THE WALL STREET JOURNAL.
PROFESSIONAL EDITION WITH FACTIVA

THE METROWEST DAILY NEWS from Factiva January 28, 2013

Tax relief act has benefits

The American Taxpayer Relief Act of 2012, which was passed by Congress on Jan. 1, provides a mixed bag for taxpayers, extending or modifying many of the tax provisions that were set to expire on Dec. 31, 2012 (1), while letting others terminate.

Where do we stand now? Let's take a closer look at some of the changes that have occurred and how you may take advantage of them.

For taxpayers with annual income less than $400,000 (individual) and $450,000 (married filing jointly), the act made permanent the current marginal income tax rates of 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent.

For taxpayers with taxable income over these thresholds, the act restores the 39.6-percent tax bracket.

Business owners may wish to examine their current entity structure to determine whether or not it remains beneficial under this new legislation.

S corporations and limited liability corporations historically have been favored over C corporations, due to the ability for business owners to report business profits on their personal returns. Now, the C corporation's highest tax bracket is lower than the highest personal tax bracket.

The spread may provide opportunities to defer compensation.

Taxpayers with income above the $400,000 and $450,000 thresholds will see an increase in the long-term capital gain and qualified dividend tax rate, which increased from 15 percent to 20 percent. The 15 percent rate will remain in place for taxpayers below these income thresholds and taxpayers in the 15 percent or lower tax bracket will continue to be exempt from capital gains taxes.

The new Medicare surtax resulting from the 2010 Patient Protection and Affordable Care Act will also play an important role for higher-income taxpayers in 2013. Starting Jan. 1, certain taxpayers will be subject to a 3.8 percent surtax on the lesser of net investment income or the excess of modified adjusted gross income (MAGI) over $200,000 for individuals and $250,000 for those who are married and filing jointly.

This is in addition to regular capital gain taxes.

The following types of investment income will be affected: taxable interest, capital gains, dividends, nonqualified annuity distributions, royalties and rental income. Exceptions include distributions from retirement accounts, pensions, 401(k), IRAs and municipal bonds, although these distributions will affect the MAGI calculation.

As a result, the effective top rate for net long-term capital gains for many higher-income taxpayers is now 23.8 percent.

The act retains the $5 million estate tax exclusion, which is adjusted annually for inflation, but increases the maximum estate tax rate to 40 percent.

The lifetime gift tax exemption remains unified with the $5 million exemption.

Portability between spouses also becomes permanent, and the act extends the GST tax-related provisions, including the inflation-adjusted $5 million exemption.

Portability allows surviving spouses to apply any unused exclusion of deceased spouses to their own transfers during life and at death, if the proper elections are made. Flexible planning strategies are needed for estates of individuals with a high net worth.

The $5 million exemption offers greater flexibility for those with a high net worth to transfer assets during life or at death, potentially without owing any gift or estate taxes.

With the "permanency" of these provisions, taxpayers are encouraged to take time to execute estate plans that are well thought out, instead of trying to implement changes at the last minute, before legislation expires.

Qualified charitable distributions Congress also restored the qualified charitable distribution (QCD) provision for 2012 and 2013.

The QCD allows taxpayers aged 70½ and older to transfer up to $100,000 from an IRA directly to a qualified charity to avoid recognition of the income, and to partially or fully satisfy the required minimum distribution requirement.

For 2013, the QCD must be made by Dec. 31, 2013.

A QCD may still be made for the 2012 tax year under the following conditions:

· An individual may make a direct transfer from the IRA to a charity by Feb. 1, 2013 and characterize it as being made on Dec. 31, 2012.

· If an individual took a required minimum distribution between Nov. 1, 2012, and Jan. 1, 2013, the individual may treat the distribution as a QCD if the amount (up to $100,000) is transferred to a charity by Feb. 1, 2013.

RMDs taken before Nov. 1, 2012, are not eligible.

The American Opportunity Tax Credit, which applies to the first four years of a student's post-secondary education, was extended through 2017. The credit covers 100 percent of the first $2,000 of qualified tuition and related expenses, and 25 percent of the next $2,000, for a maximum credit of $2,500 per eligible student.

The "above the line" deduction (e.g., you don't need to itemize to claim it) for qualified tuition and related expenses was extended to Dec. 31, 2013, and was retroactively extended for 2012. The student loan interest deduction is a $2,500 "above the line" deduction. The act makes permanent the suspension of the 60-month time limit.

The maximum contribution limit for Coverdell education savings accounts was permanently set at $2,000. Distributions must be used for qualified higher education expenses while attending elementary, secondary or post-secondary educational institutions.

Taxpayers cannot claim the qualified tuition deduction and the American opportunity tax credit or the lifetime learning credit in the same year. In addition, the tuition deduction cannot be claimed for a student if anyone else claims the American opportunity tax credit or lifetime learning credit for the same student in the same year.

The 2012 act permanently extends the alternative minimum tax (AMT) amounts to $50,600 for individuals and $78,750 for married filing jointly, retroactive for the 2012 tax year. The exemption will be adjusted for inflation in 2013.

The last AMT "patch" expired at the end of 2011. In previous years, the AMT patch was not released until the year after the previous tax year, making it difficult to plan without knowing the exemption amounts. Now that the AMT has been given a more permanent fix, planning should be easier.

Itemized deductions, personal exemptions For tax years 2010 through 2012, itemized deductions and personal exemptions were not subject to phase-out. The new legislation revives phase-out rules for 2013 at the following thresholds:

· $300,000 for married taxpayers filing jointly

· $275,000 for heads of household

· $250,000 for single filers

· $150,000 for married taxpayers filing separately The itemized deduction rules reduce the allowable itemized deductions by 3 percent of the amount by which the taxpayer's adjusted gross income exceeds the applicable threshold. The itemized deduction cannot be reduced by more than 80 percent. Certain items, such as medical expenses, investment interest, casualty, wagering, and theft losses are excluded.

The total amount of personal exemptions that may be claimed by a taxpayer is reduced by 2 percent for each $2,500 or portion thereof (2 percent for each $1,250 for married filing separately) by which the taxpayer's adjusted gross income exceeds the applicable thresholds listed above.

For taxpayers with a higher income and larger deductions, the itemized deduction and personal exemption limitations may create a "stealth" tax liability, effectively increasing the marginal tax rate. Taxpayers may wish to recognize income or deductions in certain tax years to help minimize the impact.

The act did not extend the 2 percent payroll tax cut, which temporarily reduced the Social Security tax withholding rate from 6.2 percent to 4.2 percent for tax years 2011 and 2012. The tax withholding rate will return to 6.2 percent for wage bases under $113,700, which will have an immediate impact on take-home pay.

Although Congress did act to stop the sweeping tax increases that were set to take effect as a result of the fiscal cliff, taxes will increase for many taxpayers.

We will continue to work with you - as well as with your legal and tax advisers - to help you pursue your financial and legacy goals in this new tax environment.

(1) Bush-era Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Act of 2003 (JGTRRA), both of which were extended under the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

Christopher S. Borden is vice president of Canby Financial Advisors LLC at 161 Worcester Road, Suite 408, Framingham. He offers securities and advisory services as a registered representative of Commonwealth Financial Network, a registered investment adviser and member firm of FINRA/SIPC. He can be reached at 508-598-1082
