

Tax Law Changes

Hello!

I hope the New Year is off to a good start for you. As you know, earlier this month, Congress agreed to a compromise regarding the fiscal cliff. For most Americans, the changes will not have much of a financial effect, but for those with higher incomes, they will see their taxes increase due to higher rates on earned income, investment income, and an additional percentage being assessed on Medicare taxes. Below is a summary of the ones I thought would be of interest to you. I have also attached our updated Clarity Reference Guide that highlights these new provisions as well as other topics, such as higher contribution amounts to retirement accounts and educational plans.

Income Tax Rates

Last year, there were six federal tax brackets ranging between 10% and 35%. Starting this year, the 39.6% federal tax bracket is back for those with incomes greater than \$400,000 for single filers, \$450,000 and above for joint filers, and over \$425,000 for those filing as heads of household.

Dividends

For qualified dividends, there will now be three different tax rates depending on one's federal tax bracket versus the two rates we had in prior years:

- **0%** if in the 10% or 15% tax bracket
- **15%** if in the 25%, 28%, 33% or 35% tax brackets
- **20%** if in the 39.6% tax bracket

For non-qualified dividends, they will continue to be taxed at ordinary income tax rates.

Capital Gains

For long-term capital gains (assets held for more than one year), as with qualified dividends, there are three different tax rates depending on one's federal tax bracket:

- **0%** if in the 10% or 15% tax bracket
- **15%** if in the 25%, 28%, 33%, or 35% tax brackets
- **20%** if in the 39.6% tax bracket

For short-term capital gains (those assets held for less than one year), they will continue to be taxed at ordinary income tax rates.

Medicare Tax

In the past, the Medicare tax rate has been 2.9% of one's earnings, of which half is paid by the employee and the other half by the employer. Effective this year, there is an additional 0.9% Medicare tax that will be assessed for those with certain income levels:

- Single Filers: \$200,000 and above
- Joint Filers: \$250,000 and above

In addition, there is another 3.8% tax on net investment income, which includes qualified dividends and long-term capital gains, that certain individuals would be subject to if their adjusted gross income (AGI) exceeds:

- Single Filers: \$200,000
- Joint Filers: \$250,000

Personal Exemptions

This year, the amount has been increased to \$3,900 per person but the phase-out provision has been reinstated. For those with adjusted

gross incomes over \$250,000 or \$300,000 (depending on which filing status), the deductibility of the personal exemption amount will be reduced by 2% for each \$2,500 by the amount AGI exceeds the threshold. In prior years, the personal exemption amount was fully deductible without taking into account one's income.

Itemized Deductions

Over the past few years, there was no phase-out provision on itemized deductions, so the entire amount was deductible. This is not the case starting this year. For individuals with incomes greater than \$250,000 or \$300,000 (depending on which filing status), the amount of itemized deductions one can deduct is reduced by 3% of the amount AGI goes over the threshold (but the reduction cannot exceed 80% of the deductions).