



Fiscal Cliff Deferred As Congress Finally Acts

The fiscal cliff has been avoided temporarily as the Congress has passed H.R. 8, the “American Taxpayer Relief Act of 2012” (the “Act”). The Senate passed the Act in the early morning hours of January 1, 2013, by a vote of 89-8. After spending most of the day debating whether to attempt to add additional spending cuts to the Act, the Republican leadership in the House of Representatives finally decided to bring the Senate-passed Act to the floor for a vote. On January 1, just before midnight, the House passed the Act by a vote of 257-167, with 85 Republicans joining 172 Democrats voting in favor of the Act. President Obama signed the Act on January 2, 2013. The provisions of the Act are effective for tax years beginning after December 31, 2012, so there is no gap that resulted from Congress not acting until January 1st.

The Act continues many of the income, estate, gift, and generation-skipping transfer (“GST”) tax provisions that have been in effect over the last two years, with certain important changes, which are summarized in this Special Alert.

Income Tax Rates. The maximum income tax bracket increased to 39.6% but not for taxable income in excess of \$250,000, as the President long wanted. Under the compromise worked out in the Senate, the 39.6% bracket will not apply for a married couple filing a joint return until their taxable income reaches \$450,000 (\$400,000 for an unmarried individual, \$225,000 for a married individual filing separately, and \$425,000 for heads of household). These thresholds are indexed for inflation for tax years beginning after 2013. The 3.8% tax on net investment income remains in the law and will result in a maximum income tax rate of 43.4% for taxpayers subject to that tax.

Capital Gain and Dividend Income. The current maximum income tax rate of 15% on long term capital gain and

qualified dividend income will increase to 20% beginning in 2013 for taxpayers subject to the 39.6% rate described above. These thresholds are also indexed for inflation and the 3.8% tax on net investment income will raise the tax rate to 23.8% for many taxpayers.

Estate, Gift and GST Tax Rates and Exemptions. One of the most important features of the Act for high net worth taxpayers is its treatment of the estate, gift and GST tax rates and lifetime exemption amount. The rate was scheduled to increase to 55% on January 1 and the exemption was to decrease to \$1,000,000. Instead, the exemption will continue at \$5,000,000 for the estate, gift and GST taxes and the maximum rate will increase to 40% from the 35% that was applicable the last two years. The \$5,000,000 amount is indexed for inflation after 2011 and should be approximately \$5,250,000 for 2013. This exemption also remains portable between spouses so a surviving spouse can use that part of the exemption that was not used by the previously deceased spouse, subject to the same limitations that have been applicable for the last two years.

The rates and lifetime exemption amount are now “permanent” in the sense that there is not a fixed date at which they automatically change. It is certainly the case, however, that the next Congress, or any future Congress, is free to make further changes. The extension of the \$5,000,000 lifetime exemption for gift taxes, as well as estate and GST taxes, is good news, however, for those who started the donative process too late to complete their transfers by year-end. Many were concerned that the permanent lifetime gift tax exemption would be set at

This publication may constitute “Attorney Advertising” under the New York Rules of Professional Conduct and under the law of other jurisdictions.

a lower amount; however, the Act keeps it unified with the estate and GST tax exemptions.

Phase-out of Itemized Deductions and Personal Exemptions.

The gradual phase-out of itemized deductions for high income taxpayers returns to the law in 2013 as previously scheduled. The level at which the phase-out begins, however, has been increased from previous levels. A married couple filing a joint return will lose an amount of itemized deductions equal to 3% of the excess of their adjusted gross income over \$300,000 (\$250,000 for unmarried individuals, \$150,000 for married individuals filing separately and \$275,000 for heads of household). These amounts are indexed for inflation. A maximum of 80% of a taxpayer's itemized deductions is subject to the phase-out and the phase-out does not apply to estates and trusts. The phase-out will add a little more than one percentage point to the effective income tax rate for many taxpayers.

The itemized deduction phase-out did not apply for tax years 2010, 2011 and 2012. For tax years 2009 and before, the phase-out began at \$100,000 of adjusted gross income, adjusted for inflation. The phase-out applies to all itemized deductions except for medical expenses, investment interest, the deduction for casualty or theft losses and the deduction permitted for wagering losses.

The deduction for personal exemptions will also be phased out beginning at the same threshold amounts.

Alternative Minimum Tax. The debate that has gone on each year about patching the alternative minimum tax so that it does not apply to middle income taxpayers will finally come to an end as the Act establishes inflation indexing for the threshold at which the tax applies. The threshold for 2012 will be \$78,750 for married couples filing a joint return (\$50,600 for unmarried individuals and \$39,375 for married individuals filing separately). There is no change to the alternative minimum tax imposed on corporations, estates and trusts.

S Corporation Built-in Gain Tax. The Act continues through 2012 and 2013 a reduced period of five years over which an S corporation that was previously treated as a C corporation is subject to income tax on gains in its assets that were "built-in" as of the time the corporation's election to be treated as an S corporation became effective. After 2013, the recognition period will revert to 10 years absent further legislation.

S Corporation Charitable Contribution of Appreciated Property. The Act continues for 2012 and 2013 a special

provision that allows an S corporation to pass through to its shareholders a charitable contribution deduction for the fair market value of contributed capital assets, even if the shareholder's tax basis in his stock is less than the amount of the contribution.

Exclusion of Gain on Qualified Small Business Stock. The Act extends the exclusion for 100% of the gain recognized upon the sale of qualified small business stock to such stock acquired before January 1, 2014. Qualified small business stock is stock of a C corporation that has not more than \$50,000,000 in gross assets and engages in an active business. The stock must be acquired at its original issuance and be held for at least five years. The maximum amount of gain that can be excluded is the greater of ten times the taxpayer's basis in the stock or \$10,000,000.

Bonus Depreciation. The Act extends the special first-year depreciation of 50% for new tangible personal property placed in service during 2013.

Expensing of Film and Television Production Costs.

The provision allowing the first \$15,000,000 of the cost of producing a qualified film or television program to be deducted rather than capitalized has been extended through tax years 2012 and 2013.

Extension of Increased Expensing of Certain Capital Assets.

The Act extends the expensing provisions for certain capital assets that were in effect for 2010 and 2011 through 2012 and 2013. A taxpayer may elect to expense, rather than capitalize and depreciate, the cost of certain tangible personal property with a cost up to \$500,000. This ability to expense the cost of newly acquired assets will phase out if the taxpayer acquires more than \$2,000,000 of such property.

Other Provisions. The Act also extends a variety of business and other tax credits. We have published a [separate newsletter](#) of the various energy related tax credits provided for by the Act. We will be happy to provide you with information on other specific credits upon request.

What the Act Did Not Do. A number of provisions that have been discussed as revenue raising alternatives and were of concern to many high income taxpayers are not contained in the Act. The Act does not restrict the deduction for the fair market value of capital assets donated to charity, apart from the overall itemized deduction phase-out. While the phase-out of itemized deductions did return to the law, no absolute ceiling amount on deductions was imposed. The Act also did

not impose a 10-year minimum term on Grantor Retained Annuity Trusts (“GRATs”), nor did it impose any statutory limit on valuation discounts for intra-family transfers. A proposal to include trusts that are grantor trusts for income tax purposes in the gross estate of the grantor at death was also not included in the Act.

Congress has also long debated a provision to tax as ordinary income, rather than capital gain, amounts received with respect to a profits interest in a partnership or limited liability company (often referred to as a “carried interest”). This provision is not part of the Act.

The omission of these items from the Act does not mean these items will not be considered again. The Act was just the first step in a long process to control our national deficit. The automatic spending cuts scheduled to take effect on January 1st were postponed for only two months and the debt ceiling must be addressed. The President and many in Congress believe that we still need more revenue, along with spending cuts, to manage the deficit effectively. While the watershed issue of tax rates has probably been resolved for the foreseeable future, any number of other provisions that would increase tax revenue are still very much on the table.

Please contact us if you have any questions about the Act.

This alert is a publication of Loeb & Loeb and is intended to provide information on recent legal developments. This alert does not create or continue an attorney-client relationship nor should it be construed as legal advice or an opinion on specific situations.

Circular 230 Disclosure: To ensure compliance with Treasury Department rules governing tax practice, we inform you that any advice contained herein (including any attachments) (1) was not written and is not intended to be used, and cannot be used, for the purpose of avoiding any federal tax penalty that may be imposed on the taxpayer; and (2) may not be used in connection with promoting, marketing or recommending to another person any transaction or matter addressed herein.

© 2013 Loeb & Loeb LLP. All rights reserved.

Tax Group

MICHELLE W. ALBRECHT	MALBRECHT@LOEB.COM	212.407.4181	JEFFREY M. LOEB	JLOEB@LOEB.COM	310.282.2266
JOHN ARAO	JARAO@LOEB.COM	310.282.2231	MARY ANN MANCINI	MMANCINI@LOEB.COM	202.618.5006
MARLA ASPINWALL	MASPINWALL@LOEB.COM	310.282.2377	ANNETTE MEYERSON	AMEYERSON@LOEB.COM	310.282.2156
RYAN M. AUSTIN	RAUSTIN@LOEB.COM	310.282.2268	CAITLIN L. MURPHY	CMURPHY@LOEB.COM	202.618.5026
AMY BELL	ABELL@LOEB.COM	310.282.2170	DAVID C. NELSON	DNELSON@LOEB.COM	310.282.2346
LAURA B. BERGER	LBERGER@LOEB.COM	310.282.2274	LANNY A. OPPENHEIM	LOPPENHEIM@LOEB.COM	212.407.4115
LEAH M. BISHOP	LBISHOP@LOEB.COM	310.282.2353	RONALD C. PEARSON	RPEARSON@LOEB.COM	310.282.2230
SUSAN G. BLUMENTHAL	SBLUMENTHAL@LOEB.COM	202.618.5009	ALYSE N. PELAVIN	APELAVIN@LOEB.COM	310.282.2298
DEBORAH J. BROSS	DBROSS@LOEB.COM	310.282.2245	STANFORD K. RUBIN	SRUBIN@LOEB.COM	310.282.2090
TARIN G. BROSS	TBROSS@LOEB.COM	310.282.2267	LAURIE S. RUCKEL	LRUCKEL@LOEB.COM	212.407.4836
CHRISTOPHER W. CAMPBELL	CWCAMPBELL@LOEB.COM	310.282.2321	JOHN F. SETTINERI	JSETTINERI@LOEB.COM	212.407.4851
THERESA R. CLARDY	TCLARDY@LOEB.COM	310.282.2058	C. MICHAEL SPERO	CMSPERO@LOEB.COM	212.407.4877
REGINA I. COVITT	RCOVITT@LOEB.COM	310.282.2344	ANDREW K. STEENBOCK	ASTEENBOCK@LOEB.COM	310.282.2242
TERENCE F. CUFF	TCUFF@LOEB.COM	310.282.2181	REBECCA M. STERLING	RSTERLING@LOEB.COM	310.282.2301
LINDA N. DEITCH	LDEITCH@LOEB.COM	310.282.2296	MEGAN A. STOMBOCK	MSTOMBOCK@LOEB.COM	212.407.4226
PAMELA J. DRUCKER	PDRUCKER@LOEB.COM	310.282.2234	ADAM F. STREISAND	ASTREISAND@LOEB.COM	310.282.2354
PAUL N. FRIMMER	PFRIMMER@LOEB.COM	310.282.2383	ALAN J. TARR	ATARR@LOEB.COM	212.407.4900
ANDREW S. GARB	AGARB@LOEB.COM	310.282.2302	STUART P. TOBISMAN	STOBISMAN@LOEB.COM	310.282.2323
ELIOT P. GREEN	EGREEN@LOEB.COM	212.407.4908	JESSICA C. VAIL	JVAIL@LOEB.COM	310.282.2132
RACHEL J. HARRIS	RHARRIS@LOEB.COM	310.282.2175	NICHOLAS J. VAN BRUNT	NVANBRUNT@LOEB.COM	310.282.2109
TANYA A. HARVEY	THARVEY@LOEB.COM	202.618.5024	GABRIELLE A. VIDAL	GVIDAL@LOEB.COM	310.282.2362
KAREN L. KUSHKIN	KKUSHKIN@LOEB.COM	212.407.4984	JOHN S. WARREN (Ret.)	JWARREN@LOEB.COM	310.282.2208
THOMAS N. LAWSON	TLAWSON@LOEB.COM	310.282.2289	BRUCE J. WEXLER	BWEXLER@LOEB.COM	212.407.4081
JEROME L. LEVINE	JLEVINE@LOEB.COM	212.407.4950	DANIEL M. YARMISH	DYARMISH@LOEB.COM	212.407.4116