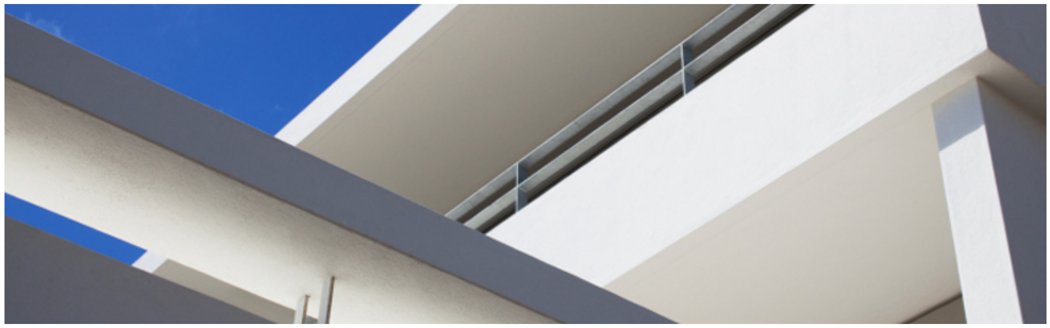
Tax Update

2013 Federal Income Tax Increases



PARR BROWN GEE & LOVELESS

January 3, 2013

On January 1, 2013 Congress passed, and on January 3, 2013 the President signed, the American Taxpayer Relief Act of 2012 (the "Act"). The Act reverses many of the federal tax increases that were scheduled to go into effect in 2013 and retains certain favorable tax benefits that were scheduled to expire. However, it also increases income taxes for some high-income individuals and increases transfer tax rates. This article summarizes certain key provisions of the Act applicable to individual taxpayers.

Individual Ordinary Income Tax Rates. Except for certain "high-income taxpayers," the federal income tax rates on the ordinary income of individual taxpayers that were in effect in 2012 will remain in effect for years after 2012 with no sunset provision. A new, higher 39.6% federal income tax rate will apply, however, to the ordinary taxable income of individual taxpayers in excess of a certain threshold amount - $450,000 in the case of married taxpayers filing jointly, $225,000 for married taxpayers filing separately and $400,000 in the case of single filers. The applicable threshold amount for application of the new 39.6% rate will be adjusted for inflation.

Long-Term Capital Gain and Qualifying Dividend Rates. For tax years after 2012, the regular federal income tax rates on long-term capital gains and qualifying dividend income of individual taxpayers will remain at 2012 levels (e.g., a maximum 15% rate for most long-term capital gains[1]), except that:

- Under the Act, the maximum regular federal income tax rates on long-term capital gains and qualifying dividend income of individual taxpayers will increase from 15% to 20% for taxpayers with incomes exceeding $400,000 ($450,000 for married taxpayers); and

- The ObamaCare 3.8% additional net investment income tax will continue to be imposed on all or a portion of the capital gains, dividends, and other forms of net investment income (e.g., interest, net rents) of taxpayers with modified adjusted gross income over $200,000 ($250,000 if married filing jointly and $125,000 if married filing separately).

Reinstatement of Limitation on Itemized Deductions. Beginning with 2013, the phase-out limitation on itemized deductions, which had previously been suspended, is reinstated with a starting threshold of $300,000 for joint filers, $250,000 for single filers, and $150,000 for married taxpayers filing separately. The dollar amounts are inflation-adjusted for years after 2013. The otherwise allowable itemized deductions of individual taxpayers subject to the phase-out limitation are reduced by 3% of the amount by which their adjusted gross income ("AGI") exceeds the applicable threshold amount, with a maximum reduction of 80% of their allowable itemized deductions. For example, a married taxpayer filing a joint

[1] The special individual long-term capital gain tax rates of 25% on "unrecaptured Section 1250 gain" with respect to depreciable real property and 28% with respect to collectibles remain unchanged.

return with 2013 AGI of $500,000 and otherwise allowable itemized deductions of $50,000 would lose $6,000 in itemized deductions and only be allowed the remaining $44,000.

Reinstatement of Phase-Out of Personal Exemptions. For tax years after 2012, the personal exemption phase-out ("PEP") is reinstated with a starting AGI threshold of $300,000 for joint filers, $250,000 for single filers, and $150,000 for married taxpayers filing separately. As a result, taxpayers will lose 2% of their otherwise allowable personal exemption amount for every $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. As a result, a married taxpayer filing a joint return with 2013 AGI of $425,000 or greater would be unable to claim any personal exemptions. The applicable PEP dollar thresholds are inflation-adjusted for tax years after 2013.

Additional Payroll Tax. The employee portion of payroll taxes for 2013 will revert to pre-2011 levels. As a result, employees will pay an additional 2% payroll tax on wages up to $113,700. Additionally, under ObamaCare, an additional 0.9% Medicare tax on employees will apply to wages and other compensation income over $250,000.

Alternative Minimum Tax Relief. The Act increases the alternative minimum tax ("AMT") exemption amount for 2012 from $33,750 for unmarried taxpayers, $45,000 for joint filers, and $22,500 for married persons filing separately to $50,600 for unmarried taxpayers, $78,750 for joint filers and $39,375 for married persons filing separately. In addition, for tax years beginning after 2012, the Act indexes the AMT exemption amounts for inflation.

Transfer Tax Provisions. The Act reverses increases in estate, gift and generation-skipping transfer tax that were scheduled to occur for individuals dying and gifts made after 2012 by continuing without any sunset provision the inflation-adjusted exemption level at $5,000,000. It also continues the portability feature that allows the estate of the first spouse to die to transfer his or her unused exclusion amount to the surviving spouse. The Act, however, does increase the tax rate on transfers in excess of the exemption amounts from 35% to 40%.

If you have any questions concerning these or any of the additional changes to federal income taxes, please contact Kenneth Tillou, Dale Hansen, Stanley Neeleman or Chase Manderino at the numbers below.

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