# 2012 Tax Guide Update

**By AAII Staff**

### Article Highlights

- Updates to our tax guide to reflect changes made by American Taxpayer Relief Act of 2012.
- Federal income tax brackets are unchanged for most taxpayers.
- A permanent patch has been applied to the AMT and the estate tax exemption is now indexed to inflation.

**The outstanding uncertainties about the 2012 and the 2013 tax code were resolved after we sent the 2012 "Individual Investor's Guide to Tax Planning" (January 2012 *AAII Journal*) to the printer. The American Taxpayer Relief Act of 2012 kept rates unchanged for most taxpayers, but added a new maximum tax bracket and adjusted various other deductions and exemptions.**

After the law was passed, we updated the tax guide on AAII.com. However, since many of you may not have seen the update online or simply prefer to have the updated information in hand as a separate article, we are providing this addendum to the tax guide. The tax guide tables with updated rates for 2013 are reprinted here on pages 31 to 33. The fully revised tax guide can be accessed online at www.aaii.com/journal/article/the-individual-investors-guide-to-personal-tax-planning-2012.

## What's New?

The 10%, 15%, 25%, 28%, 33% and 35% federal income tax brackets that were scheduled to expire at the end of 2012 are now permanent. Single filers with adjusted gross income (AGI) above $400,000 and married couples filing jointly with AGI above $450,000, however, will pay a new, higher maximum tax rate of 39.6%.

The payroll tax cut that had been in existence for 2011 and 2012 has expired. Effective January 1, 2013, the payroll tax (for Social Security) has reverted to its full rate of 6.2% of employee wages.

A permanent patch to the alternative minimum tax (AMT) has been written into law. The 2012 exemptions were raised to $50,600 for single filers and $78,750 for married couples filing jointly. In 2013, these amounts rise to $51,900 for single filers and $80,800 for married couples filing jointly. The exemptions are indexed to the rate of inflation and will be raised accordingly in the future. This automatic increase is important because previously the AMT exemption was not indexed to inflation. New legislation had to be passed to prevent the AMT from ensnaring an ever larger number of taxpayers.

The repeal of the phase-out for the personal exemption was extended through 2012. The phase-out returns in 2013, but at higher levels than in the past. The personal exemption phases out at income levels of $250,000 for single filers and $300,000 for married couples filing jointly. According to tax authority CCH, the total amount of exemptions that can be claimed by a taxpayer is reduced by 2% for each $2,500 or portion thereof by which adjusted gross income exceeds the threshold level. Married couples filing separate returns will see their exemptions reduced by 2% for each $1,250 of adjusted gross income.

The $1,000 maximum child tax credit was maintained in 2012 and has been extended into 2013. The credit was phased out for married couples filing jointly with modified adjusted gross income (MAGI) above $110,000 in 2012. If the child tax credit exceeds the tax liability, the difference will be paid to the taxpayer, subject to certain requirements.

In 2013 and beyond, most taxpayers will continue to pay a 15% tax on long-term capital gains and qualified dividends. Single filers with incomes above $400,000 and married couples filing jointly with incomes above $450,000 will pay a 20% tax on long-term capital gains and dividends. (A 61-day holding period must be met for the reduced qualified dividend tax rates.) Single filers with net investment income or modified adjusted gross incomes above $200,000 and married couples filing joint returns with net investment income and modified adjusted gross incomes above $250,000 will also pay a new, additional 3.8% tax on capital gains and dividends (Net Investment Income Tax, NIIT). If you are in the 10% or 15% tax bracket, long-term capital gains and qualified dividends are not taxed. Collectibles, which include gold coins and bars, continue to be taxed at a 28% rate, but are eligible for the new 3.8% additional tax as well starting in 2013.

### The Estate Tax

The estate tax exemption is now indexed to inflation. The exemption rose to $5.12 million in 2012 and adjusts to $5.25 million in 2013. Effective this year (2013), a new, higher tax rate of 40% is in effect.

The first $5.25 million of an estate is excluded from taxes for those who pass in 2013. This is a per spouse exclusion and it is portable, meaning if one spouse passes away, the surviving spouse can claim the exclusion, resulting in a total effective exclusion of $10.5 million. The large figures will prevent most families from having to pay estate taxes.

The step-up basis rule remains in effect for 2013 and beyond. If an inherited asset is sold, the capital gain resulting from the sale is calculated as the difference between the proceeds at the time of the sale transaction and the value of the assets at the time of inheritance.

### Charitable Donations From an IRA

The American Taxpayer Relief Act of 2012 extends a provision that allows those age 70½ or older to distribute up to $100,000 from their traditional individual retirement account (IRA) tax-free to qualified charities for both the 2012 and 2013 tax years. (You had until January 31, 2013, to make a charitable distribution from your IRA for the 2012 tax year.)

### Itemized Deduction Phase-Outs

The phase-out of itemized deductions for taxpayers with adjusted gross income above a certain amount was fully repealed in 2010. This repeal remained in place for 2012, allowing the full benefit of itemized deductions to be applied. The phase-out returns in 2013 for both single and married filing jointly taxpayers with incomes of $250,000 and $300,000, respectively, or higher.

### Sales Tax Deduction

The provision allowing taxpayers who itemize deductions the option of choosing between a deduction of sales taxes or income taxes when claiming a state and local tax deduction was extended into both 2012 and 2013.

### Education Savings

The maximum American Opportunity education credit was $2,500 per year for the first four years of post-secondary education for tuition and related expenses (including books). This credit has been extended and can be claimed in both 2012 and 2013.

The Lifetime Learning credit can be claimed for education expenses beyond the fourth year of post-secondary education and for non-degree courses intended to improve job skills. The maximum credit is $2,000 annually and is subject to income phase-outs.

For 2012 and beyond, the contribution limit to a Coverdell Education Savings Account stays at $2,000 per beneficiary. The contributions are not deductible, but they grow tax-free in the IRA. Coverdell accounts may be used to fund qualified elementary, secondary and higher education expenses. However, the amount that can be contributed is limited for higher-income taxpayers.

## Social Security Benefits

Though this was not part of the new tax law, a member called asking for guidance on how to determine the percentage of Social Security benefits that are taxed.

Up to 50% of Social Security benefits are taxed for single filers with "combined income" between $25,000 and $34,000 and married joint filers with combined incomes between $32,000 and $44,000. Up to 85% of benefits are taxed for single filers with combined incomes above $34,000 and married joint filers with combined incomes above $44,000.

The Social Security Administration lists the formula for "combined income" as: Your adjusted gross income + Non-taxable interest + ½ of your Social Security benefits.

## Take Advantage of Lowered Marginal Rates

Deferring income that is taxed at higher ordinary tax rates makes sense. Most taxpayers will pay long-term capital gain tax rates of 0% or 15%. For single filers with income above $400,000 and married couples filing jointly with income above $450,000, long-term capital gains rates rise to 20% in 2013. Short-term capital gains, in contrast, are taxed at ordinary income tax rates, which run as high as 39.6% in 2013. The new 3.8% Net Investment Income Tax (NIIT), which went into effect on January 1, 2013, applies to taxpayers with income above the $200,000/$250,000 threshold in 2013. This tax applies to both short- and long-term capital gains, as well as taxable interest, dividends, non-qualified annuities, rents and royalties, and passive income from partnerships.

Similar rules apply to qualified dividends. For single filers with income above $400,000 and married couples filing jointly with income above $450,000, dividends will be taxed at 20% in 2013.

Though tax considerations should never be the primary reason for selling a security, if you have large positions in either gifted or inherited stocks, or stocks received from a sale of a business, you should consider whether it makes sense to sell shares over a period of time to take advantage of the long-term capital gains rates and use the proceeds from selling the stock to diversify your

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# 2013 Tax Rates

## Income Tax

### For Single Taxpayers

| Taxable Income Over ($) | But Not Over ($) | The Tax Is | Of the Amount Over |
|---|---|---|---|
| 0 | 8,925 | $0 + 10% | $0 |
| 8,925 | 36,250 | $892.50 + 15% | $8,925 |
| 36,250 | 87,850 | $4,991.25 + 25% | $36,250 |
| 87,850 | 183,250 | $17,891.25 + 28% | $87,850 |
| 183,250 | 398,350 | $44,603.25 + 33% | $183,250 |
| 398,350 | 400,000 | $115,586.25 + 35% | $398,350 |
| 400,000 | — | $116,163.75 + 39.6% | $400,000 |

### For Married Taxpayers Filing Joint Returns

| Taxable Income Over ($) | But Not Over ($) | The Tax Is | Of the Amount Over |
|---|---|---|---|
| 0 | 17,850 | 0 + 10% | $0 |
| 17,850 | 72,500 | $1,785 + 15% | $17,850 |
| 72,500 | 146,400 | $9,982.50 + 25% | $72,500 |
| 146,400 | 223,050 | $28,457.50 + 28% | $146,400 |
| 223,050 | 398,350 | $49,919.50 + 33% | $223,050 |
| 398,350 | 450,000 | $107,768.50 + 35% | $398,350 |
| 450,000 | — | $125,846.00 + 39.6% | $450,000 |

### For Married Taxpayers Filing Separate Returns

| Taxable Income Over ($) | But Not Over ($) | The Tax Is | Of the Amount Over |
|---|---|---|---|
| 0 | 8,925 | 0 + 10% | $0 |
| 8,925 | 36,250 | $892.50 + 15% | $8,925 |
| 36,250 | 73,200 | $4,991.25 + 25% | $36,250 |
| 73,200 | 111,525 | $14,228.75 + 28% | $73,200 |
| 111,525 | 199,175 | $24,959.75 + 33% | $111,525 |
| 199,175 | 225,000 | $53,884.25 + 35% | $199,175 |
| 225,000 | — | $62,923.00 + 39.6% | $225,000 |

### For Individuals Filing as Head of Household

| Taxable Income Over ($) | But Not Over ($) | The Tax Is | Of the Amount Over |
|---|---|---|---|
| 0 | 12,750 | 0 + 10% | $0 |
| 12,750 | 48,600 | 1,275 + 15% | $12,750 |
| 48,600 | 125,450 | $6,652.50 + 25% | $48,600 |
| 125,450 | 203,150 | $25,865.00 + 28% | $125,450 |
| 203,150 | 398,350 | $47,621.00 + 33% | $203,150 |
| 398,350 | 425,000 | $112,037.00 + 35% | $398,350 |
| 425,000 | — | $121,364.50 + 39.6% | $425,000 |

## Capital Gains and Qualified Dividends

| | Taxpayers in 15% Bracket or Below (%) | Taxpayers in the 25% to 35% Brackets* (%) | Taxpayers in the 39.6% Bracket* (%) |
|---|---|---|---|
| Short-Term Capital Gains | taxed as income | taxed as income | taxed as income |
| Long-Term Capital Gains** | 0 | 15 | 20 |
| Qualified Dividends | 0 | 15 | 20 |
| Collectibles*** | 28 maximum | 28 maximum | 28 |
| Real Estate Unrealized Gain (Section 1250 Property) | 15 maximum | 25 maximum | 25 maximum |

**May also be subject to the 3.8% Net Investment Income Tax (NIIT).*
***For investments held longer than one year.*
****Includes art, rugs, jewelry, precious metals or gemstones, stamps or coins, fine wines and antiques.*

## Kiddie Tax

| Unearned Income of Minor Children (under age 19 and ages 19–23 in certain circumstances) | |
|---|---|
| First $1,000 | 0% |
| Next $1,000 | child's rate |
| Over $2,000 | parent's rate |

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# 2013 Allowable Tax Benefits

## Standard Deduction

| Under Age 65 | |
|---|---|
| Married, Filing Joint | $12,200 |
| Single | $6,100 |
| Married, Filing Separate | $6,100 |
| Head of Household | $8,950 |

| Additional—Age 65 or Older | |
|---|---|
| Married (or Qualifying Widow) | $1,200 |
| Single | $1,500 |

| Additional—Blind | |
|---|---|
| Married (or Qualifying Widow) | $1,200 |
| Single | $1,500 |

## Personal Exemption

$3,900

## Maximum Child Tax Credit

$1,000 per child under age 17 at the end of the year

## Standard Mileage Deductions

| | |
|---|---|
| Business Standard Mileage Rate | 56.5 cents |
| Medical Standard Mileage Rate | 24.0 cents |
| Moving Standard Mileage Rate | 24.0 cents |
| Charitable Serv Standard Mile Rate | 14.0 cents |

## Deductible IRA Contribution

If taxpayer and spouse NOT covered by employer-sponsored plan:

| | |
|---|---|
| If younger than 50 | $5,500 |
| If 50 or older | $6,500 |

## Maximum 401(k) Employee Contribution

| | |
|---|---|
| If younger than 50 | $17,500 |
| If 50 or older | $23,000 |

## Self-Employed Medical Insurance Premium Deduction

100%

## Annual Gift Tax Exclusion (per person)

$14,000

## Estate Tax Exclusion

$5.25 million

# 2013 Other Tax Items

## 2013 Social Security Tax Rates

| | Employers & Employees | Self-Employed | Wage Limits |
|---|---|---|---|
| Social Security | 6.20% | 12.40% | $113,700 |
| Medicare | 1.45% | 2.90% | no limit |
| Total | 7.65% | 15.30% | |

## 2013 Itemizable Deductions

Among other items they include:

- Interest and taxes on your home
- Uninsured medical expenses above 10.0% of AGI (7.5% if age 65 or older)
- Miscellaneous itemized deductions above 2.0% of AGI
- Uninsured casualities or theft losses above 10.0% of AGI
- Contributions to qualified charities
- You can itemize either state and local income taxes or state and local sales taxes, but not both

## 2013 Safe Harbor for Underpayment Penalty

Avoid underpayment penalties by paying (through witholding or estimated tax payments):

AGI $150,000 or less ($75,000 married filing separate)

- 100% of prior tax liability or
- 90% of current year tax liability

AGI $150,000 or greater ($75,000 married filing separate)

- 110% of prior year tax or
- 90% of current year tax liability

## 2013 AMT Exemption Amount

| | |
|---|---|
| Single | $51,900 |
| Married, Filing Joint | $80,800 |
| Married, Filing Separate | $40,400 |
| Head of Household | $51,900 |

# 2013 Tax Benefit Phase-Outs

## Personal Exemption

| | AGI Phase-Out Level |
|---|---|
| Married, Filing Joint | $300,000 |
| Single | $250,000 |
| Married, Filing Separate | $150,000 |
| Head of Household | $275,000 |

## Itemized Deduction ("Pease" Limitation)

| | AGI Phase-Out Level |
|---|---|
| Married, Filing Joint | $300,000 |
| Single | $250,000 |
| Married, Filing Separate | $150,000 |
| Head of Household | $275,000 |

## IRA Deductibility

For those covered by employer retirement plan [$5,500 maximum contribution per taxpayer; if 50 or older, maximum is $6,500]

| | Modified AGI* Phase-Out Level |
|---|---|
| Married, Filing Joint | $95,000 |
| Single | $59,000 |
| Married, Filing Separate | $0** |
| Head of Household | $59,000 |
| Married, Filing Joint not covered by pension plan, but spouse is | $178,000 |

## Roth IRA Eligibility

Maximum $5,000 non-deductible contribution; if 50 or older, maximum is $6,000

| | Modified AGI* Phase-Out Level |
|---|---|
| Married, Filing Joint | $178,000 |
| Single | $112,000 |
| Married, Filing Separate | $0 |
| Head of Household | $112,000 |

## Coverdell Education Account

$2,000 maximum non-deductible contribution per beneficiary; withdrawals are tax-free for qualified education expenses

| | Modified AGI* Phase-Out Levels |
|---|---|
| Married, Filing Joint | $190,000 to $220,000 |
| Single | $95,000 to $110,000 |
| Married, Filing Separate | $95,000 to $110,000 |
| Head of Household | $95,000 to $110,000 |

**Modified AGI starts with your AGI (adjusted gross income) and adds back certain tax-exempt amounts including any IRA deductions.*
***$59,000 if strict criteria are met.*

*(continued from page 30)*
portfolio. This is particularly the case if a large portion of your wealth is concentrated in just a few securities.

### Tax Software, Books and Guides

Although the tax rates, deductions and exemptions for 2012 were mostly known, if you use a software program (e.g., TurboTax), book (e.g., "J.K. Lasser's Your Income Tax 2013") or a related aid, check for updates before filing. Doing so will ensure that you are using the most up-to-date information.

Be sure to check for updated information regarding 2013 as well, if you intend to plan for this year. Since the new legislation was not passed until the start of January 2013, the first versions of the aids will likely have incomplete or outdated information. Check with the provider of any software, book or guide to see if a download or a supplement is available. We can tell you that as of this writing, TurboTax is already pushing through updates for its software and J.K. Lasser has made an update available on its website, www.jklasser.com. ▲