Overview of the New “Fiscal Cliff” Law – Key Tax Provisions for Individuals

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The new American Taxpayer Relief Act—officially signed on January 2, 2013—averted a drastic plunge off the “fiscal cliff.” Here is a summary of the main tax provisions of interest to individual taxpayers.

Income tax rates: The new law permanently retains the 10%, 15%, 25%, 28%, 33% and 35% individual income tax brackets from the 2012 rate structure. However, it also adds a top rate of 39.6% for single filers with incomes above $400,000 and joint filers with incomes above $450,000. Thus, the tax rate increase will affect only upper-income taxpayers.

Capital gains and dividends: The new law preserves the favorable 15% tax rate (0% for certain low-income taxpayers) on net long-term capital gain and qualified dividends that was scheduled to expire after 2012. However, it imposes a higher maximum rate of 20% for single filers with incomes above $400,000 and joint filers above $450,000 in 2013 and thereafter.

Alternative minimum tax: Absent another “patch” by Congress, tens of millions of additional taxpayers would have been ensnared by the alternative minimum tax (AMT). Retroactive to January 1, 2012, the new law provides a permanent fix through increased exemption amounts and inflation-indexing of those amounts in future years, as well as allowing full offsets through nonrefundable personal credits.

Itemized deductions/personal exemptions: Under a special tax provision reinstated in 2013, itemized deductions are reduced by 3% of the excess adjusted gross income (AGI) above a specified threshold (but no more than 80% overall). The new law raises the thresholds to $250,000 of AGI for single filers and $300,000 for joint filers. A similar phaseout based on the same AGI thresholds applies to personal exemptions, beginning in 2013.

Family tax breaks: Several tax breaks for family members have been permanently extended, including provisions relating to the child tax credit, the dependent care credit, the adoption tax credit and exclusion for employer-provided adoption benefits, the earned income credit, and relief from the “marriage penalty.”

Education tax breaks: Similarly, the new law permanently extends the expanded $2,000 contribution limit for Coverdell Education Savings Accounts, the exclusion for employer-provided education assistance and the enhanced student loan interest deduction. It also extends the maximum $2,500 American

Opportunity Tax Credit (AOTC) for five years, subject to a phaseout based on modified adjusted gross income (MAGI). Furthermore, the above-the-line tuition deduction is extended for two years, retroactive to January 1, 2012. Depending on your MAGI, you may be able to claim a tuition deduction of either $4,000 or $2,000 in lieu of a higher education credit.

Tax extenders: A wide array of tax law provisions are extended for varying time periods (and, in some cases, retroactive to January 1, 2012), including:

- the optional state sales income tax deduction (which may be claimed in lieu of deducting state and local income taxes)
- the $2 million tax exclusion on mortgage debt forgiveness
- the $240-per-month tax exclusion for employer-provided mass transit and vanpooling benefits
- the deduction for mortgage insurance premiums
- the up-to-$250 deduction for classroom expenses of educators
- tax benefits for charitable donations of property for conservation purposes
- tax-free distributions from an IRA made directly to charity by individuals age 70½ or older (maximum of $100,000 annually)

Estate and gift taxes: Under the unified estate- and gift-tax system, the estate-tax exemption, which was scheduled to be only $1 million in 2013, remains at $5 million (plus inflation indexing). The top estate-tax rate, which was scheduled to be 55%, rises slightly from 35% to 40%. Among other "sunsetting" provisions, portability of exemptions between spouses is permanently extended.

Remember that this is only an overview of the key provisions in the new tax law. Consult your Henry & Horne, LLP tax professional concerning the application of the new rules to your situation.

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