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Dear Clients and Friends,

As you may have heard, the President signed and enacted the **American Taxpayer Relief Act** into law to avoid the "Fiscal Cliff."

The major federal tax provisions are as follows:

- The Bush-era tax cuts are made permanent and individual income tax rates remain the same for all except the newly defined "high income" taxpayers. The income tax rate increases to 39.6% (up from 35%) for single individuals with taxable income greater than $400,000 and $450,000 for joint filers.

- The two-percentage-point reduction in payroll taxes for Old Age, Survivors and Disability Insurance (OASDI) tax, commonly known as the Social Security tax, will be allowed to expire thereby bringing this rate back to 6.2% from last year's rate of 4.2%.

- The higher exemption amounts for alternative minimum tax (AMT), the so-called "patch," are made permanent, resulting in an estimated 30 million taxpayers escaping being subject to the AMT.

- Qualified dividends and long term capital gains are taxed at 20% (up from 15%) for single individuals with taxable income of at least $400,000 and $450,000 for joint filers. When adding the new health care tax of 3.8% (see below for an explanation of this) for investment income and gains, the overall rate for higher income taxpayers will be 23.8%.

- The Personal Exemption Phase-out, which had previously been suspended, is reinstated with a starting threshold of $250,000 for single filers and $300,000 for joint filers. Under the phase-out, the total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by 2% for each $2,500 (or portion thereof) by which the taxpayer's adjusted gross income (AGI) exceeds the applicable threshold.

- A limitation on itemized deductions is reinstated with a threshold of

$250,000 for single filers and $300,000 for joint filers. Thus, for taxpayers subject to the limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which their AGI exceeds the threshold amount, with the reduction not to exceed 80% of the otherwise allowable itemized deductions.

- For estate, gift, and generation-skipping transfer (GST) tax purposes, for individuals dying and gifts made after 2012, there is a $5 million exemption (adjusted for inflation), and the top estate, gift and GST rate is permanently increased from 35% to 40%.
- Tax incentives for businesses, including the research credit and the special expensing rules for qualified film and television productions are generally extended through the end of 2013.
- A number of individual tax provisions have been retroactively extended through 2013. In addition, there is a five-year extension of credits, including the college tuition credit, the earned income tax credit, and the child tax credit.
- Various energy credits are also extended.
- Business tax extenders include increased expensing amounts under Section 179 and the availability of an additional 50% first-year bonus depreciation on purchases of qualified business assets through 2013. There is also the return of the fifteen-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements.

In addition to the various provisions discussed above, some new taxes took effect January 1st as a result of the 2010 health care reform legislation.

Additional Medicare tax on high-income wage earning taxpayers.

The employee portion of the Medicare tax, normally 1.45% of covered wages, is increased by 0.9% on wages that exceed a threshold amount. The additional tax is imposed on the combined wages of both the taxpayer and the taxpayer’s spouse, in the case of a joint return. The threshold amount is $200,000 for single filers and $250,000 for joint filers. For self-employed taxpayers, the same additional Medicare tax applies to self-employment income in excess of the threshold amount.

Medicare tax on investment income.

A new tax is imposed on individual taxpayers equal to 3.8% of the lesser of the individual's net investment income for the year or the amount the individual's modified AGI exceeds a threshold amount. For estates and trusts, the tax equals 3.8% of the lesser of undistributed net investment income or AGI over the dollar amount at which the highest trust and estate tax bracket begins.

The threshold amount is $200,000 for single filers and $250,000 for joint filers.

Net investment income means investment income reduced by deductions properly allocable to that income. Investment income includes income from interest, dividends, annuities, royalties, rents, and net gain from disposition of property, other than such income derived in the ordinary course of a trade or business. However, income from a trade or business that is a passive activity and from a trade or business of trading in financial instruments or commodities is included in investment income.

As you can see, there are many changes and the implementation will be complicated. **Please feel free to call me or any of the partners of our firm** to discuss these matters and the potential effect on your own income tax situation.

Very Truly Yours,

Mark Umemoto, CPA
Senior Tax Manager

Sobul, Primes & Schenkel

12100 Wilshire Blvd. Suite 1150 Los Angeles, CA 90025 p. 310.826.2060
info@spscpa.com www.spscpa.com

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