CribSheet 13-1 3/15/13

Fiscal Cliff (after the deal)

An unprecedented number of tax provisions were set to expire on December 31, 2012. The combined effect – the "fiscal cliff" – would have increased taxes by almost $500 billion, most of it falling on small businesses and individuals. The year-end deal (ATRA) was a mixed bag.

The fiscal cliff was averted by ATRA.

The fiscal cliff deal averted many, but not all, tax increases. Until the end of 2012, America faced the so-called "fiscal cliff" – an unprecedented array of expiring tax provisions. Details of these provisions are described in CribSheet #12-9, Fiscal Cliff (before the deal). Congress dealt with the fiscal cliff by enacting the American Taxpayer Relief Act (ATRA). The provisions described in CribSheet #12-9 and in this cribsheet (#13-1) involve both core individual tax rates and a variety of business tax extenders.

The fiscal cliff deal has its positives.

On a positive note, ATRA permanently spares a majority of small businesses from a tax increase on their income or estates. This permanency increases certainty and improves cash flow for many small businesses.

The deal also has its negatives.

Unfortunately, the law also makes the tax code more complicated and raises taxes on some higher-income taxpayers. For that reason, comprehensive tax reform that lowers tax rates and simplifies the tax code remains a top priority for NFIB.

Healthcare taxes were unchanged.

The second page of CribSheet #12-9 lists several tax components of the Patient Protection and Affordable Care Act (PPACA) that went into effect in 2013. None of these was affected by the fiscal cliff deal.

Individual tax rates matter most for small business owners.

Small-business taxes flow through to individual business owners. Most small businesses are organized as pass-through entities, not C corporations. Pass-through owners report business income on their individual tax returns. ATRA set the top rate at 39.6% on income over $400,000 for individuals and $450,000 for joint filers. The law permanently extends rates in effect in 2012 for taxpayers below those thresholds.

AMT is now indexed for inflation.

Because the Alternative Minimum Tax (AMT) was never indexed for inflation, Congress has had to adjust it for inflation every year – the so-called AMT patch. ATRA contains a permanent AMT patch, eliminating this annual legislative requirement. According to the Joint Committee on Taxation, this change prevents almost 30 million additional taxpayers, many of them small businesses, from facing tax increases under the AMT.

The payroll tax holiday ended.

A payroll tax cut reduced the share of Social Security payroll taxes from 6.2% to 4.2% for employees and from 12.4% to 10.4% for the self-employed on the first $110,000 in wages in 2012. These cuts expired at year's-end.

Estate taxes were increased and stabilized.

In 2012, the estate tax (also known as the "death tax") had a $5 million exemption and a 35% rate. Without ATRA, the exemption would have plunged to $1 million, and the rate would have increased to 55%. Under ATRA, the exemption is $5.12 million and will rise with inflation. The tax rate is 40%.

Rates on capital gains and dividends changed.

The individual tax rate thresholds ($400,000 for individual filers and $450,000 for joint filers) will apply to capital gains rates and dividends. Earnings below those thresholds will be taxed at 15%, while those on earnings above the thresholds will be taxed at 20%.

PEP repeal was extended.

ATRA extended the repeal of the personal exemption phaseout (PEP) for those with income at or below $250,000 for individual filers and $300,000 for joint filers. These amounts are adjusted for inflation.

The Pease limitation on itemized deductions remains repealed.

ATRA permanently extended the repeal of the Pease limitation on itemized deductions. This applies to individual filers at $250,000 and joint filers at $300,000. The limitation affects deductions reported on Schedule A, such as the mortgage interest deduction and medical expenses. Most business deductions taken on Schedule C are not affected by this deduction limitation.

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Expensing limits increased.

The Section 179 expensing limits were temporarily expanded for both 2012 and 2013, allowing small businesses to immediately deduct up to $500,000 of equipment purchases and up to $250,000 of the cost of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

The required holding period for S Corp assets held steady.

The Small Business Jobs Act of 2010 reduced the holding period for built-in gains on appreciated S corporation assets to 5 years, but was scheduled to increase to 10 years in 2013. This tax on capital assets is triggered when a C corporation converts to an S corporation, locking in capital assets for the holding period. ATRA renewed the 5-year holding period through 2013.