On January 1, 2013, President Obama and Congress came to an agreement on legislation to address the “fiscal cliff”—the combination of higher taxes and forced spending cuts that were scheduled to go into effect at the beginning of 2013. The American Taxpayer Relief Act (ATRA) prevents income tax rate increases for all but about the top 1% of taxpayers and extends the deadline for the implementation of the automatic spending cuts.

ATRA also extends other income tax breaks for individuals and businesses and addresses the alternative minimum tax (AMT) and estate tax. The act does not, however, extend payroll tax cuts that were in place for 2011 and 2012, so payroll taxes will increase by two percentage points in 2013.

Here is an overview of some of the Act’s important tax law changes.

**Individual income taxes**

- **Ordinary income tax rates:** ATRA makes permanent the 2012 ordinary-income tax rates for individual taxpayers earning less than $400,000 (or $450,000 if married filing jointly). For taxpayers above these thresholds, the top marginal tax rate increases from 35% to 39.6% starting in 2013.

- **Limits on itemized deductions:** ATRA brings back the limits on certain itemized deductions and the personal exemptions. For these limits, the act sets thresholds of $250,000 (single) and $300,000 (married filing jointly). The provision reduces the total amount of itemized deductions by 3% of the amount of adjusted gross income over the threshold amounts above. The reduction in itemized deductions will not exceed 80% of otherwise allowable deductions. Personal exemptions are reduced by 2% for each $2,500 (or portion thereof) by which the adjusted gross income exceeds the threshold amounts above.

- **Alternative Minimum Tax:** ATRA makes the AMT “patch” permanent and retroactive to January 1, 2012. For 2012, the AMT exemption amounts will be $50,600 for individuals and $78,750 for married couples filing jointly. These amounts are indexed for inflation for years after 2012.
• **Long-term capital gains and dividends:** ATRA makes permanent the 2012 capital gains tax rates of 0% and 15% for taxpayers earning less than $400,000 (single) or $450,000 (married filing jointly). For taxpayers above these thresholds, the long-term capital gains rate increases to 20%. The act also makes permanent the long-term capital gains treatment for qualified dividends, which means taxpayers making more than the thresholds will face a rate increase from 15% to 20% on qualified dividends.

• **Charitable IRA rollovers:** Under certain circumstances, ATRA allows taxpayers age 70½ or older to make a direct tax-free rollover from an IRA to a qualified charitable organization. Distributions taken in December 2012 or January 2013 may be retroactively applied to 2012.

• **Other income tax items:** ATRA extends through 2013 (and in some cases retroactively to January 1, 2012) other tax breaks for individuals, including: the deduction for state and local sales tax in lieu of state and local income tax; various child- and education-related credits and deductions; contributions of capital gain real property made for conservation easements, which had expired at the end of 2011, are now applicable for 2012 and continued through 2013.

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**Estate taxes**

Under ATRA, the top estate tax rate increases to 40%. This is a 5% increase over the 2012 rate, but significantly less than the 55% rate that was scheduled to return for 2013.

The estate and gift tax exemption amount will continue to be $5 million adjusted annually for inflation. For 2013 the exemption amount will likely increase slightly from the $5.12 million 2012 exemption. This will provide significant tax savings and wealth-transfer opportunities relative to the $1 million exemption that had been scheduled to return for 2013. ATRA also makes permanent a portability provision that allows for the transfer of one spouse's unused estate exemption to the surviving spouse.

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**Businesses**

The act also extends several tax breaks for businesses, including:

- Bonus depreciation
- Enhanced Section 179 expensing
- Accelerated depreciation for qualified leasehold, retail, and restaurant improvements
- Work Opportunity credit
- Research and development credit

Owners of pass-through entities, such as sole-proprietorships, partnerships, limited liability companies, and S corporations, should also be aware of how ATRA’s individual income tax changes will affect the taxation of business income.

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**New Medicare Taxes**

It is also important to keep in mind that high-income taxpayers will face two new taxes, which were not part of ATRA, starting in 2013. Taxpayers making more than $200,000 (single) or $250,000 (married filing jointly) will face an additional 0.9% Medicare tax on earned income above those amounts and a 3.8% Medicare surtax on investment income.

For more information about how these two new taxes could affect your tax situation, please see our recent Financial Planning Update, “Two New Medicare Taxes in 2013”, in the Private Investors Resources section of williamblair.com.
How will you be affected?

**Summary of Tax Changes for 2013**
Taxpayers at all income levels will face a slew of tax changes in 2013. Here is a rundown of some of the most important changes going into effect this year and who they affect:

**All taxpayers**
- 2% increase in payroll taxes for social security on the first $113,700 of earned income
- AMT exemption “patch” now permanent and indexed for inflation
- Option to deduct state and local sales taxes instead of state income taxes restored for 2012 and 2013
- Distributions from IRAs directly to charities are restored for 2013 and, under certain circumstances, are made retroactive for 2012
- Estate tax exemption of $5 million (as indexed for inflation) for wealth-transfer taxes now permanent; top estate tax rate increases from 35% to 40%

**Individuals earning > $200,000 (or $250,000 per couple)**
- 3.8% Medicare surtax on investment income
- 0.9% Medicare tax on wages greater than these thresholds
- Limitations on itemized deductions and personal exemptions begin for those earning $250,000 (or $300,000 per couple)

**Individuals earning > $400,000 (or $450,000 per couple)**
- Top marginal tax rate increases from 35% to 39.6%
- Tax rate for long-term capital gains and qualified dividends increases from 15% to 20% (plus 3.8% Medicare surtax)

In addition to the changes highlighted above, ATRA includes other provisions that may affect you or your business. Please contact your William Blair advisor to discuss how the new tax laws will affect your personal situation in 2013 and beyond.