January 2013

New Legislation

As we have discussed in prior e-mails, the United States was set to plunge over the “fiscal cliff” on New Year’s Day if Congress failed to act. Bi-partisan business as usual in Washington D.C. brought us to the brink of a major financial crisis. Thankfully, a deal was made that averted the crisis and made the majority of the Bush-era tax cuts permanent. President Obama signed the American Taxpayer Relief Act of 2012 into law in the early hours of Wednesday, January 2nd. Talk about getting something done in the eleventh hour (in this case the 13th hour).

This new legislation will have a noticeable financial impact (good and bad) on all of our clients. Here are the details of how it may impact you:

New Marginal Tax Rates

Because the American Taxpayer Relief Act of 2012 was actually passed in 2013, Congress technically voted to cut taxes (since the Bush era taxes had expired earlier that day).
The majority of Americans have had no change to their marginal tax rates. Only individuals earning more than $400,000 or married couples filing jointly earning more than $450,000 will see their marginal tax rates increase. These wage earners will see their marginal taxes increase from 35% to 39.6%. This is the same rate during the Clinton administration, although the income threshold was $250,000 to reach these marginal tax rates. Unlike the Bush era tax cuts (which had a sunset clause), these new tax rates are permanent until voted otherwise.

Dividend and Capital Gains Taxes

The rate set for capital gains and dividends will be permanently set at 20% for investors at the 39.6% marginal income tax rate (the $400,000/$450,000 income earners). Dividends and capital gains will be taxed at 15% for everyone else. This was a huge win for our clients because there were serious discussions of taxing dividends as ordinary income (as they were in during the Clinton administration).

Social Security Taxes

Congress chose not to extend the “payroll tax cut holiday.” This means that your Social Security taxes will return to 6.2% from 4.2% for income up to $113,700. This tax cut was never meant to be a permanent tax cut but rather a stimulus to the economy.

Estate Taxes

The estate tax limits have been set at $5 million per person ($10 million for a couple with a Living Trust), indexed for inflation. The tax rate was set at 40% on assets above these levels.

AMT Taxes

The new tax laws set a permanent rate for Alternative Minimum Tax as well as indexing the rate for inflation. It sets an exemption of $50,600 for single taxpayers and $78,750 for joint filers.

Other Taxes

The Obamacare Medicare tax will go into effect in 2013. Individuals earning over $200,000 or married couples filing jointly earning more than $250,000 will pay an additional 3.8% taxes on modified adjusted gross income above these levels. For taxpayers in these same categories, a 0.9% Medicare Hospital Insurance tax will be assessed on any wages that exceed the threshold.

Tax Deductions

The new tax laws reinstate both the Pease Limitation on Itemized Deductions and the Personal Exemption Phaseout (PEP), affecting married couples filing jointly earning more than $300,000 and single filers earning more than $250,000. The Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit, aimed at individuals in lower tax brackets, were extended for five years.

What's Still Looming?

The government still has two major hurdles to be negotiated in the next couple of months. The first is the debt ceiling. The United States government officially hit its current authorized borrowing limit of $16.4 trillion at the end of 2012. Treasury Secretary Timothy Geithner informed Congress that he will be able to avoid violating the limit through what he deemed "extraordinary measures." This move supposedly would give Congress until late February or early March to solve the problem. Now it appears that without an agreement, the U.S. government will hit the debt ceiling on February 15th.
The second hurdle is addressing the scheduled spending cuts, which were simply delayed for two months. Without a deal, the spending cuts will go into effect automatically.

I hope that our government (both parties) recognizes the impact that their bi-partisan bickering may have on our ever fragile economy and address both issues with the American public in mind.

As always, we remain ever vigilant on your behalf and welcome all comments and questions.

Sincerely,
Jeff