

# WNTS Insight

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*Congress passes fiscal cliff  
agreement to extend tax rates for  
incomes below \$450,000; deal  
includes business "tax extenders"*

## *In brief*

The House and Senate have approved a "fiscal cliff" agreement ([H.R. 8 as amended](#)) reached with the Obama Administration that would extend permanently certain 2001 and 2003 tax provisions for individuals with incomes below \$400,000, and joint filers with incomes below \$450,000. President Obama is expected to sign the legislation.

The bill also provides permanent indexing of individual alternative minimum tax (AMT) exemption levels for 2012 and subsequent years.

In addition, the approved bill extends certain expired and expiring business and individual tax provisions through the end of 2013. Renewed business tax provisions include the research credit (with modifications), CFC look-through, the exception for active financing income, and various renewable energy tax credits. In addition, the agreement extends a current 50-percent "bonus" depreciation provision for qualified property through the end of 2013.

The bill delays for two months automatic across-the-board spending cuts that are a consequence of debt limit increase legislation enacted in 2011. The bill also extends for one year expanded federal unemployment assistance, Medicare physician pay levels, and federal agriculture programs. In addition, the bill eliminates a scheduled pay raise for Members of Congress.

The Joint Committee on Taxation staff has estimated that the bill would reduce federal revenues by \$3.9 trillion over ten years. This estimate is relative to current law that provides for a December 31, 2012 sunset of 2001 and 2003 tax provisions for all taxpayers absent action by Congress.

## *Actions to think about*

While Congress appears set to approve a retroactive extension of business tax provisions that expired at the end of 2011 and 2012, this extension would be taken into account for financial reporting purposes in the quarter in which the legislation is enacted by Congress and signed into law by the President. President Obama's signing of the bill would be a financial statement event for the first quarter of calendar year 2013. Thus, regardless of the timing or retroactive nature of the potential legislation, calendar year businesses would not be expected to reflect the financial statement benefits of these extensions in their 2012 calendar year-end financial statements. Nonetheless, financial statement disclosure in 2012 may be appropriate depending upon the potential impact of the potential legislation.

The bill does not include a specific process for tax reform legislation in 2013, as had been featured in the original House-approved version of H.R. 8. It is unclear how permanent extension of individual tax rates may affect consideration this year of comprehensive tax reform legislation.

## *Key elements of fiscal cliff agreement*

Under the bill, a top rate of 39.6-percent will be effective beginning after December 31, 2012 for individuals with incomes above \$400,000, and joint filers with incomes above \$450,000.

A top rate of 20 percent for capital gains and qualified dividends will be effective beginning after December 31, 2012 for individuals with incomes above \$400,000, and joint filers with incomes above \$450,000. Under the 2010 health care law, a separate 3.8-percent Medicare net investment income tax is effective as of January 1, 2013 for single incomes above \$200,000 (above \$250,000 for joint incomes).

A personal exemption phaseout and limitation on itemized deductions will be reinstated beginning after December 31, 2012 for single filers with adjustable gross incomes above \$250,000 (\$300,000 for joint filers).

In addition to addressing the expiration of 2001 and 2003 income tax rates, the bill includes a permanent 40-percent estate tax rate that will apply beginning after December 31, 2012 on estates above a \$5.12 million exemption amount (indexed for inflation). While the exemption amount continues current policy, the new rate is a compromise between the 35-percent rate that has been in effect since 2010 and the Obama Administration's proposal to return to 2009 estate tax levels, with a top rate of 45 percent and a \$3.5 million exemption amount. Under prior law, the estate tax was set to revert to pre-2001 levels, with a top rate of 55 percent and a \$1 million exemption amount.

The bill increases the individual AMT exemption amount to \$50,600 for single filers (\$78,750 for joint filers) for 2012 and indexes the AMT exemption amount for inflation beginning in 2013.

Other expired individual provisions would be extended for varying periods. A federal deduction for state sales taxes, an exclusion for mass transit benefits, an IRA

charitable donation provision, and certain other temporary individual tax provisions that had expired at the end of 2011 have been extended through 2013. An expanded child tax credit, earned income tax credit, and college tuition tax credit first enacted in 2009 will be extended through 2017.

The agreement does not continue the two-percentage point reduction in employee Social Security tax withholding that expired at the end of 2012.

The bill provides for a retroactive extension through December 31, 2013 of the research credit (with modifications), CFC look-through, the exception for active financing income, and certain other provisions that had expired at the end of 2011. The bill also extends through December 31, 2013 certain energy tax provisions, and modifies the expiration date for the renewable electricity production tax credit to construction beginning before the end of 2013.

### *Debate over "balanced" deficit reduction to continue*

The bill does not provide for an increase in the federal debt limit. Treasury Secretary Timothy Geithner has informed House and Senate leaders that the Federal Government's \$16.394 trillion statutory debt limit was reached on December 31, 2012, and Treasury has begun taking "extraordinary measures" to "postpone the date on which the United States would otherwise default on its legal obligations."

Secretary Geithner in a December 26 letter noted that such measures under normal circumstances would provide "roughly two months of headroom" to meet the government's debt obligations, but additional time could result from the uncertainty over tax and spending policies.

The bill delays for two months automatic across-the-board "sequestration" spending cuts that are a consequence of the last debt limit increase legislation in 2011. The "Budget Control Act of 2011" reduced future federal discretionary spending by \$1 trillion over 10 years, and provided for an additional \$1.2 trillion in automatic defense and non-defense spending set to begin on January 2, 2012 if Congress could not agree on alternative proposals providing an equal amount of deficit reduction.

**Observation:** The delay in sequestration spending cuts through the end of February coincides with the approximate date by which the federal debt limit would need to be increased, assuming Treasury Secretary Geithner's projection that Treasury can rely on "extraordinary measures" to continue funding the government. An additional factor in upcoming debate over deficit reduction will be the March 27, 2013 expiration of a temporary funding measure for federal departments and agencies.

This delay in scheduled spending cuts is offset in part by a provision allowing for conversions to a Roth retirement account from 401(k) plans and certain other employee retirement accounts. The amount converted would be subject to regular income tax.

The bill also extends for one year expanded federal unemployment assistance, Medicare physician pay levels, and federal agriculture programs. In addition, the bill eliminates a scheduled pay raise for Members of Congress.

President Obama yesterday stated that "we're going to have to do more to reduce our debt and our deficit." While commenting that he was prepared to reduce the cost of Medicare and other federal programs, President Obama stated "it's going to have to be balanced," and "that kind of [entitlement] reform has to go hand-in-hand with doing some more work to reform our tax code so that wealthy individuals, the biggest

corporations can't take advantage of loopholes and deductions that aren't available ... to most Americans."

The 113th Congress will be sworn into office at noon on January 3, 2013. In the House, Rep. John Boehner (R-OH) is expected to be re-elected as Speaker. House Republicans will hold a 234 to 201 seat majority, with Democrats having picked up nine seats from the November 6, 2012 elections. Senate Democrats will hold a 55 to 45 seat majority, having gained two seats.

President Obama will begin his second term on January 20, 2013, with the inauguration ceremony set for January 21.

### Let's talk

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