# Private Client Alert

# Fiscal Cliff Averted:

# Tax Consequences for High-Net-Worth Individuals

January 7, 2013

The American Taxpayer Relief Act of 2012, Congress's partial solution to avert the "fiscal cliff", was signed into law by President Obama on January 2, 2013. The Act extended the Bush-era tax rates originally enacted in 2001 for all but "high-income taxpayers" (individuals with incomes above $400,000 and joint filers with incomes above $450,000) for whom the top tax rate on ordinary income increased to 39.6% effective January 1, 2013. The Act also included several other tax increases and extended a variety of tax cuts that had expired. Here is a summary of some of the key provisions:

**Income Tax Changes:**

1. In addition to the increase in ordinary income rates for high-income taxpayers, the long-term capital gains rates increased to 20% for those above the same income thresholds.

2. Rates on "qualified dividends" were scheduled to revert back to ordinary income rates, but the Act permanently taxes qualified dividends at the preferential rates for long-term capital gains.

3. The alternative minimum tax "patch" is made permanent with AMT exemptions of $78,750 for joint filers and $50,600 for individuals (phased out at higher income levels), effective retroactively for the 2012 tax year.

4. The personal exemption and itemized deduction phase outs (PEP and PEASE) return for individuals earning more than $250,000 ($300,000 for joint filers). These phase outs effectively raise the marginal tax rate for these taxpayers.

5. Exemption amounts, income bracket thresholds, the AMT exemption, and all phase-out thresholds are now indexed for inflation.

**Estate and Gift Tax Provisions:**

1. Providing some permanence to what has been over a decade of instability for estate planners, the Act sets the unified exemption for estate, gift, and generation-skipping transfer taxes to $5,000,000 indexed for inflation from 2011 ($5,250,000 in 2013). Transfers in excess of the exemption will be taxed at a flat 40% rate. Non-resident aliens with U.S. property retain their historic $60,000 exemption, unless increased by an applicable treaty.

2. The Act makes the provisions allowing for portability of the exemption to surviving spouses permanent.

3. The state death-tax credit was not reinstated.

4. The Act makes permanent several helpful technical generation-skipping transfer tax provisions that had expired on January 1.

**Tax Extenders:**

The Act extended, through at least 2013 (and when necessary retroactively to 2012), dozens of expired tax benefits and code provisions including:

1. The allowance for charitable contributions of distributions from individual retirement accounts for individuals older than 70 ½ and increased contribution limitations for the charitable donation of certain conservation property;

2. The extension of various business provisions, including: the R&D credit, 50% bonus depreciation, various renewable energy credits, the look-through treatment of certain payments under the foreign personal holding company rules, and the Subpart F exemption for proceeds from the active conduct of an insurance business abroad; and

3. The extension for five years of certain benefits contained in the 2009 “stimulus” bill such as boosts to the child tax credit and earned income tax credit.

**Other Tax Changes for 2013:**

The Act did not alter the following tax increases that were already slated to take effect in 2013:

1. The 2% payroll tax holiday expired January 1, 2013, and rates for FICA taxes returned to 6.2%.

2. The 3.8% Medicare surtax on investment income added by the Affordable Care Act took effect on January 1, 2013, for individuals with adjusted gross incomes above $200,000 ($250,000 for joint filers).

3. In addition, the annual exclusion from gift tax increased to $14,000 per donor per donee.

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