

THE FISCAL CLIFF WAS AVOIDED – BUT WHAT DOES IT MEAN?

After a long and difficult negotiation process over the last several months, Congress finally passed legislation that allowed the nation to avert the fiscal cliff. The Senate and House of Representatives each approved the American Taxpayer Relief Act (“ATRA”) on January 1, 2013, and President Obama subsequently signed the bill into law.

For most taxpayers, ATRA provides much-needed stability for tax rates that, until now, were uncertain. The only exception is the payroll tax which was reduced to 4.2% for the past two years, and that reduced rate was not extended for 2013. Accordingly, employees' share of Social Security taxes will return to 6.2%, and workers will likely see a change in their first paycheck of 2013.

Other than the expiration of the payroll tax cut, the agreement provides for the following:

- **Income tax** - rates will remain the same, except that individuals earning more than \$400,000 and couples earning more than \$450,000 will now be taxed at 39.6%.
- **Capital gains and dividends** - will continue to be taxed at 15%, except for single/married filers above \$400,000/\$450,000, whose rate will increase to 20%.
- **Estate tax** - will be set permanently at a top rate of 40% on estates valued at more than \$5 million (\$10 million for married couples) and it will be adjusted annually for inflation. The gift and estate taxes will remain unified. With the inflation adjustment, the gift and estate tax exemption in 2013 is \$5.2 million. **REMEMBER – the Minnesota estate tax exemption remains \$1 million.**
- **Alternative minimum tax** - The Alternative minimum tax (AMT) patch (higher exemption amounts and personal credits allowed to offset regular tax and AMT) has been made permanent.

In addition, certain individual tax provisions that expired at the end of 2011 have been extended for both 2012 and 2013, including:

- Deductions for state and local sales taxes;
- Deduction for tuition expenses; and,
- The IRA charitable rollover, which allows individuals over age 70 ½ to give up to \$100,000 from an IRA directly to a charity.

Up next for Congress – likely a full-scale ‘debate’ regarding the debt ceiling and what to do about those automatic spending cuts set to take effect March 1st. The outcome is likely to impact how much will be available in Medicare and Medicaid benefits.