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American Taxpayer Relief Act of 2012- Part 2

Income Tax, Capital Gains and Additional Medicare Tax Rates

The debate over the income tax rates took much of the press over the entire fiscal cliff and brought some complication with compromise. For anyone whose taxable income is less than $450,000 (married filing jointly) or $400,000 (single), the tax rates remain the same that we've been used to since the "Bush Tax Cuts" were put into place over 10 years ago. If your income is over the designated amount, your highest tax rate will be 39.6%. What was not expected by all is they made these tax rates permanent rather than setting an expiration date for a few years down the road. This is significant since it should avoid a future "fiscal cliff" to be avoided at the last minute.

They also permanently extended the current capital gains tax rates while raising the rate for those over the $450,000/$400,000 level. So if your total income falls in the 10% or 15% income tax brackets, your capital gains will be 0%. If you taxable income is over the 15% bracket, but under the $450,000/$400,000 level, you will pay 15% capital gains. If you are over the $450,000/$400,000, you will pay a maximum of 20% capital gains. They also made permanent that qualified dividends (like those paid from family corporations) will be taxed at capital gains rates.

The tax rates are complicated by measures that are also taking effect in 2013 from the Healthcare bill. Part of that legislation called for an additional Medicare tax on individuals whose income was greater than $250,000. The additional tax is 3.8% on unearned income (rental, interest, dividends, etc) and 0.9% on earned income (wages, farm income, etc).

The following chart is an attempt to summarize all three tax rate schedules and how they fit together. Remember that while the capital gains tax replaces the income tax rate for qualified income, the Medicare Tax (both earned and unearned) is an additional tax on top of the income or capital gain tax.

Estimated 2013 Tax Tables for Married Filling Joint Returns

Income Range	Income Tax Bracket	Capital Gains Bracket	Unearned Medicare Tax	Earned Medicare Tax
$0 to $17,900	10%	0%	0%	0%
$17,901 to $72,500	15%	0%	0%	0%
$72,501 to $146,400	25%	15%	0%	0%
$146,401 to $223,050	28%	15%	0%	0%
$223,051 to $398,350	33%	15%	3.8%*	0.9%*
$398,351 to $450,000	35%	15%	3.8%	0.9%
$450,000 and up	39.6%	20%	3.8%	0.9%

**Starting at incomes of $250,000.*

Nebraska Farm Business, Inc. www.nfbi.net

Alternative Minimum Tax

The alternative minimum tax was enacted in 1969 to keep wealthy tax payers from using legal deductions to avoid paying income taxes. When it was put in place, it affected 155 taxpayers. What they failed to do at the time was index the exemption for inflation. In time, inflation caught up with the exemption and Congress got into the habit of passing a two-year "patch" to fix the problem for the middle class. The last patch expired at the end of 2011 so we were due for another patch to avoid a significant tax of most taxpayers making over $50,000 a year.

The American Taxpayer Relief of 2012 permanently fixed the Alternative Minimum Tax, retroactively to January 1st, 2012 and indexed the exemption for inflation.

Estate Tax

The Federal estate tax has been very widely talked about in the agricultural community for the past 5 years. Debate over repeal of the estate tax versus higher exclusions has finally been solved with the American Taxpayer Relief Act of 2012.

When discussing the Federal Estate tax, a few definitions are important to know.

Estate Tax Exclusion: *Annual limit of net assets (in general terms assets at fair market value minus liabilities) that can pass through an estate tax free.*

Estate Tax Rate: *The percentage of tax you will pay on net assets that exceed the annual tax exclusion.*

The American Taxpayer Relief Act of 2012 put a $5 Million exclusion in place that is indexed for inflation with no expiration date. This is another pleasant surprise that comes out of the tax bill. A permanent exclusion provides an opportunity to do good long term estate planning. With the rapid increase in the value of farmland, there are more and more producers who are in need of quality estate planning. It is, of course, possible that Congress will again address the issue in the future.

If you have a net worth of more than $5 Million ($10 million per couple), it is now a good time to find a good accountant and attorney to start working on a reasonable plan that can reduce the value of your estate. If you're married and your net worth is more than $5 million, you may consider some simple planning to make sure asset ownership are divided evenly between spouses. Anyone, regardless of net worth, should periodically review their wills and other estate planning devices to make sure provisions are up to date.

Another provision that they made permanent with this bill was the Portability Provision. The Portability Provision was new in 2010. This allows a spouse who doesn't use their entire exclusion to "give" the remainder to their spouse. In other words, if the first to die has net assets of $2 million, an election can be made on their estate tax return that the remaining $3 million can be added to the surviving spouse's exclusion. So when the second to die passes away, his or her exclusion would be $8 million.

This is a great tool, but it doesn't take away the need to make sure the assets are split as evenly as possible. Some simple planning can make sure the marital exclusion can be used to its fullest potential and ensures that little to no exclusion is lost. It would also be beneficial in a situation where assets values are low when the first spouse dies and there is a rapid increase in valves before the second spouse dies. The election does have to be made on a timely filing estate tax

return and you are limited to the portability from your last spouse (you can't stock pile portability from multiple spouses.)

What does permanent mean?

In the past few years we have been facing many expiring tax laws. These expiration dates are what caused a "fiscal cliff" to be in the future. The action of making these tax laws permanent means that it will take Congress acting to change the laws. They are able to change them in the future, but they will not change without a future law change. This means they are less likely to be adjusted than if an expiration date was tied to them.