Money Matters

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Question of the Month: What are the effects of the American Taxpayer Relief Act of 2012?

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Q: Will we pay more or less taxes in 2013 due to The American Taxpayer Relief Act of 2012?

A: The Problem – Irrelevant Statements
President Obama announced the new law as follows, "Under this law, more than 98% of Americans and 97% of small businesses will not see their income taxes go up." Unfortunately, this is an irrelevant statement for 77% of workers who will see tax increases due to the new law. Although President Obama's statement is technically true, it ignores a host of higher taxes for many. To answer your question; probably more.

The Solution — Learn the Relevant Facts
As evidenced above, the devil is in the details. The new law punishes you for making more income and the punishments are cumulative as your income increases. Rather than encouraging you to earn more income, the law discourages you by taking a larger percentage of your income as it increases. Fortunately, with proper planning you can circumvent some or all of the new taxes. Let's examine the devilish details below.

Payroll Taxes. The 2013 new 6.2% payroll tax rate is 48% higher than the 2012 old 4.2% rate. And, the new rate applies to 3.3% more of your income than the old tax; $113,700 in 2013 versus $110,100 in 2012.

Income Taxes. The 2013 new 39.6% top marginal income tax rate is 13% higher than the 2012 old 35% rate, for those making $400,000 (single) or $450,000 (couples).

Medicare Taxes. The 2013 new 0.9% Medicare tax applies to those making $200,000 (single) or $250,000 (couples). This additional Medicare tax did not apply in 2012.

Reduced Exemptions and Deductions. The 2013 new law phases out exemptions and deductions for those making $250,000 (single) or $300,000 (couples).

Capital Gains, Dividends and Interest Taxes. The 2013 new 20% long-term capital gains and dividends tax rates are 33.3% higher than the 2012 old 15% rate, for those making $400,000 (single) or $450,000 (couples). The 2013 new investment surtax on capital gains, dividends and interest applies to those making $200,000 (single) or $250,000 (couples). The combined 2013 new 23.8% tax rate is 59% more than the 2012 old 15% rate (note: the surtax did not apply in 2012).

Estate Taxes. The 2013 new 40% estate tax rate is 14% higher than the 2012 old rate, for those with at least $5.25 million in assets (indexed for inflation). Fortunately, the Act makes permanent the concept of estate and gift tax exemption portability. Portability means that spouses can transfer their unused $5.25 million estate and gift tax exemption to each other, effectively creating a combined $10.5 million estate tax exemption. Unfortunately, a number of states are still 'out for blood' in the form of their own state estate taxes. Examples of those states and their lower exemption amounts include New Jersey at $675,000 and New York at $1 million.

Crunching the Numbers. The average tax increase for households earning $200,000 to $500,000 is an estimated $2,711, according to the Tax Policy Center, Committee for a Responsible Budget. The average tax increase for households earning $500,000 to $1 million is an estimated $14,812. The average tax increase for households earning more than $1 million is an estimated $170,341.

Action Steps. Fortunately, there are a host of actions you can take to avoid or mitigate these devilish new taxes. Internal Revenue Code Sections 401(k), 403(b), 457(b), 1031, 1035 and many others present powerful means to combat this tidal wave of taxes. Avoiding required minimum distributions (RMDs) is yet another means of protecting your hard earned assets. Work closely with a Registered Investment Adviser (RIA) to determine a best course of action.

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