ANALYSIS OF AMERICAN TAXPAYER RELIEF ACT OF 2012
(INCLUDING CALIFORNIA CONFORMITY)

AMERICAN TAXPAYER RELIEF ACT OF 2012

In the wee hours of New Year’s morning, the Senate passed the American Taxpayer Relief Act of 2012. (HR 8) By early evening, the House had signed off on it. It was signed into law by the President on January 2, 2013.

The bill contains about 80 pages of tax law including extenders, many of which were needed in order to complete 2012 returns.

Among the highlights:

• The lower Bush-era income tax rates are made permanent for 2013 and beyond, except for high earners, whose top rate increases from 35% to 39.6%;
• The AMT exemption amount is made permanent and indexed for inflation;
• Capital gains and qualified dividend rates remain at 15% for most taxpayers, but they will increase to 20% for high earners;
• 50% bonus depreciation and $500,000 IRC §179 are extended through 2013; and
• The 2% payroll tax holiday is not extended.

INDIVIDUAL PROVISIONS

Payroll tax holiday not extended

The 2% cut in the Social Security tax for all earners will not be extended into 2013. For wages paid on or after January 1, 2013, the Social Security tax will return to 6.2% (along with the Medicare tax, the total employee share of the tax will be 7.65%).

Top tax rate increased

Beginning in 2013, the top tax rate of 39.6% (up from 35%) will be imposed on individuals with taxable income of more than $400,000 a year, $425,000 for head of household, and $450,000 for married filing joint. (Act §101(b)) These thresholds are indexed for inflation.

Aside from the top rates, other rates remain the same as 2012.

Capital gains rate increased and qualified dividends made permanent

Beginning in 2013, the maximum capital gains tax will rise from 15% to 20% for individuals taxed at the 39.6% rate (taxable incomes above $400,000, $425,000, or $450,000, depending on filing status as noted above). (Act §102(b))

The treatment of qualified dividends taxed at capital gains rates is made permanent. (Act §201(a))

California does not have a reduced capital gain rate for capital gains or dividends.
**Itemized deduction and exemption phaseouts return**

Beginning in 2013, phaseouts of itemized deductions and exemptions return for higher income taxpayers. (Act §101(b)(2))

<table>
<thead>
<tr>
<th>Itemized deduction and exemption phaseouts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filing status</td>
</tr>
<tr>
<td>Single</td>
</tr>
<tr>
<td>Head of household</td>
</tr>
<tr>
<td>Married filing joint; surviving spouse</td>
</tr>
<tr>
<td>Married filing separate</td>
</tr>
</tbody>
</table>

The threshold amounts are adjusted for inflation.

**Itemized deduction phaseout**

The mechanics of the computation do not change from prior law; only the threshold amount changes. Thus, a taxpayer’s itemized deductions are reduced by the lesser of:

- 3% of the excess AGI over the threshold amount; or
- 80% of the itemized deductions otherwise allowable.

As with prior law, certain items, such as medical expenses, investment interest expenses, and casualty, theft, or wagering losses are excluded.

**California phaseout calculated differently:** California has continued the phaseout of itemized deductions and personal exemptions.

For 2012, the threshold amounts are $339,464 for joint filers and a surviving spouse, $254,599 for heads of household, and $169,730 for single and married taxpayers filing separately. Under the phaseout, the total amount of exemptions that can be claimed by a taxpayer subject to the limitation is reduced by:

- $6 for each $2,500 (or portion thereof) for single taxpayers and heads of household;
- $6 for each $1,250 (or portion thereof) for married taxpayers filing separately; and
- $12 for every $2,500 (or portion thereof) for joint filers and a surviving spouse.

(R&TC §§17054)

When applying the phaseout amount, apply the $6 or $12 amount to each exemption credit, but do not reduce the credit below zero. If a personal exemption credit is less than the phaseout amount, do not apply the excess against a dependent exemption credit. (R&TC §17054.1)

**Personal exemption phaseout**

As with the itemized deduction phaseout, the mechanics of the computation do not change; only the threshold AGI amount changes. Thus, exemption amounts phase out by 2% for each $2,500 (or fraction thereof) by which the taxpayer’s AGI exceeds the threshold amount.

**California reduction in itemized deductions:** Itemized deductions must be reduced by the lesser of 6% of the excess of the taxpayer’s federal AGI over the threshold amount or 80% of the amount of itemized deductions otherwise allowed for the taxable year. (R&TC §17077)

- Single and married filing separate: $169,730
- Head of household: $254,599
- Married filing joint; surviving spouse: $399,464
AMT exemption “patch” and application of nonrefundable credits made permanent

The AMT exemption amount is made permanent and adjusted for inflation beginning in the 2012 tax year. (Act §104)

<table>
<thead>
<tr>
<th>Filing status</th>
<th>Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing separate</td>
<td>$39,375</td>
</tr>
<tr>
<td>Single; head of household</td>
<td>$50,600</td>
</tr>
<tr>
<td>Married filing joint</td>
<td>$78,750</td>
</tr>
</tbody>
</table>

Comment

These amounts are approximately the amounts we would have had if we’d had an inflation-adjusted “patch.” The 2011 amounts were $74,450 and $48,450.

The phaseout amounts are also made permanent and adjusted for inflation.

California conforms to AMT, but California has its own phaseout and exemption amounts that have been annually adjusted for inflation. The 2012 AMT exemption amounts are $83,225 for joint filers and a surviving spouse, $62,420 for single taxpayers and heads of household, and $41,612 for married taxpayers filing separately and estates and trusts.

The AMT exemption phaseout amounts are $312,095 for joint filers and a surviving spouse, $234,072 for single taxpayers and heads of household, and $156,047 for married taxpayers filing separately and estates and trusts. (R&TC §17062(b))

Nonrefundable credits

The Act makes permanent the IRC §26(a)(2) provision that allows nonrefundable credits to be allowed against AMT. Those credits are:

- Child and Dependent Care Credit;
- Credit for the elderly and disabled;
- Adoption Credit;
- Child Tax Credit;
- Credit for interest on certain mortgages;
- American Opportunity Tax Credit (Hope Credit) and Lifetime Learning Credit;
- Saver’s Credit;
- D.C. Homebuyer’s Credit;
- Nonbusiness Energy Credit;
- Residential Energy Efficient Property Credit; and
- The nonbusiness portion of the Plug-in Elective Drive Motor Vehicle Credit.
California allows these credits to reduce regular tax below tentative minimum tax:

- Child Adoption Credit (R&TC §17052.25);
- Child and Dependent Care Credit (R&TC §17052.6);
- Dependent Parent Credit (R&TC §17054.5);
- Enterprise Zone Hiring and Sales or Use Tax Credit (R&TC §§17053.74, 17053.70, 23622.7, 23612.2);
- Exemption Credit (R&TC §17054);
- Joint Custody Head of Household Credit (R&TC §17054.5);
- Low-Income Housing Credit (R&TC §§17058, 23610.5);
- Natural Heritage Preservation Credit (R&TC §§17053.3, 23630);
- New Home Credit (R&TC §17059.1);
- Other State Tax Credit (R&TC §§18001, 18002);
- Renter’s Credit (R&TC §17053.5);
- Research Credit (R&TC §§17052.12, 23609);
- Senior Head of Household Credit (R&TC §17054.7); and
- Targeted Tax Area Hiring and Sales or Use Tax Credit (R&TC §§17053.33, 17053.34, 23633, 23634).

California allows this credit to reduce AMT:

- Enterprise Zone Hiring and Sales or Use Tax Credit (R&TC §§17053.74, 17053.70, 23622.7, 23612.2).

Provisions made permanent

The Act provides that the sunset provisions of EGTRRA '01 are repealed. (Act §101(a)(1)) Thus, any provision of EGTRRA that has not been repealed or amended by later law is now made permanent.

- The enhanced rules for student loan interest deductions (the 60-month limitation is now permanently gone). (IRC §221) California conforms (R&TC §17024.5(a)(2)(B), 17201);
- The enhanced Child and Dependent Care Credit rules that allow the credit to be calculated based on up to $3,000 of expenses for one dependent or up to $6,000 for more than one. (IRC §21) California conforms (R&TC §17052.6);
- The EGTRRA version of the Adoption Credit, which is nonrefundable. The maximum is $10,000 adjusted for inflation (projected to be $12,770 for 2013);
- Marriage penalty relief (the increased size of the 15% rate bracket and increased standard deduction for married taxpayers filing jointly) (IRC §§1(f)(8), 63(c)(2));
- The exclusion for National Health Services Corps and Armed Forces Health Professions Scholarships. (IRC §117(c)(2)) California conforms (R&TC §17131);
- The exclusion for employer-provided educational assistance (IRC §127);
- The higher contribution amount and other EGTRRA changes to Coverdell education savings accounts. (IRC §530) California conforms (R&TC §§17024.5, 23712);
- The employer-provided child care credit. (IRC §45F) California’s credit expired (R&TC §§17052.18, 23617.5); and
- Special treatment of tax-exempt bonds for education facilities. (IRC §142(a)(13))
Individual provisions that expired after 2011

The Act retroactively extends for 2012 and through 2013 the following provisions that expired at the end of 2011:

- The $250 maximum deduction for educator expenses (Act §201; IRC §62);
- Exclusion from gross income of discharge of qualified principal residence indebtedness. (Act §202; IRC §108) California has its own law that also expired December 31, 2012. The Legislature must extend California’s law (R&TC §17144.5);
- The enhanced exclusion from income for employer-provided mass transit and parking benefits. (Act §203; IRC §132(f)) California has its own exclusions (R&TC §17149);
- Mortgage insurance premiums treated as qualified residence interest (Act §204; IRC §163(h));
- Deduction of state and local general sales taxes (Act §205; IRC §164(b));
- Special rule for contributions of capital gain real property made for conservation purposes (Act §206; IRC §170(b)); and
- Above-the-line deduction for qualified tuition and related expenses. (Act §207; IRC §222)

Except as noted, California does not conform to any of these provisions.

IRA-to-charity exclusion extended

The IRA-to-charity exclusion, which expired after 2011, has been revived for 2012 and continued through 2013. (Act §208; IRC §408(d))

Because of its late passage, the Act provides two special rules:

- A taxpayer may make a charitable distribution in January 2013 and it is deemed to have been made in 2012; and
- Any portion of a distribution from an IRA to the taxpayer in December 2012 may be treated as a qualified charitable distribution to the extent that the distribution is transferred to a qualifying charity before February 1, 2013.

California automatically conforms to this provision. (R&TC §17501(b))

Individual credits expired at the end of 2012

The Act extends for five years (through 2017):

- The American Opportunity Tax Credit for qualified tuition and other expenses of higher education (IRC §25A);
- The reduced earnings threshold for the refundability of the child tax credit (IRC §24(d));
- Enhanced provisions of the earned income tax credit (IRC §32(b)).

(Business Provisions)

Depreciation and IRC §179

IRC §179, generally

The maximum IRC §179 amount for assets placed in service in tax years beginning in 2012 and 2013 is $500,000. The phaseout threshold reverts to $2 million (full phaseout occurs at $2.5 million). (Act §315; IRC §179(b)(1))
Off-the-shelf software and revocation of election

Off-the-shelf computer software is eligible for IRC §179 depreciation through 2013. The rule allowing taxpayers to make, change, or revoke an IRC §179 election on a timely-filed amended return without IRS consent is extended for one year to apply to elections for tax years beginning after 2002 and before 2014.

Comment

Thus, the $139,000 limitation in place for assets placed in service in tax years beginning in 2012 is replaced with the $500,000 limitation.

IRC §179 on qualified real estate

The Act extends, for 2012 and 2013, the provision that allows up to $250,000 of IRC §179 on qualified real estate, including:

- Qualified leasehold improvement property as defined under IRC §168(e)(6);
- Qualified restaurant property as defined under IRC §168(e)(7); and
- Qualified retail improvement property as defined under IRC §168(e)(8).

Comment

Under prior law — that expired after 2011 — any amount disallowed under the business income limitation could only be carried over to the last year the law was effective (i.e., 2011). Any unused amount had to be treated as placed in service in that last year. A similar rule is in effect for the renewed law; any unused amount must be treated as placed in service and depreciated in 2013.

The law is now extended and dates are replaced. However, the law does not state whether an amended return may be filed to remove 2011 amounts as depreciable assets and carried forward as IRC §179 amounts.

Bonus depreciation

Bonus depreciation was scheduled to expire after 2012. The Act extends 50% bonus depreciation for one year (i.e., for assets placed in service on or before December 31, 2013). (Act §331; IRC §168(k))

For certain property with longer production periods, the Act also gives a one-year extension to property placed in service on or before December 31, 2014.

15-year depreciation on qualified real estate

The Act extends, through 2013, 15-year depreciation on qualified real estate (of the type noted above, under (“IRC §179 on qualified real estate”). (Act §311)

California doesn’t conform to any of these provisions. (R&TC §§17201, 17255, 17268, 24356, 24356.8)
Other business provisions

Other business provisions extended through 2013, and in some cases modified, are:

- Temporary exclusion of 100% of gain on certain small business stock (Act §324; IRC §1202) California doesn’t conform. California has a similar provision for exclusion of gain. However, that provision has been found unconstitutional and the FTB is disallowing exclusions taken in prior years. (Cutler v. Franchise Tax Board (August 28, 2012) Cal.App.2d, Case No. B233773)
- Basis adjustment to stock of S corporations making charitable contributions of property. (Act §325; IRC §1367) California previously conformed but does not conform to this extension. (R&TC §17024.5);
- Reduction in S corporation recognition period for built-in gains tax (Act §326; IRC §1374(d));
- Temporary minimum low-income tax credit rate for non-federally subsidized new buildings. (Act §302; IRC §42) California continues to require a 10-year period (R&TC §23809);
- Housing allowance exclusion for determining area median gross income for qualified residential rental project exempt facility bonds (Act §303; Housing Assistance Tax Act of 2008 §3005);
- Indian employment tax credit (Act §304; IRC §45A);
- New markets tax credit (Act §305; IRC §45D);
- Railroad track maintenance credit (Act §306; IRC §45G);
- Mine rescue team training credit (Act §307; IRC §45N);
- Employer wage credit for employees who are active duty members of the uniformed services (Act §308; IRC §45P);
- Work opportunity tax credit (Act §309; IRC §51);
- Qualified zone academy bonds (Act §310; IRC §54E);
- Accelerated depreciation for business property on an Indian reservation (Act §313; IRC §168(j));
- Enhanced charitable deduction for contributions of food inventory (Act §314; IRC §170(e));
- Election to expense mine safety equipment (Act §316; IRC §179E);
- Special expensing rules for certain film and television productions (Act §317; IRC §181);
- Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (Act §318; IRC §199(d));
- Modification of tax treatment of certain payments to controlling exempt organizations (Act §319; IRC §512(b));
- Treatment of certain dividends of regulated investment companies (Act §320; IRC §871(k));
- Regulated investment company qualified investment entity treatment under the Foreign Investment in Real Property Act (Act §321; IRC §897(h));
- Extension of subpart F exception for active financing income (Act §322; IRC §953(e));
- Lookthrough treatment of payments between related controlled foreign corporations under foreign personal holding company rules (Act §323; IRC §954);
- Empowerment Zone tax incentives (Act §327; IRC §1391);
- Tax-exempt financing for the New York Liberty Zone (Act §328; IRC §1400L);
- Temporary increase in limit on cover-over of rum excise taxes to Puerto Rico and the Virgin Islands (Act §329; IRC §7652(f)); and
- American Samoa economic development credit (Act §330; Tax Relief and Health Care Act of 2006 §119, P.L. 109-432, as modified).

Except as noted, California has never conformed to these provisions and will not conform.
ENERGY PROVISIONS

The Act extends through 2013, and in some cases modifies, a number of energy credits and provisions that expired at the end of 2011:

- Nonbusiness energy credits for energy-saving improvements made by individuals to their principal residence. The $500 lifetime cap remains in place (Act §401; IRC § 25C);
- Credit for alternative fuel vehicle refueling property (Act §402; IRC §30C);
- Credit for two- or three-wheeled plug-in electric vehicles (Act §403; IRC §30D);
- Cellulosic biofuel producer credit (Act §404; IRC §40(b), as modified);
- Incentives for biodiesel and renewable diesel (Act §405; IRC §40A);
- Production credit for Indian coal facilities placed in service before 2009 (extended to an eight-year period) (Act §406; IRC §45(e));
- Credits with respect to facilities producing energy from certain renewable resources (Act §407; IRC §45(d), as modified);
- Credit for energy-efficient new homes (Act §408; IRC §45L);
- Credit for energy-efficient appliances (Act §409; IRC §45M);
- Special allowance for cellulosic biofuel plant property (Act §401; IRC §168(l), as modified);
- Regulatory Commission or state electric restructuring policy for qualified electric utilities (Act §411; IRC §451); and
- Alternative fuels excise tax credits (Act §412; IRC §6426).

ESTATE TAX PROVISIONS

The Act permanently provides for a maximum estate tax rate of 40% for estates of decedents dying after 2012, with an exclusion of $5 million, adjusted annually for inflation using 2010 as a base year. (Act §101(a)(2)) The Act also provides a 40% tax rate and a unified estate and gift tax exemption of $5 million (inflation adjusted) for gifts made after 2012. The exemption amount for 2012 is $5,120,000. Although it’s not yet released, the inflation-adjusted exclusion amount for 2013 is projected to be $5,250,000.

In addition, the Act continues and makes permanent the portability election between spouses. California does not have an estate or gift tax.
## Provisions that would have expired after 2011

<table>
<thead>
<tr>
<th>Provision</th>
<th>Federal</th>
<th>California Conformity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$250 deduction for educator expenses</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Tuition deduction</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Sales tax deduction</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Deduction of mortgage insurance</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>AMT exemption</td>
<td>Made permanent and indexed for inflation</td>
<td>Yes (different amounts)</td>
</tr>
<tr>
<td>Nonrefundable credits offset AMT</td>
<td>Made permanent</td>
<td>No</td>
</tr>
<tr>
<td>Nonbusiness energy credit</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>IRA-to-charity exclusion</td>
<td>Extended through 2013 with special provisions for late transfers</td>
<td>Yes</td>
</tr>
<tr>
<td>$500,000 IRC §179</td>
<td>2012 and 2013</td>
<td>No</td>
</tr>
<tr>
<td>IRC §179 for certain real estate</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Revoke IRC §179 election</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>IRC §179 for computer software</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>15-year depreciation for certain real estate</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>100% bonus depreciation</td>
<td>Drops to 50% in 2012; 50% extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Enhanced transportation fringe benefits</td>
<td>Extended through 2013</td>
<td>Different amounts</td>
</tr>
<tr>
<td>Reduced built-in gains holding period</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Research Credit</td>
<td>Extended through 2013</td>
<td>Permanent</td>
</tr>
<tr>
<td>Enhanced charitable deductions for computer software and for food and book inventory</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>S corporation basis adjustment for charitable contributions</td>
<td>Extended through 2013</td>
<td>No, expired December 31, 2011</td>
</tr>
<tr>
<td>Work Opportunity Credit for non-veterans</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>100% exclusion for small business stock</td>
<td>Extended through 2013</td>
<td>No, provision found unconstitutional</td>
</tr>
<tr>
<td>IRC §181 expensing of film and TV productions</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Seven-year motorsports depreciation</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
</tbody>
</table>
Provisions that would have expired after 2012

<table>
<thead>
<tr>
<th>Provision</th>
<th>Federal</th>
<th>California Conformity</th>
</tr>
</thead>
<tbody>
<tr>
<td>EGTTRA tax rates</td>
<td>Made permanent beginning in 2013</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>except for higher top rates</td>
<td></td>
</tr>
<tr>
<td>Exemption phaseout</td>
<td>Reinstated for 2013</td>
<td>California</td>
</tr>
<tr>
<td></td>
<td>with higher thresholds</td>
<td>has its own</td>
</tr>
<tr>
<td>Qualified dividends</td>
<td>Made permanent</td>
<td>N/A</td>
</tr>
<tr>
<td>Capital gains rates</td>
<td>15% rate continued except for</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>20% rate for higher income</td>
<td></td>
</tr>
<tr>
<td></td>
<td>beginning in 2013</td>
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<tr>
<td>Itemized deduction phaseout</td>
<td>Reinstated for 2013</td>
<td>California</td>
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<td></td>
<td>with higher thresholds</td>
<td>has its own</td>
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<tr>
<td>Adoption Credit</td>
<td>EGTRRA provisions made</td>
<td>California</td>
</tr>
<tr>
<td></td>
<td>permanent. Nonrefundable</td>
<td>has its own</td>
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<tr>
<td></td>
<td>Maximum $10,000 (projected to</td>
<td></td>
</tr>
<tr>
<td></td>
<td>be $12,770 for 2013).</td>
<td></td>
</tr>
<tr>
<td>Enhanced Child Credit</td>
<td>Extended through 2017</td>
<td>N/A</td>
</tr>
<tr>
<td>American Opportunity Tax Credit</td>
<td>Extended through 2017</td>
<td>N/A</td>
</tr>
<tr>
<td>Enhanced EITC</td>
<td>Extended through 2017</td>
<td>N/A</td>
</tr>
<tr>
<td>2% payroll tax cut</td>
<td>Not extended</td>
<td>N/A</td>
</tr>
<tr>
<td>COD exclusion for principal residence</td>
<td>Extended through 2013</td>
<td>No</td>
</tr>
<tr>
<td>Enhanced student loan interest</td>
<td>Made permanent</td>
<td>Yes</td>
</tr>
<tr>
<td>Refundable credit for unused AMT</td>
<td>Made permanent</td>
<td>No</td>
</tr>
<tr>
<td>Enhanced Dependent Care Credit</td>
<td>Made permanent</td>
<td>Yes</td>
</tr>
<tr>
<td>Enhanced Coverdell Education Savings Accounts</td>
<td>Made permanent</td>
<td>Yes</td>
</tr>
<tr>
<td>Changes to estate tax</td>
<td>Made permanent with a higher</td>
<td>N/A</td>
</tr>
<tr>
<td></td>
<td>top rate. Exemption amount set at</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$5 million with adjustment for</td>
<td></td>
</tr>
<tr>
<td></td>
<td>inflation. Portability election</td>
<td></td>
</tr>
<tr>
<td></td>
<td>made permanent.</td>
<td></td>
</tr>
</tbody>
</table>

Spidell has created a letter to inform your clients about the American Taxpayer Relief Act of 2012. To download the letter, go to:

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