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2012 American Taxpayer Relief Act: A Focus on Investments

Congress passed the American Taxpayer Relief Act to avert the tax side of the "Fiscal Cliff" and bring some certainty to the Tax Code. Almost all taxpayers are affected by the numerous extensions and modifications. This letter provides some highlights of the American Taxpayer Relief Act as it applies to investments. Watch for subsequent newsletters to address the business side of the new law.

INVESTMENTS

CAPITAL GAINS/DIVIDENDS SUNSETS

The American Taxpayer Relief Act raises the top rate for capital gains and dividends to 20 percent, up from the Bush-era maximum 15 percent rate. That top rate applies to the extent that a taxpayer's income exceeds the thresholds set for the 39.6 percent rate ($400,000 for single filers; $450,000 for joint filers and $425,000 for heads of households).

All other taxpayers will continue to enjoy a capital gains and dividends tax at a maximum rate of 15 percent. A zero percent rate will also continue to apply to capital gains and dividends to the extent income falls below the top of the 15 percent income tax bracket—projected for 2013 to be $72,500 for joint filers and $36,250 for singles. Qualified dividends for all taxpayers continue to be taxed at capital gains rates, rather than ordinary income tax rates as they were prior to 2003.

The 28 and 25 percent tax rates for collectibles and recaptured Code Sec. 1250 gain, respectively, continue unchanged after 2012. Also unchanged is the application of ordinary income rates to short-term capital gains; only long-term capital gains, those realized on the sale or disposition of assets held for more than one year, can benefit from the reduced net capital gain rate.

Generally, dividends received from a domestic corporation or a qualified foreign corporation, on which the underlying stock is held for at least 61 days within a specified 121-day period, are qualified dividends for purposes of the reduced tax rate. Certain dividends do not qualify for the reduced tax rates and are taxed as ordinary income. Those include (not an exhaustive list) dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.

Installment payments received after 2012 are subject to the tax rates for the year of the payment, not the year of the sale. Thus, the capital gains portion of payments made in 2013 and later is now taxed at the 20 percent rate for higher-income taxpayers.

It should be noted that starting in 2013, under the Patient Protection and Affordable Care Act (PPACA), higher income taxpayers must also start paying a 3.8 percent additional tax on Net Investment Income (NII) to the extent certain threshold amounts of income are exceeded

($200,000 for single filers, $250,000 for joint returns and surviving spouses, $125,000 for married taxpayers filing separately). Those threshold amounts stand, despite higher thresholds now set for the 20 percent capital gain rate that previously had been proposed by President Obama to start at the same levels. The NII surtax thresholds are not affected by the American Taxpayer Relief Act. Starting in 2013, therefore, taxpayers within the NII surtax range must pay the additional 3.8 percent on capital gain, whether long-term or short-term. The effective top rate for net capital gains for many "higher-income" taxpayers thus becomes 23.8 percent for long term gain and 43.4 percent for short-term capital gains starting in 2013.

The American Taxpayer Relief Act has a significant impact on all taxpayers. Our next newsletter will take a look at some of the business provisions that may affect you. If you have any questions about the new law or how it affects you, please call our office for an appointment. We will be happy to assist you.

Sincerely yours,

Freeman & Williams, LLP