Peter Leonard & Company
CERTIFIED PUBLIC ACCOUNTANT

Expertise Integrity Results

American Taxpayer Relief Act of 2012

How it impacts you and your business

10780 Santa Monica Blvd., Suite 401
Los Angeles, CA 90025
(323) 651-4900
Fax: (323) 988-7171

HOMEOWNER MORTGAGES

Cancellation of Indebtedness on Personal Residence – Through 2013, homeowners will continue to be able to exclude up to $2 million of income from cancellation of mortgage indebtedness.

Mortgage Insurance Premiums – Mortgage insurance premiums will continue to be treated as deductible qualified residence interest through 2013.

Key Tax Provisions for Businesses

DEDUCTIONS AND EXPENSING PROVISIONS

Section 179 Small Business Expensing Election – Amounts allowed to be expensed under section 179 for certain property and equipment expenditures, including computer software, were substantially increased to $500,000 with a $2 million investment limit.

Bonus Depreciation – 50% Bonus depreciation was extended through 2013 for property with a twenty year MACRS recovery period or less. The Act extended the 50% bonus depreciation for aircraft and long-production period property through 2014. Unlike the section 179 expensing election, bonus depreciation property must meet the first-use requirement. The Act also allows corporations to elect to take additional alternative minimum tax credits in 2013 if they forego the use of bonus depreciation on qualified property placed in service in those years and depreciate such property using the straight-line method.

Qualified Leasehold/Retail Improvements and Restaurant Property – The Act extends the 15-year MACRS recovery period for qualified leasehold improvements, qualified retail improvements and qualified restaurant property that is place in service before 2014.

Qualified Film and Production Costs – Rules allowing producers to expense the first $15 million of qualified film and television production costs incurred in the United States was extended through 2013.

TAX CREDITS & INCENTIVES

Research Tax Credit – The research tax credit that expired after 2011 has been extended through 2013. This credit applies to businesses engaging in certain qualified research activities. The credit also applies to qualified research expenditures and payments to universities and other qualified institutions. The Act modifies rules for computing the credit when a trade or business changes hands.

Work Opportunity Credit – The work opportunity tax credit was extended through 2013 for employers that hire certain targeted hard-to-employ workers or unemployed veterans with service connected disabilities.

Tax Incentives for Empowerment Zones – Tax incentives for empowerment zones were extended through 2013.

OTHER BUSINESS PROVISIONS

Exclusion for the Gain on the Sale of Small Business Stock – The exclusion of 100% of the gain on the sale of qualified small business stock was extended through 2013.

Shortened Built-In-Gains Tax Recognition Period – The recognition period for S Corporation built-in-gains tax was shortened from ten years to five years through 2013. The Act provides new rules clarifying how to treat built-in-gains property sold using the installment sale method.

Charitable Deduction for Food Inventory – The enhanced deduction for charitable contributions of food inventory was extended through 2013.

S Corporation Charitable Contribution Rules – The charitable contribution rules allowing S corporation shareholders to take their share of charitable contributions, even if the deductions exceed their adjusted basis in the S corporation, were extended through 2013.

Please contact **Peter Leonard & Company** to find out more about the American Taxpayer Relief Act of 2012. We can help you develop effective tax strategies to deal with these changes in the tax law.

The provisions and changes contained in the Act should be reviewed in their entirety before making any decisions.

Your Guide to the American Taxpayer Relief Act of 2012

This guide identifies key provisions of the American Taxpayer Relief Act of 2012 (the "Act") that may affect you or your business—both now and in the future. The Act, which was a last-minute compromise by Democrats and Republicans to avert what has been called the "fiscal cliff," was passed by Congress on January 1, 2013 and signed into law by President Obama on January 2.

Some of the highlights of the Act:

- Allows the "Bush-era" tax rates for high-income tax payers—individuals and families with taxable income over $400,000 and $450,000 respectively—to sunset
- Permanently patches the alternative minimum tax
- Provides for a 40% estate tax with a $5 million unified gift and estate tax exclusion
- Revives many tax extenders

Key Tax Provisions for Individuals

TAX RATES

Individual Tax Rates – Marginal tax rates for individuals with taxable income levels above $400,000 ($450,000 for married taxpayers; $425,000 for heads of households) are permanently increased to 39.6% for years beginning in 2013. Tax rates for taxable income below these income levels will be 10, 15, 25, 28, 33, and 35%. All rates will be adjusted for inflation after 2013. The maximum rate of 35% for C corporations will be lower than the maximum rate of 39.6% for individuals operating businesses using pass-through entities, such as partnerships and S corporations. Business owners may want to rethink their tax structures, especially since there is bi-partisan support to reduce C corporation rates even further. Starting in 2013, the under the Patient Protection and Affordable Care Act (the "PPACA"), the Medicare tax will increase by .9% for married couples with $250,000 of earned income or other taxpayers with $200,000 of earned income.

Tax Rates on Capital Gains and Qualified Dividends – Starting in 2013, the rate for capital gains and qualified dividends will increase to 20% to the extent that a taxpayer is in the 39.6% tax bracket. All other taxpayers will continue to be taxed on capital gains and qualified dividends at 15%, or lower. However, starting in 2013, the PPACA will impose an additional 3.8% tax on net investment income (income from rents, royalties, dividends and interest). This additional 3.8% tax will kick in for couples whose adjusted gross income ("AGI"), as modified, is above $250,000 for married couples ($200,000 for single individuals). Municipal bond interest will not be subject to the new 3.8% tax.

Alternative Minimum Tax (AMT) Patch – Starting in 2012, the Act permanently patches the AMT by increasing the exemption amount to $50,600 for single individuals ($78,750 for married couples). The patch also allows for nonrefundable personal credits to be fully utilized for both the taxpayer's regular and AMT tax liability. Beginning in 2013, the AMT exemption amounts will be adjusted annually for inflation. This patch will save an estimated 60 million taxpayers from being subject to the AMT.

Federal Estate and Gift Taxes – The Act permanently creates a 40% estate tax rate for decedents dying after 2012, with a $5 million exclusion that will be adjusted for inflation. The Act also provides for a $5 million gift tax exclusion. The Act makes permanent a portability election that allows a surviving spouse to utilize the unused portion of the first-to-die spouse's $5 million exclusion. The GST provisions scheduled to expire after 2012 were extended.

EXEMPTIONS AND DEDUCTIONS

Phase-out of Personal Exemption – The phase-out of personal exemptions is reinstated for AGI thresholds of $300,000 for married couples ($250,000 for single taxpayers). Exemptions will be reduced by two percent for each $2,500 that AGI exceeds the threshold amount.

Reinstatement of Limitations on Certain Itemized deductions – Itemized deductions are reduced by 3% of the amount that a taxpayer's AGI exceeds $300,000 for married couples ($250,000 for single taxpayers). Itemized deductions cannot be reduced by more than 80%. Certain itemized deductions including medical expenses, investment interest, casualty and theft losses and gambling losses are excluded from this phase-out provision. The AGI threshold amount will be increased after 2013 for inflation.

State and Local Sales Tax Deduction – An itemized sales tax deduction, in lieu of taking a deduction for state and local income taxes, was extended through 2013.

Teachers Classroom Expenses – The above-the-line de-duction for up to $250 of qualified expenses incurred by primary and secondary education professionals was extended.

Deduction for Qualified Tuition and Student Loan Interest – The deduction for qualified tuition and expenses was extended for years 2012 and 2013. The Act also suspended the sixty month limitation period for deductibility of interest on student loans that was to expire in 2013 and expanded the modified AGI phase-out limits.

IRA Distributions to Charities – The Act extends through 2013 the provision allowing tax-free distributions from IRAs to public charities for taxpayers who are age 70 1/2 or older.

CREDITS

Child Tax Credit – The $1,000 per child tax credit was extended. This credit was to be reduced to $500 after 2012. The child tax credit will not be adjusted for inflation.

Earned Income Credit – The earned income credit rules were extended through 2017. The Act simplified definitions of earned income and changed the relationship test and tie breaking rules for determining eligibility. The estimated decrease in revenue over 10 years is projected to be approximately $29 billion.

Child and Dependent Care Credits – The existing provisions of the child and dependent care credit were permanently extended. The limits for qualified expenses will remain at $3,000 for one children and $6,000 for two or more children. Qualified expenses must be reduced by amounts the taxpayer's employer pays, if such amounts are excluded from the taxpayer's W-2 income. The Act also permanently extends the employer provided child care facilities and services credit.

EMPLOYEE BENEFITS

Transit Benefits – Through 2013 transit benefits paid to employees will continue to be a tax-free fringe benefit.

Employer Provided Education Assistance – The Act permanently extended the exclusion of up to $5,250 of employer-provided education assistance. The exclusion applies to both the employee's income and the calculation of their employment taxes. Employers may also deduct the cost of such education assistance.