Over the Fiscal Cliff

Who got Parachutes?

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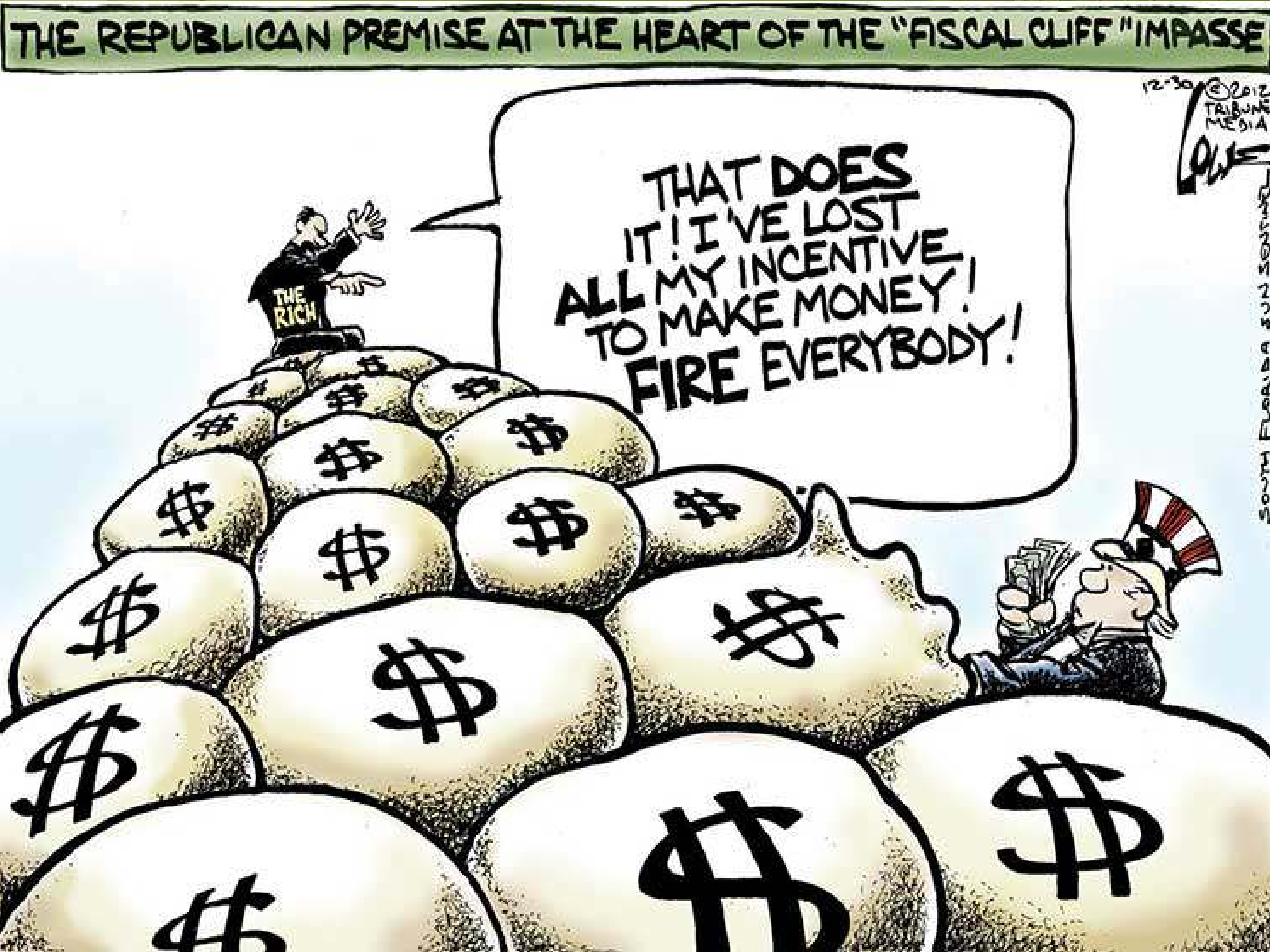
CPA, Shareholder

March 6, 2013


THE REPUBLICAN PREMISE AT THE HEART OF THE "FISCAL CLIFF" IMPASSE
THE RICH
THAT DOES IT! I'VE LOST ALL MY INCENTIVE TO MAKE MONEY! FIRE EVERYBODY!
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Overview

- American Taxpayer Relief Act of 2012
- The Medicare Surtax
- State and local tax updates
- New Repairs and Maintenance rules

2013 Tax Rate Increases

Pre Fiscal Cliff

Provision	2011 2012	2013
Rates for ordinary income	35.0%	39.6%
	33.0%	36.0%
	28.0%	31.0%
	25.0%	28.0%
	15.0%	15.0%
	10.0%	15.0%
Top rates for investment income		
Long-term capital gains	15.0%	20.0%
Qualified dividends	15.0%	39.6%

American Taxpayer Relief Act 2012

Post Fiscal Cliff

	Rate	Single Filers	MFJ Filers
Ordinary Rates	10%	$0 to $8,925	$0 to $17,850
	15%	$8,925 to $36,250	$17,850 to $72,500
	25%	$36,250 to $87,850	$72,500 to $146,400
	28%	$87,850 to $183,250	$146,400 to $223,050
	33%	$183,250 to $398,350	$223,050 to $398,350
	35%	$398,350 to $400,000	$398,350 to $450,000
	39.6%	$400,000 and above	$450,000 and above

American Taxpayer Relief Act 2012

- **Phase-out itemized deductions and exemptions**
  - Applies to
    - Single filers >$250,000
    - MFJ filers > $300,000
  - Itemized deductions reduced by 3% of AGI in excess of threshold
    - Limited to 80% of itemized deductions
  - Does not include
    - Medical expenses
    - Investment interest expense
    - Casualty losses
    - Gambling losses

American Taxpayer Relief Act 2012

- 2% social security tax reduction on employee wages, eliminated for 2013

American Taxpayer Relief Act 2012

- **Depreciation for 2012 & 2013**
  - 50% bonus depreciation
  - Sec.179 limitation $500,000 ($2M phase out)
  - 15 year tax life for qualified leasehold, retail and restaurant property extended for 2012 & 2013
- **Nontaxable forgiveness of qualified principal residence indebtedness**

American Taxpayer Relief Act 2012

- Permanently patched AMT and indexed it to inflation

AMT Exemption	Pre Cliff 2012	Post Cliff 2012
Single	$33,750	$50,600
Married Filing Joint	$45,000	$78,750

American Taxpayer Relief Act 2012

- **Tax planning to take advantage of the 0% rate on Capital Gains & Qualified Dividends**

	Rate	Single Filers	MFJ Filers
Capital Gains & Qualified Dividends	0%	$0 to 36,250	$0 to $72,500
	15%	$36,250 to $400,000	$72,500 to $450,000
	20%	$400,000 and above	$450,000 and above

American Taxpayer Relief Act 2012

Capital gains & dividends are considered highest rate element of a taxpayer's annual income:

MFJ filer

Earns	**$100,000**	**Wages**
Add	**$72,500**	**LTCG/qualified dividends**
Total	**$172,500**	**Adjusted gross income**
Less	**$100,000**	**Itemized deductions**
	$72,500	**Taxable income**

Itemized deductions reduce ordinary income first.

Capital gains and dividends are taxed at 0% rate!

Estate & Gift Tax Changes

Pre Fiscal Cliff

Estate Tax	2011	2012	2013
Top rate	35.0%		55.0%
Annual Gift Tax Exemption	$13K		$14K

Gift Tax	2011	2012	2013
	Estate and gift tax regime reunified for 2011-2012 ($5 million exemption for gifts with highest rate of 35%)		**$1 million lifetime exemption** (55% top rate)

Estate & Gift Tax Changes

Post Fiscal Cliff

Estate & Gift Tax Regime	Reunified for 2013-Forward
Top rate	40.0%
Lifetime Exemption	$5,000,000*
Annual Gift Tax Exemption	$14,000

*$5,250,000 for 2013 (up from $5,120,000 for 2012)

The Medicare Surtax

Surprise!

Starting in 2013: **3.8%**

Surtax

- Imposed on certain investment income of high-income tax payers
- Even more surprising, it goes to the General Fund

The Medicare Surtax

Who

Individual taxpayer threshold amounts:

Single Taxpayer

$200,000

Married Filing Jointly

$250,000

Married Filing Separately

$125,000

The Medicare Surtax

How

For Individuals the 3.8% surtax will be imposed on the lesser of:

- Net investment income for the tax year, or…
- The amount by which the modified adjusted gross income (MAGI) exceeds the threshold amount in that year

Medicare Surtax Example

Married Filing Jointly:

Husband and wife, filing jointly

Earn	**$200,000**	in salaries
Plus	**<u>$150,000</u>**	of net investment income
for	**$350,000**	of total MAGI

The **3.8%** surtax applies to $100,000 of income **since it is the lesser** of $150,000 of net investment income or the excess over the MAGI threshold of $250,000.

Medicare Surtax Example

Surtax is gross, not net tax:

Single filer

Earns **$2,200,000** MAGI (all investment income)

Less **$1,000,000** Charitable contribution

Less **$1,100,000** Medical expenses

TI **$100,000**

The 3.8% surtax applies to $2,000,000 of income **since it is the lesser** of $2,200,000 of net investment income or the excess over the MAGI threshold of $200,000.

What IS investment income?

Net investment income *includes* the following:

- Interest, dividends, royalties, annuities
- Net capital gains derived from the disposition of property (other than property held in an active trade or business)

Long-term capital gains	15.0%	~~20.0%~~ 23.8%
Qualified dividends	15.0%	~~39.6%~~ 23.8%

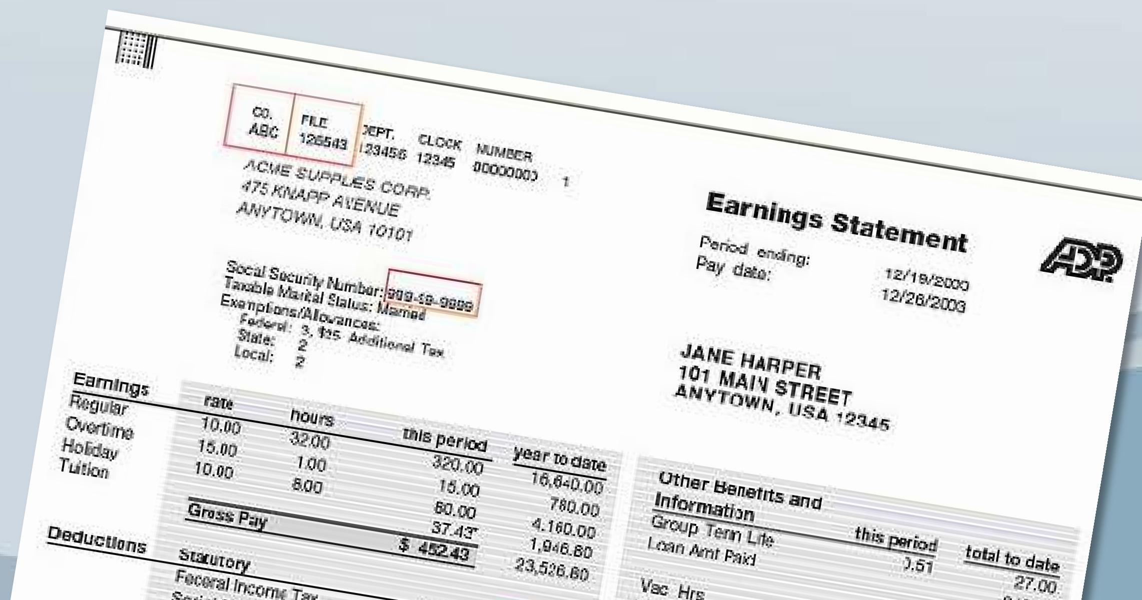
- Income derived from all passive activities

Rental Income

What IS investment income?

Net investment income *does not* include the following:

- Wages or salary
- Active trade or business income
- Distributions from IRAs or qualified retirement plans
- Income from tax-exempt municipal bonds



0.9% Medicare Tax

- Applied to wages & self-employment income in excess of:
  - Single taxpayers > $200,000
  - MFJ taxpayers > $250,000
- Employer is required to withhold from wages in excess of $200,000
- Self-employment loss does not reduce amount of tax

0.9% Medicare Tax

Case One

Single taxpayer with ***high*** wages and S/E loss

Wages	**$300,000**
Less partnership loss	**<u>$60,000</u>**
Total S/E income	**$240,000**

Medicare tax is $900

$300,000 W-2 - $200,000 threshold X 0.9%

0.9% Medicare Tax

Case Two

Single taxpayer with ***low*** wages and ***high*** S/E income

Wages	**$ 20,000**
Partnership income	**<u>$280,000</u>**
Total S/E income	**$300,000**

Medicare tax is $900

($280,000 partnership income - $180,000 Threshold ($200,000 threshold - $20,000 wages) X 0.9%

Other Tax Measures included in...

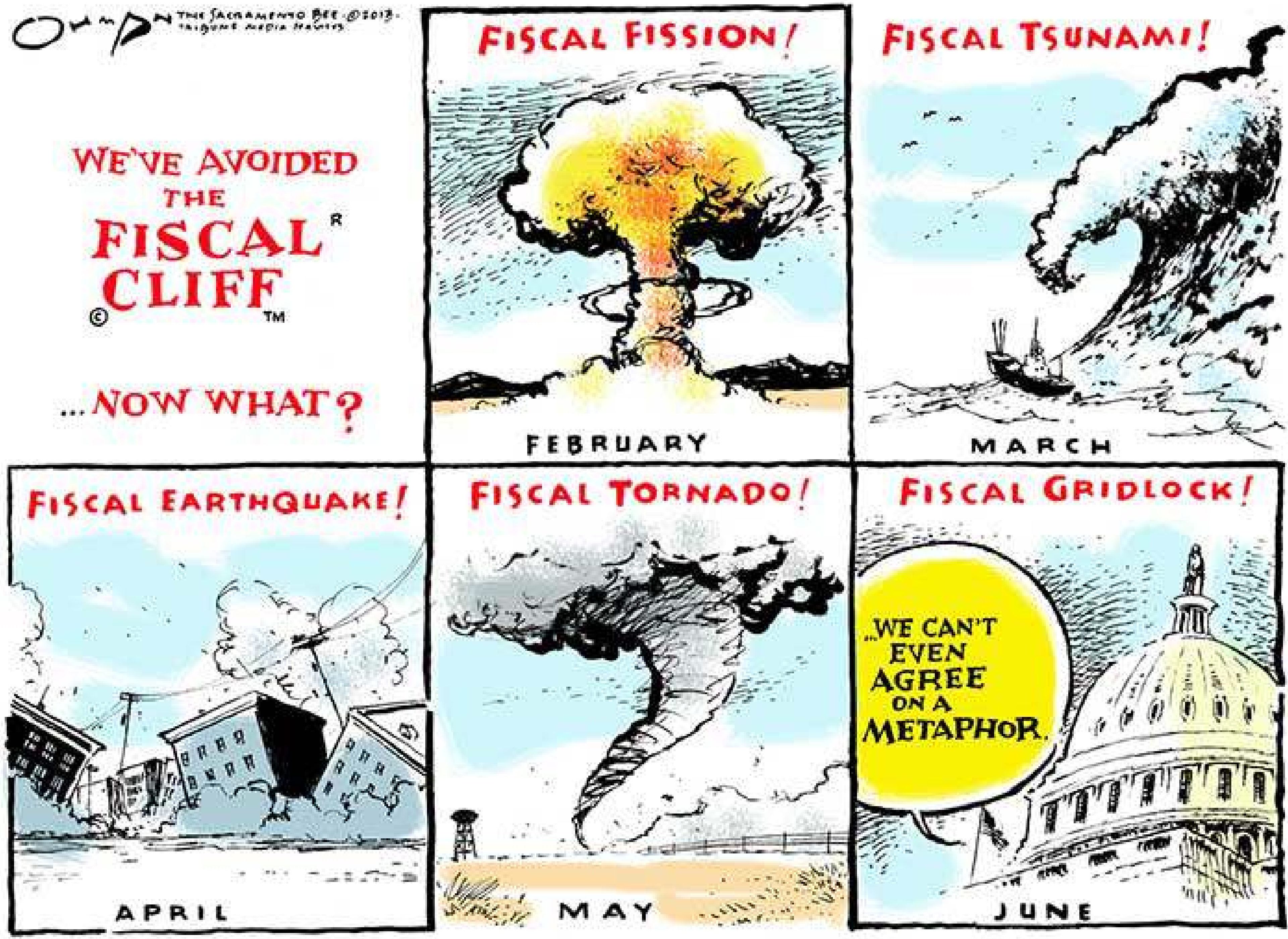
The Affordable Care Act

- Medical itemized deduction threshold increased to 10% from 7.5% (2013)

- Maximum pre-tax FSA reimbursable amount reduced to $2,500 from $5,000 (2013)

- Large employers (>250 W-2s in 2011) must report value of employer-sponsored, employee health coverage on each W-2 (2012)

- Adoption of credit and assistance programs expire in 2012



THE SACRAMENTO BEE ©2013
WE'VE AVOIDED THE FISCAL CLIFF ® © ™
...NOW WHAT?
FISCAL FISSION!
FEBRUARY
FISCAL TSUNAMI!
MARCH
FISCAL EARTHQUAKE!
APRIL
FISCAL TORNADO!
MAY
FISCAL GRIDLOCK!
...WE CAN'T EVEN AGREE ON A METAPHOR.
JUNE

Uncertain Future

2014 & beyond…

- **Tax reform coming?**
- **Increase Tax Rates**
  - Individuals – “high income” taxpayers
  - Corporations – minimum taxes on foreign profits
- **Increase Tax Base**
  - Individuals – limitations on itemized deductions
  - Corporations – limitations on deductions/ preference items

Other Items to Note

State Tax Update

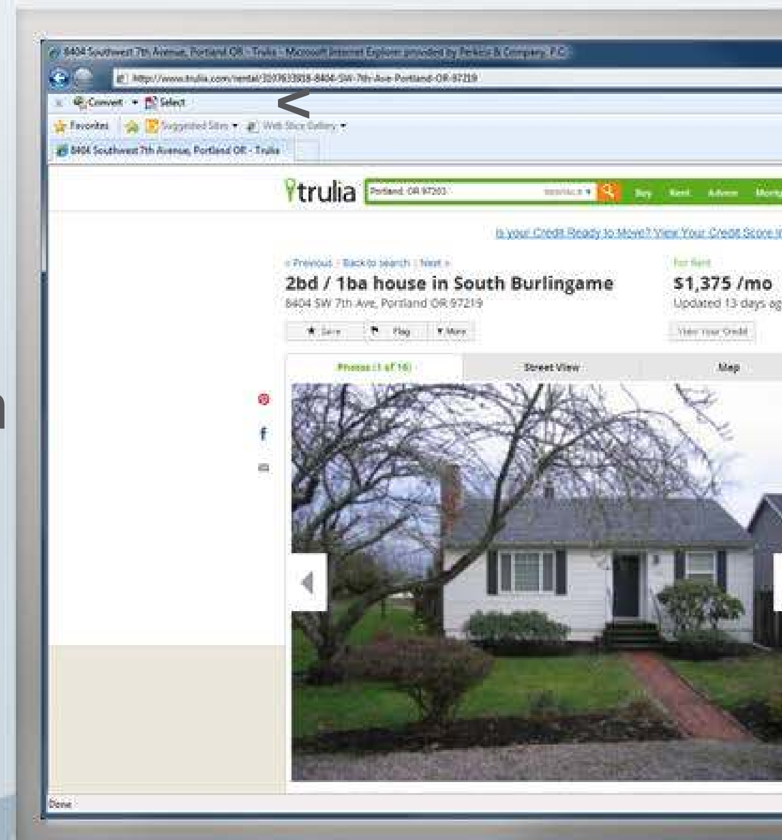
- **Oregon**
  - Corp tax rate 6.6% in 2013 (7.6% over $10M)
  - Individual tax rate 9.9% in 2012 forward

- **California**
  - Individual tax rates increased retroactively to 10.3-12.3% in 2012
  - Single sales factor apportionment for business in 2013

Other Items to Note

Portland/Multnomah County Update

- **Rental Real Estate**
  - City of PDX, no exemption for 10 rentals if only business activity for 2012
  - $50k gross receipts exemption still applicable
  - Multnomah County, no change



Other Items to Note

Portland/Multnomah County Update

› **Real Estate Brokers**

- Brokers acting as agents of a principal real estate broker exempt from City of PDX tax
- Must be only business activity
- Multnomah County, no change (still taxable activity)

Other Items to Note

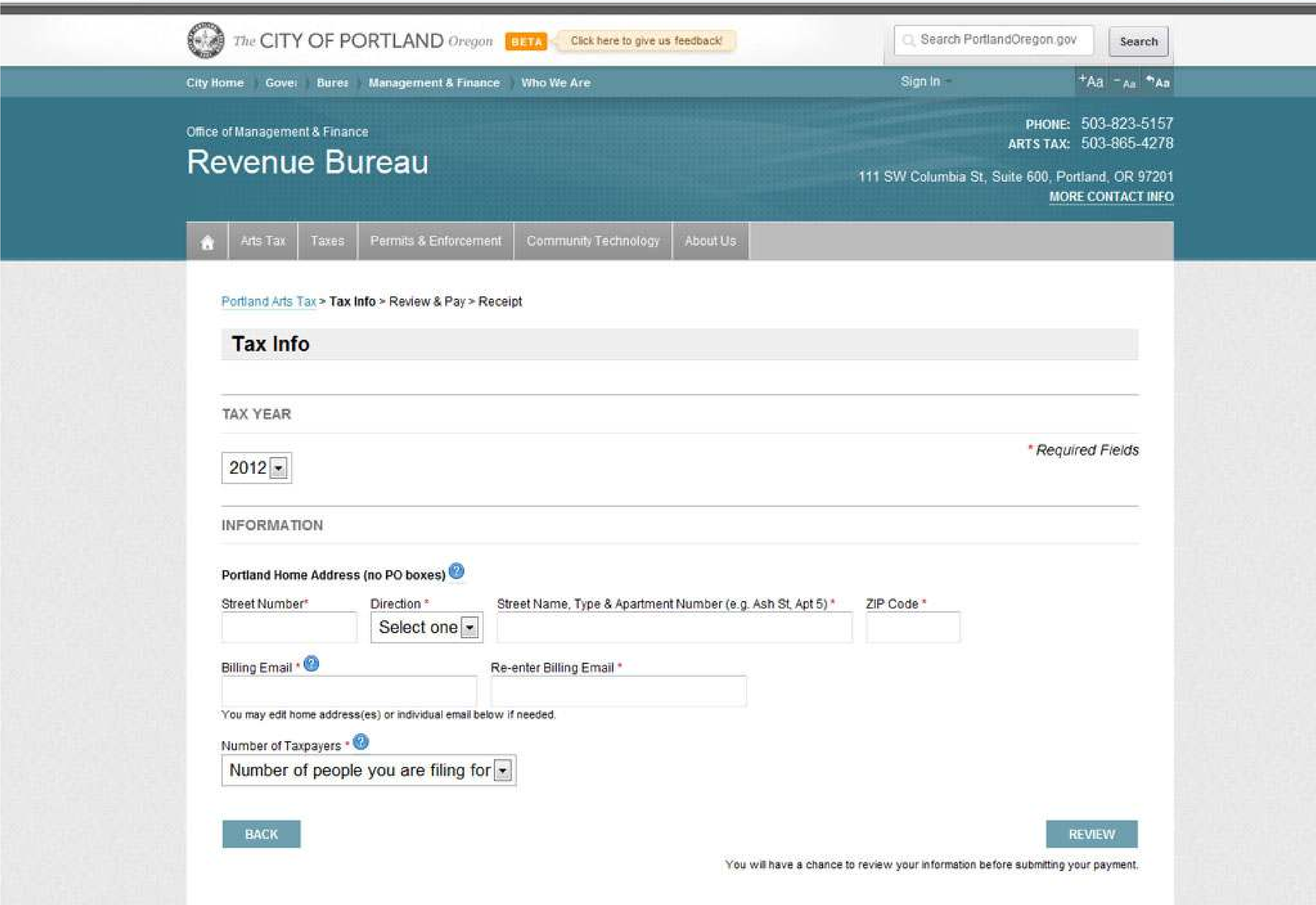
Portland/Multnomah County Update

- **Recent Audit Activity**
  - LLC owner's compensation deduction for rental real estate
  - Must provide detail of activities with at least 100 hours
- **City of Portland Arts Tax**

Arts Education & Access Tax

- $35 tax imposed on the income of each income-earning resident of the City of Portland who is at least 18 years old
- No tax will be imposed on filer(s) within any household that is at or below the federal poverty guideline for that tax year
- No proration for part-year residents
- Returns due on April 15th, no extension available, $15 penalty if not paid by 4/15
- Mail in the form with payment or file and pay online

http://www.portlandoregon.gov/revenue/60076



Form **ARTS 2012**

City of Portland - Revenue Bureau

Arts Tax Annual Report Form

Creating the Arts Education & Access Fund

For the year Jan. 1 - Dec. 31, 2012 Due: April 15, 2013

Portland residents age 18 and older. Attach sheet(s) for more than 4 residents and/or address changes.

1
First name | Middle name | Last name | Suffix
Social Security # (Last 4 #s) | Birth year | Email address | Income earner? (Y/N)
Street Number | Direction | Street Name, Type & Apartment Number (e.g., Ash St, Apt 5) | Zip Code

2
First name | Middle name | Last name | Suffix
Social Security # (Last 4 #s) | Birth year | Email address | Income earner? (Y/N)
Street Number | Direction | Street Name, Type & Apartment Number (e.g., Ash St, Apt 5) | Zip Code

3
First name | Middle name | Last name | Suffix
Social Security # (Last 4 #s) | Birth year | Email address | Income earner? (Y/N)
Street Number | Direction | Street Name, Type & Apartment Number (e.g., Ash St, Apt 5) | Zip Code

4
First name | Middle name | Last name | Suffix
Social Security # (Last 4 #s) | Birth year | Email address | Income earner? (Y/N)
Street Number | Direction | Street Name, Type & Apartment Number (e.g., Ash St, Apt 5) | Zip Code

Balance Due Number of Portland residents (above) age 18 and older who earn income: ______ **x $35 =** Arts Tax Total Amount Due: ______ Check #: ______

Sample amounts due: 1 person = $35; 2 people = $70; 3 people = $105; 4 people = $140

Payer name ______ Date ______ Payer daytime phone number ______ Payer email (*if different from above*) ______

Send this form to: Revenue Bureau Arts Tax, PO Box 1278, Portland, OR 97207 | **File/Pay online:** www.artstax.net

Instructions

- Complete this form to pay the tax. You may include all family adults on one form. If your household income is at or below the federal poverty level, complete form ARTX 2012.
- For each adult you are filing for, enter their information above. If they do not have an email address, you may leave that space blank. Providing an email address allows the Revenue Bureau to send an electronic notice ... remind you to file. Electronic notices are the only notices that will be sent in future tax years.
... amount, whether it is

Repairs & Maintenance

Status update:

2011

- 12/23 Temporary Regulations issued

2012

- 1/1 Temporary Regulations effective date
- 3/7 Revenue Procedures 2012-19 & 20 issued
- 3/15 IRS issues directive to agents to cease exams
- 9/17 IRS expects changes to Regulations prior to finalizing in 2013
- 11/20 IRS issues Notice 2012-73

Repairs & Maintenance

Affect of new regulations:

"The temporary regulations will affect all taxpayers that acquire, produce, or improve tangible property."

Acquisition of Production of Property

Materials and Supplies Tax Treatment

In general, materials and supplies are categorized and treated as:

- Incidental: Carried on hand, for which no record of consumption is kept, or which physical inventories are not taken, are deductible in the year purchased
- Non-incidental: Deductible in the year used or consumed
- Special rules for rotable and temporary spare parts

Acquisition of Production of Property

De Minimis Rule:

- Permits taxpayers to deduct costs incurred under a capitalization threshold
- Four requirements for safe harbor:
  - Applicable financial statement (“AFS”)
  - Written capitalization policy at beginning of year
  - Expense in AFS in accordance with written capitalization policy
  - Deduction cannot exceed ceiling for aggregate amount deducted

Acquisition of Production of Property

- **Ceiling is less than or equal to the greater of:**
  - 0.1% of the federal income tax gross receipts; or
  - 2% of AFS depreciation and amortization expense
- **Not intended to prevent a taxpayer from reaching an agreement with IRS exam agent that exceeds the safe harbor ceiling**

Improvement to Property

Application:

- Determine the Unit of Property ("UOP")
- Apply the capitalization standards
- Optional: Routine Maintenance safe harbor (currently not available for real property)

Improvement to Property

Unit of Property - Buildings

- **Each building and its structural components is a single UOP. The capitalization standards are applied separately to the building structure and the following 8 building systems:**
  - Gas distribution
  - Electrical
  - Elevators
  - HVAC
  - Building structure
  - Plumbing
  - Escalators
  - Fire protection
  - Security systems

Improvement to Property

Unit of Property – Property other than buildings

***In general*: All of the components that are functionally interdependent comprise a single UOP.**

- Components are functionally interdependent if placing in service one is dependent upon the placing in service of another component.

Improvement to Property

Unit of Property – Leased Property

In general: In the case of a **taxpayer that is a lessee** of all or a portion of a building, the **UOP is each building and its structural components or the portion of each building** subject to the lease and the structural components associated with the leased portion.

Improvement to Property

In the case of a **lessee of an entire building**, the **building or its structural components** are the units of property

Improvement to Property

In the case of a **lessee that leases a portion** of a building, **the portion of the building structure subject to the lease or the portion of any structural component associated with the leased** space are the units of property

Improvement to Property

Capitalization Standards

In general: **Taxpayers must capitalize amounts paid to improve tangible property if the amount paid results in a:**

- **B**etterment
- **A**daption to a new and different use; or
- **R**estoration

General Asset Accounts (GAA)

Election

- **Assets may be grouped in a single GAA if they have the:**
  - Same depreciation method (cannot combine bonus and non-bonus)
  - Same recovery period
  - Same convention
  - Placed in service in same taxable year
- **A single asset can be placed into a GAA**

General Asset Accounts (GAA)

- **If GAA elected, no loss on disposition recognized until all assets in GAA completely disposed.**
- **However, can elect to treat a component of an asset as a single asset for disposition purposes:**
  - Structural components of buildings generally defined under Section 48 regs.
  - Definition of component must be consistently used for all assets
  - Election provides flexibility in determining whether to take a loss on a disposition or a repair expense, if permitted.

Accounting Method Changes

Under the regulations:

Automatic consent for method changes to comply with temporary regulations

- Form 3115 must be attached to the timely filed (including extensions) fed tax return for the year of change
- National Office copy of Form 3115 must be filed with IRS Ogden, UT office in lieu of IRS National Office in DC

Accounting Method Changes

Change can result in:

- Section 481(a) adjustment
- Cut-off method adjustment
- Modified cut-off method adjustment

IRS Notice 2012-73

- **Optional application of temporary regulations for 2012-2013**
- **Final regulations issued in 2013, effective 1/1/2014**
- **Potential changes for:**
  - De minimis rule
  - Dispositions
  - Routine maintenance safe-harbor

Repairs & Maintenance

What to do now?

- Formalize written capitalization policy to implement 1/1/2014 if not already present
- For buildings, evaluate the new component UOPs and consider potential for write-off of previously disposed components
- Evaluate expense accounts currently being used for small purchases as well as repairs and maintenance
- Consider early adoption of some or all of these rules

- Parachutes for: high-income taxpayers
- Repairs & Maintenance: capital intense businesses feel more impact
- Sequester could mean higher taxes for high net worth taxpayers
- Oregon tax reform ?

And…

New this week, all taxpayers can finally file returns now that the IRS has their computers programmed for January 1, 2013 tax law.


WITH the SEQUESTER, GOVERNMENT AS WE KNOW IT WILL CEASE TO EXIST!!!
STILL WAITING TO HEAR THE DOWNSIDE...

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