 of itemized deductions. The reduction of itemized deductions is the* ***lesser*** *of $3,000 (3% x ($400,000 - $300,000)) or $40,000 (80% x $50,000). Therefore, itemized deductions allowed are $47,000. The personal exemptions are reduced by 80% (($100,000/$2,500) x 2%).*

[1] This extension also allows a taxpayer to expense up to $250,000 of the cost of qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvement property under Internal Revenue Code § 179.

[2] Prior to ATRA, the amount of expense for 2012 was limited to $125,000 and was reduced once the cost of 179 property placed in service exceeded $500,000.

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INDIVIDUAL PROVISIONS (CONT.)

- **Alternative Minimum Tax** – ATRA finally provides permanent relief from the AMT by indexing the exemption amounts for inflation. It also increases the amount of the exemption for 2012 to $50,600 for single taxpayers (from $33,750 for 2011) and $78,750 for married filing joint taxpayers (from $45,000).
- **Payroll Tax Increase** – ATRA does not extend the reduction of Social Security tax. Therefore, individuals will see the rate of Social Security tax increase from 4.2% to 6.2%. The wage base to which this applies for 2013 is $113,700.

EMPLOYER PROVIDED MASS TRANSIT BENEFITS

- **ATRA Increases Employer-Provided Mass Transit Benefit** – Prior to January 1, 2012, employers could withhold up to $230 a month on a pre-tax basis for mass transit and parking benefits. Starting January 1, 2012, the amount an employer could withhold for parking expenses increased to $240 a month on a pre-tax basis while the amount for mass transit benefits was reduced to $125. ATRA brings back parity retroactive to January 1, 2012 allowing employers to withhold $240 for mass transit - the same amount on a pre-tax basis as for parking. The IRS recently issued procedures describing how employers can apply this benefit retroactively.

ESTATE TAX PROVISIONS

- **Estate Tax Exclusion** – The $5,000,000 exclusion is made permanent and is indexed for inflation for estates of decedents that are U.S. citizens dying after December 31, 2012. The inflation adjusted amount for 2012 is $5,120,000 and for 2013 is $5,250,000. Please note that the exclusion for non-U.S. citizens that are not domiciled in the U.S. remains at $60,000 (unless increased by an Estate tax Treaty).
- **Estate Tax Rates Increased** – Tax rates on estates are increasing from a top-rate of 35% to 40%.

The Affordable Care Act - New Taxes for 2013

Aside from ATRA several tax provisions included in the Affordable Care Act take effect in 2013. These include the following:

- ***Medicare Tax*** – *Taxpayers will pay a .90% Medicare tax on earnings that exceed $200,000 (single) or $250,000 (married filing jointly). Employers will withhold this tax on all wages over $200,000 and individuals will receive any refund upon filing their individual income tax return.*

- ***Tax on Net Investment Income*** – *Once a taxpayer reaches the threshold amount he/she must pay a surtax of 3.8% on the lesser of their "net investment income," or the excess of the individual's modified adjusted gross income for the tax year, over the threshold amount. The threshold amount is $200,000 for a single taxpayer and $250,000 for a taxpayer that is married filing a joint return.*

These rules, especially defining "net investment income" are fairly complex.

If you have questions about any of the provisions and how they might impact you please contact us directly.

Mindy Piatoff	Norma Han	Luigi Perin	Alessandro-Adelchi Rossi
mindy.piatoff@funaro.com	norma.han@funaro.com	luigi.perin@funaro.com	adelchi.rossi@funaro.com