The Future of Private Company Financial Reporting

A Q&A with David Morgan, Chair of the AICPA FRF for SMEs Task Force

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When signed by President Obama, the so-named "American Taxpayer Relief Act" passed in the wee hours by the Senate on Jan. 1, 2013, and later that day by the House, may pull the country back from a self-created fiscal/political ditch, but leaves the country at the edge of a fiscal cliff with spending cut issues, debt ceiling issues and undoubtedly more tax issues to be dealt with before March 1, 2013.

Overview. This legislation increases the tax on individual taxpayers with taxable income above specified thresholds (generally stated to be $400,000 or $450,000). Note, limited liability companies are now the predominate form of closely-held businesses and a source of much of the U.S. job growth. LLC income that is retained by the business nevertheless is included in the owner's taxable income subject to this tax increase.

The legislation also phases out personal exemptions and phases down itemized deductions for such taxpayers; increases the capital gains tax rate for such taxpayers; raises the tax rate to 40 percent; provides a permanent, indexed and higher alternative minimum tax exemption; and has a number of "extenders" for provisions that generally expired at the end of 2011 to carry them through 2013. IRA distributions to charity in the month of January 2013 can be treated as if made in 2012. A few of the many extenders are:

- The option to deduct state and local sales tax in lieu of income tax remains for 2012 and 2013.
- 50 percent bonus depreciation for 2012 and 2013.
- R&D credit for 2012 and 2013.
- Expensing of up to $500,000 of certain property is permitted for 2012 and 2013.
- Exclusion for forgiven home mortgage debt in 2013.

The legislation did not postpone the two percent of wages increase in the employee portion of the social security payroll taxes, so all taxpayers regardless of income level will feel some pain (commentators estimate an average of $700 per taxpayer).

In addition to the tax provisions, there are many Medicare and other health extensions as well as an extension of the emergency unemployment compensation program and related benefits. Congress will not receive a cost of living increase in fiscal year 2013 as a result of this legislation.

Surprisingly, there is an amendment to the National Defense Authorization Act for Fiscal Year 2013 dealing with certain arms control obligations and Russia.

Finally, the 2013 sequestering called for by the Balanced Budget and Emergency Deficit Control Act of 1985 is deferred from Jan. 2, 2013 to March 1, 2013. In accordance with the president's remarks at 1:45 p.m. EST on Dec. 31, 2012, it is anticipated there will be further tax law changes accompanying any spending cuts.

GENERAL EXTENSIONS
(Extension and Modification of 2001 and 2003 Tax Relief, Extension of 2009 Tax Relief and Permanent Alternative Minimum Tax Relief)

A. Individual Income Tax Brackets
1. The "Bush Tax Cut" brackets were made permanent for individuals with taxable income less than:
   a) Married (filing jointly) - $450,000
   b) Head of Household - $425,000
   c) Single - $400,000
   d) Married (filing separately) - $225,000

   The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

   A 39.6 percent bracket applies to taxable income higher than the thresholds above.

B. Capital Gains and Dividends
1.15 percent or lesser of adjusted net capital gain (or taxable income) that
would be taxed at a rate below 39.6 percent over the amount that would be subject to capital gains rate of five percent (taxable income bracket with capital gains below 25 percent rate); 2. 20 percent for capital gain in excess of “A” above; 3. AMT and capital gains utilizes the 15 percent and 20 percent brackets 4. In the extenders discussed below, the gain from certain small business stock (as defined in Section 1202 of the Code) if acquired in 2012 and 2013 if held for five years or more is entitled to 100 percent exclusion from gross income upon its sale.

The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

Note: The 3.8 percent non-deductible ‘Medicare contribution’ excise tax on investment income was not modified and still applies as otherwise scheduled. This applies when adjusted gross income exceeds $250,000 for married filing jointly, $125,000 for married filing separately and $200,000 for all others.

C. Phase-Out of Personal Exemptions and Itemized Deductions (Extension of Clinton Era Caps and Phase Out)

1. Itemized Deductions - can be reduced by up to 80 percent a) Itemized deductions are reduced by 3 percent of excess of adjusted gross income over:
   (1) Married (filing jointly) - $300,000
   (2) Head of Household - $275,000
   (3) Single - $250,000
   (4) Married (filing separately) - $150,000

The above thresholds are indexed for CPI inflation occurring after 2012 for tax years beginning after 2013.

2. Personal exemption
   a) The personal exemption amounts ($2,000 per exemption) are phased out two percentage points for each

F. Extension of Certain Credits for Five Years (Tax Years Beginning Before 2018)

1. American Opportunity Tax Credit
2. Child Tax Credit
3. Refundable credits (or advance payments) made to individuals under Title 28 (income tax provisions) received after Dec. 31, 2012, are not taken into account for means testing for any federal program or state or local program financed in whole or in part with federal funds.

G. Other

1. Amounts in applicable retirement plans which include a qualified Roth contribution program may be directed by the individual to be transferred after Dec. 31, 2012, to the Roth account and treated as a qualified rollover, and the plan shall not be treated as violating various otherwise applicable rules.
2. The budgetary effects of this legislation will not count in any PAYGO scorecards.

For a complete overview of the provisions within the legislation, please see the full article in the News section of the TSCPA website at www.tscpa.com.

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