HOW THE AMERICAN TAXPAYER RELIEF ACT OF 2012 IMPACTS YOU AND MORE NEW TAXES FOR 2013

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The fiscal cliff was avoided in January 2013 when President Obama signed the "American Taxpayer Relief Act" into law. The law contains a wide array of tax provisions that will affect taxpayers in all income tax brackets. Unfortunately, it is another short-term patch for a long-term problem.

Alternative Minimum Tax: The law permanently sets the Alternative Minimum Tax income exemption level (amount at which the exemption is phased-out) at $50,600 (single taxpayers) and $78,750 (married couples) for 2012. In future years the exemption level will adjust for inflation.

Estate and Gift Taxes: The exemption for estate taxes remains at $5.12 million and will be indexed to inflation going forward (estimated to be $5,250,000 in 2013). But the top rate rises to 40% (from 35%) for those in the highest income bracket. Portability has also been extended.

Marriage Penalty: Married couples will continue to receive a standard deduction that's twice that of individuals. The income ranges for the 10% and 15% income tax brackets are also doubled.

Income Tax Breaks and Deductions: The law extends the following tax breaks and deductions through 2013: (i) state and local sales tax deduction; (ii) teachers can continue to deduct $250 expended on school supplies; and (iii) eligible students can continue to deduct tuition and other education-related expenses. The following tax breaks and deductions are extended through 2017; (i) the American Opportunity Tax Credit (a partially refundable credit of up to $2,500 a year for four years for low-income families); (ii) the Child Tax Credit (allows lower-income parents to claim as much as $1,000 for each child under age 17); (iii) the Earned Income Tax Credit (a credit for working Americans with low- and moderate-incomes); and (iv) the Dependent Care Credit (allows certain taxpayers to deduct up to 35% of expenses to a maximum of $6,000 for two children).

Payroll Taxes: The payroll tax rate reverts back to 6.2% (it had been 4.2% for 2011 and 2012) on an employee's first $113,700 in wages. The end result is less take home income for employees. For example, an employee earning the national average salary of $41,000 will receive $32 less in every biweekly paycheck. Similarly, the 2% reduction in the Self-Employment Contributions Act ("SECA") tax rate was not extended, and the total SECA tax rate will be 15.3% beginning in 2013, including the Medicare component, but subject to the increased Medicare payroll tax.

Income Tax Rates: Individual taxpayers with incomes above $400,000 ($450,000 for couples) will be subject to a 39.6% income tax rate (they had been subject to a 35% rate since 2001). Otherwise, the 10%, 15%, 25%, 28%, 33% and 35% (for taxable income under $400,000 (single), $425,000 (head of household), and $450,000 (joint filers) income tax brackets from the Bush era tax cuts become permanent.

Capital Gains | Dividends Tax: The capital gains and dividend tax rates for individual taxpayers earning more than $400,000 ($450,000 for couples) will increase to 20% (up from 15%). Taxpayers in the two lowest tax brackets (10% and 15%) will continue to pay 0%, while all others will pay 15%. In addition, taxpayers with investment income above $200,000 (single) and $250,000 (joint filers) in adjusted gross income will also pay an additional 3.8% tax as a result of the Affordable Care Act.

Itemized Deductions | Personal Exemption: Individual taxpayers earning $250,000 (married couples earning $300,000) will be limited in the personal exemptions and itemized deductions they may utilize when filing their income tax return. Taxpayers with incomes above $422,500 will not qualify for a personal exemption. Many charities are concerned the phase out of itemized deductions will adversely impact charitable giving by taxpayers in the highest income tax brackets.

Debt Forgiveness: Homeowners who receive principal debt forgiveness (through a short sale or foreclosure) will not be subject to income tax on the amount of debt forgiven.

Charity Donations: The law brings back, for a very short period of time, the ability of citizens over the age of 70.5 to donate up to $100,000 from their IRA to charity for 2012. The provision may only be utilized by IRA owners who have postponed taking their IRA distribution until December. If that IRA owner makes the donation before the end of January 2013, then the amount that they donated will count towards their 2012 minimum required distribution.

NEW TAXES FOR 2013

The following is a brief look at new taxes, courtesy of the "Affordable Care Act," that will adversely impact taxpayers beginning in 2013:

Medicare Tax on Investment Income: Taxpayers with net investment income (income from interest, dividends, annuities, royalties, and rents, and net gain from disposition of property) or modified adjusted gross income (AGI) above $200,000 (single) and $250,000 (joint filers will pay an additional 3.8% tax. For definition purposes, "net investment income" means investment income reduced by deductions properly allocable to that income.

Medical Care Itemized Deduction Threshold: The itemized deduction threshold for unreimbursed medical expenses is increased to 10% of AGI (previously 7.5% of AGI) for regular income tax purposes. An exception applies for tax years 2013 – 2016 if a taxpayer or their spouse has turned 65 before the end of the tax year.

Additional Hospital Insurance Tax on High-Income Taxpayers: The employee portion of the hospital insurance tax part of FICA is increased to 2.35% (previously 1.45%) of covered wages that exceed a threshold amount ($250,000 in the case of a joint return or surviving spouse and $200,000 for a single individual). The tax paid by employers is not increased.