January 1, 2013
Fixing The Fiscal Cliff: An Imperfect Solution

Instead of waiting until the 11th hour—the Senate waited until the 13th hour to cobble together an answer to the fiscal cliff. Now, at 9:55 P.M. on New Year's Day, the House of Representatives have approved the Senate plan. Being as this legislation is being led by the Democratic Party, we have no reason to believe President Obama will not approve the fix to the fiscal cliff.

Although very little that comes out of Congress makes good sense, the main details of the legislation mainly raises taxes on earners above $450,000 of adjusted gross income--and does little else.

These are the main details as we understand them:

NO DEFICIT REDUCTION: This is NOT a package designed to address spending cuts or deficits. For every $1 in cuts, it raises taxes by $41.The elimination of a 2% payroll tax cut will actually cause middle income and low income households to experience a tax increase. For an individual earning the maximum 2013 cap of $113,700 or more, the increase would be nearly $200 per month. Overall, the expiration of this stimulus would cost working Americans $125 billion a year.

The U.S. has hit its $16.4 trillion debt limit, forcing the Treasury Department to take "extraordinary measures" to fund the government for now. The Treasury probably will exhaust such measures by late February or early March, setting up another confrontation between the president and congressional Republicans. So much for spending restraint.

INCOME TAX RATES: The top rate on ordinary income (wages) for joint filers earning more than $450,000 ($400,000 for single filers) rises to 39.6% (up from 35%). Current tax rates would be permanently extended for income earned below that level. It is unclear whether the $450,000 threshold refers to adjusted gross income (AGI) or taxable income. AGI doesn't include subtractions for itemized deductions, while taxable income does.

INVESTMENT TAX RATES: Joint filers with income above $450,000 ($400,000 single), will see the top rate on long-term capital gains and dividends rise to 20% (up from 15%). Taxpayers earning less than $450,000 would have a permanent 15% top rate on long-term capital gains and dividends. Some of the lowest-bracket taxpayers may continue to have a zero rate.

ESTATE & GIFT TAX: The estate, gift and generation skipping tax exemption remains at $5 million as opposed to the $1 million scheduled to go into effect in 2013. The tax rate on estates or gifts above $5 million will increase from the 35% rate to 40%. Furthermore, it will continue to be indexed for inflation. For the majority of our clients, this is hugely beneficial.

ALTERNATIVE MINIMUM TAX: The bill permanently and retroactively adjusts the alternative minimum tax. This will alleviate more and more middle income Americans from dealing with the AMT.

PERSONAL EXEMPTION PHASEOUTS & PEASE LIMITATIONS: These are permanently restored for joint filers with incomes above $300,000 ($250,000 for singles). The Personal Exemption Phaseout reduces or eliminates the value of personal exemptions for taxpayers earning more than the income threshold. The Pease limitation limits the amount of itemized deductions a taxpayer can claim.

TAX EXTENDERS: Several provisions that lapsed would be extended for varying periods, and provisions that expired in early 2012 would be extended retroactively. Among these provisions are:

- Deductions for $250 of teachers' classroom expenses
- State and local sales taxes in lieu of state income taxes
- Tuition and related expenses
- A conservation donation benefit
- Direct charitable contributions of up to $100,000 of IRA assets for people 70½ and older

TAX CREDITS: The deal extends for five years the American Opportunity Tax Credit (this dollar-for-dollar credit is worth up to $2,500). The deal extends for five years the current versions of the Child Tax Credit and Earned Income Tax Credit, which are claimed by many lower-income workers making up to about $50,000.

DEPRECIATION: A one year extension of current "bonus" depreciation rules allowing businesses to deduct up to 50% of the cost of property and equipment.

Although we are disappointed there are no meaningful spending cuts, this is probably about the best we could have hoped for. This at least gives us some clarity.

That said, Happy New Year! We wish you tremendous health and prosperity in 2013. Please let us know what questions or comments you have.

Sincerely,

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