**"The American Taxpayer Relief Act of 2012"**

**MassMutual Advanced Sales**
**Summary of Significant Provisions**

***On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 which deals with one aspect of the so-called "Fiscal Cliff" by making many permanent changes to the federal tax code. While many view the Act as a tax increase, it is estimated to add over $3.6 trillion to the federal deficit over the next 10 years. The mandatory spending cut portion of the Fiscal Cliff was officially postponed by two months. The federal debt ceiling is likely to hit by early March. The bottom line is that there remain serious budgetary issues and political battles that will arise over the next several months. The budgetary impact of this current tax legislation is likely to only increase the rhetoric and possibly, the need for Congress to take a serious look at "Tax Expenditures."***

***Estate tax exemptions and rates***
The current federal estate, gift, and generation-skipping transfer (GST) tax exemptions were scheduled to decrease to $1 million per person and $2 million per couple beginning January 1, 2013. Tax rates were scheduled to return to pre-Economic Growth and Tax Relief Reconciliation Act (EGTRRA) rates with a top rate of 55%. The new law permanently increases the exemption to the 2010 indexed exclusion amount ($5,000,000) and indexes that amount for inflation going forward. Unofficially, the 2013 estate, gift and GST tax exemptions have been calculated to be $5,250,000. The top tax rate is set at 40% for decedents dying, gifts made, and taxable generation-skipping terminations or distributions occurring after December 31, 2012.

***Other important estate and gift tax provisions***

***Reunification of the estate and gift taxes.*** Under EGTRRA, the estate and gift taxes were "decoupled," so that, by December 31, 2009, the estate and GST tax exemptions were equal to $3.5 million per person, while the gift tax exemption remained at $1 million per person. The Tax Relief Act of 2010 reunified the estate and gift taxes, effective for gifts made after December 31, 2010. The new law makes permanent the reunification of rates and exemptions.

***Portability of unused estate tax exemption.*** Under current law, for a two year window ending December 31, 2012, the executor of a deceased spouse's estate was permitted to transfer any unused exemption to the surviving spouse. The new law makes portability permanent.

***"Pay-fors."*** Like the Tax Relief Act of 2010, there were virtually no revenue raisers or spending cuts accompanying this tax act. The total budgetary impact of the new law is estimated to be $3.6 trillion over the next 10 year budgetary period. There have been a number of proposals in Congress over the past two years, as revenue raisers, that were intended as an offset to the revenue costs of increasing the estate, gift and GST tax exemptions or reducing applicable tax rates. Some of these proposals included eliminating short term and "zeroed out" GRATs, eliminating the ability to take discounts on transfers of non-business assets, changing the grantor trust income tax rules, requiring uniformity of basis for estate and income tax purposes, and several others. The new tax law does not contain any of these proposed pay-fors.

## Income Tax Provisions

***Permanent extension of the 10% (lowest) income tax bracket.***

***Permanent extension of the 25%, 28%, 33%, and 35% brackets for certain taxpayers.*** Without the new tax law, these rates had been scheduled to increase on January 1, 2013 to 28%, 31%, 36%, and 39.6% respectively. The law extends the 25%, 28%, 33% and 35% rates on income at or below $400,000 (individual filers), $425,000 (heads of households) and $450,000 (married filing jointly) for taxable years beginning after December 31, 2012.

***Repeal of the personal exemption phase-out ("PEP") and itemized deduction ("Pease") limitation.*** EGTRRA repealed the phase-out of personal exemptions and limitations on itemized deductions for 2010 (extended by the Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the 2010 Tax Act) through 2012). The law extends the repeal of PEP on income at or below $250,000 (individual filers), $275,000 (heads of households) and $300,000 (married filing jointly) for taxable years beginning after December 31, 2012.

***Permanent extension of the 15% (and lower) capital gains and dividend rates (Qualified dividends only).*** Under current law, the capital gains and dividend rates for taxpayers below the 25% bracket is equal to zero percent. For those in the 25% bracket and above, the capital gains and dividend rates are currently 15%. Without the new tax law, these rates had been scheduled to increase on January 1, 2013 to 10% and 20%, respectively, and dividends would be subject to the ordinary income rates. The law extends the current capital gains and dividends rates on income at or below $400,000 (individual filers), $425,000 (heads of households) and $450,000 (married filing jointly) for taxable years beginning after December 31, 2012. For income in excess of these amounts, the rate for both capital gains and dividends will be 20%.

***Permanent Alternative Minimum Tax (AMT), featuring inflation indexing.*** Currently, a taxpayer receives an exemption of $33,750 (individuals) and $45,000 (married filing jointly) under the AMT. Current law also does not allow nonrefundable personal credits against the AMT. The law increases the exemption amounts for 2012 to $50,600 (individuals) and $78,750 (married filing jointly) and indexes the exemption and phase-out amounts for inflation* thereafter. It also allows the non-refundable personal credits against the AMT. The law is effective for taxable years beginning after December 31, 2011.

> **The inflation indexing of the AMT exemption and phase-out amounts are done by a formula that starts with the basic exemption amount and reduces by 25% of the amount that the taxpayer's AMT income exceeds $112,500 (individuals) and $150,000 (married filing jointly).*

***IRA charitable rollover extended to 2013. Transition rule available for 2012.*** The law extends for two years (through 2013) the provision that permits tax-free distributions to charity from an Individual Retirement Account (IRA) of up to $100,000 per taxpayer, per taxable year. The law provides that individuals who took a distribution in December of 2012 will be able to contribute that amount to a charity in cash by January 31, 2013, and count it as an eligible charitable rollover to the extent it otherwise meets applicable requirements. Further, an individual can make a charitable rollover during January 2013 and treat it as a distribution made in 2012.

***Deduction for state and local general sales taxes***. The law extends for two years the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes.

***Roth conversions for retirement plans.*** Under current law, a deferral plan under section 401(k) (including the Thrift Savings Plan), 403(b) or 457(b) governmental plan can have Roth accounts that allow participants to make after tax contributions to the plan and both initial contributions and earnings are tax-free when distributed. Plans can currently allow participants to convert their pre-tax accounts to Roth accounts, but only with respect to money they have a right to take out of the plan, usually because they have reached age 59½ or separated from service. The new law will allow any amount in a non-Roth account to be converted to a Roth account in the same plan, whether or not the amount is distributable. The amount converted would be subject to regular income tax.

***Unemployment insurance.*** The law continues for one year extended federal unemployment insurance benefits.

**Not extended – Social Security 2% tax holiday.** The payroll/self-employment tax holiday originally passed for 2011, but later extended also to 2012, was not further extended by this legislation. This means employees will again pay 6.2% on wages, and self-employed individuals will pay 12.4% on self-employment income up to the threshold. The 1.45% Medicare Tax (2.9% for self-employed individuals) is not impacted by this change. Therefore, employees will now pay a total of 7.65% tax on the first $113,700 of taxable income (2013), the Medicare tax of 1.45% applies to wages above $113,700. An additional 0.90 tax for high wage earners remains (see below).

**New 2013 taxes not impacted by the American Taxpayer Relief Act of 2012.** In order to help pay for the Patient Protection and Affordable Care Act of 2010, Congress imposed two new taxes on higher income Americans that take effect January 1, 2013. These new taxes were not impacted by the new tax law.

**3.8% surtax on unearned income.** This new tax applies to interest, dividends, capital gains, rental income, passive investment income, annuities, taxable gains from the sale of a personal residence (in excess of the exclusion amount) or vacation homes. The tax applies to single individuals with Modified Adjusted Gross Income (MAGI) of $200,000 per year and married couples with MAGI of more than $250,000.

> Note: Under proposed regulations, the new unearned income surtax does not apply to distributions from life insurance policies, unless they are received as an annuity. Distributions from life insurance policies that are not Modified Endowment Contracts are treated for tax purposes first as a return of the owner's investment in the contract (return of basis). Policy loans are not considered to be taxable distributions. Any taxable distribution from an annuity contract is subject to this surtax if the holder meets the income criteria.

**FICA/SECA Medicare/Hospitalization surtax of 0.90%.** This tax applies to earned income above $200,000 for single taxpayers and $250,000 for married filing jointly taxpayers.

**Miscellaneous New Tax Law Provisions**

***Other extensions: Permanent.*** Numerous other provisions are extended, including:

- Child tax (some refundability provisions)
- Adoption credits
- Expanded dependent care credit
- College tuition deduction
- Student loan interest
- Employer provided child and dependent care payments excluded

***Other extensions: Temporary.***

- Child tax (some refundability provisions) – extended for 5 years
- American Opportunity Tuition Tax Credits – extended for 5 years
- Qualified tuition expense deduction – extended for 1 year
- Mortgage insurance treated as mortgage interest – extended for 1 year
- Energy efficient home and appliance credit – extended thru 2013 (2 years)

***Miscellaneous business provisions of interest.***

- Bonus depreciation - extended thru 2013 (thru 2014 for certain "longer lived" and transportation assets)
- 15 year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements and qualified retail improvements – extended thru 2013 (2 years)
- Section 179 asset expensing - extended thru 2013 (2 years)
- Full or partial exclusion on gain from sale of certain small business stock held for at least 5 years – applies to stock acquired prior by December 31, 2013
- Reduction in S Corporation holding period for recognizing built-in gain tax. Holding period reduced from 10 years to 5 years for sales occurring during 2012 and 2013.

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