TAX UPDATE

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AMERICAN TAXPAYER RELIEF ACT OF 2012

- If you don’t have more than $1,000,000 or earn more than $200,000 nothing has changed
- The lower income tax rates imposed on individuals, estates and trusts under EGTRRA have been made permanent for tax years beginning after 12/31/2012
  - Including marriage penalty relief

ESTATE TAXES

- Reunified gift and estate taxes
- $5,000,000 applicable exclusion amount made permanent and adjusted for inflation
- 40% maximum tax rate
- Portability made permanent

ESTATE TAXES

- A recent Congressional Research Service Report states that less than 0.2% of decedent’s estates will be affected by transfer taxes
  - Transfer taxes include gift, estate and generation-skipping transfer taxes
  - At $5 million, only 3,600 estates or 0.14% would be subject to taxes in 2011
  - At $3.5 million, only 6,160 estates or 0.24%
  - At $1 million, 46,000 estates or 1.76%

HISTORICAL APPLICABLE EXCLUSION AMOUNTS

Year	AEA ($)	Tax Rate (%)
2001	675,000	55 (5 surcharge)
2002-3	1,000,000	50; 49
2004-5	1,500,000	48; 47
2006-8	2,000,000	46; 45; 45
2009	3,500,000	45
2010	no tax or 5,000,000	0 or 35

APPLICABLE EXCLUSION AMOUNTS

Year	AEA ($)	Tax Rate (%)
2011	5,000,000	35
2012	5,120,000	35
2013	5,250,000	40

PORTABILITY

- Portability is the opportunity for the surviving spouse to use a deceased spouse's unused applicable exclusion amount (Deceased Spousal Unused Exclusion)
  - For 2013 each spouse has an applicable exclusion amount of $5,250,000; so, a couple could transfer $10,500,000 to the next generation without estate taxes

ESTATE TAX PLANNING

- Review your current estate plan
- Portability has eliminated the need for the
  - Credit shelter trust and
  - Dividing assets to fund the plan

ESTATE TAX PLANNING

- Estate tax planning is essentially a gifting program where assets are transferred to the younger generation for no or reduced taxes
- Benefit of lifetime transfers
  - Removes income and appreciation
  - Effective gift tax rate is lower (rate is the same but the base is different)
    - Gifts are tax exclusive
    - Estates are tax inclusive

BASIS CONSIDERATIONS IN GIFTING

- The donee takes the donor’s basis plus tax paid on the appreciation §1015
  - Even if you don’t plan to sell the property, you still need to establish the basis in the timber
- A devisee (estate) gets a step-up (or down) to FMV date of death §1014
  - You can regenerate a stand, recover your cost over 7 years and leave it to your children who will get to recover the cost again

INCOME TAXES

- What's new?
  - 39.6% income tax rate
  - 0.9% Additional Medicare tax
  - 3.8% Medicare surtax on investment income
  - 20% capital gains rate
  - Phase-out of personal exemption
  - Phase-out of itemized deductions
  - AMT fix
  - Temporary extension of some other provisions

TAX TABLES
(Projected)

Tax Rate	Married, Joint	Trust
10%	$17,850	
15%	$72,500	$2,450
25%	$146,400	$5,700
28%	$233,050	$8.750
33%	$398,350	$8,750
35%	$450,000	No 35% bracket
39.6%		

* Trust income should be distributed

ADDITIONAL MEDICARE TAX

- Applies to wages and self-employment income above a threshold amount
- Rate is 0.9%
- Threshold
  - Married filing jointly: $250,000
  - Single: $200,000
- Paid by the individual not the employer (employers must withhold)
- For 2013
  - 6.2% of the first $113,700
  - 1.45% Medicare tax on all wages
  - 0.9% Additional Medicare tax on wages in excess of $250,000

3.8% MEDICARE SURTAX ON INVESTMENT INCOME

- For an individual the tax is imposed on the lesser of
  - “net investment income” (NII) or
  - The excess of modified adjusted gross income (MAGI) over a certain threshold amount
- For trusts and estates the tax is imposed on the lesser of:
  - Undistributed NII, or
  - The excess of adjusted gross income over a threshold (about $12,000 for 2013; $11,650 for 2012)

NET INVESTMENT INCOME

- Gross income from interest, dividends, annuities, royalties and rents
- Gross income from (1) a passive activity, or (2) a trade or business of trading in financial instruments or commodities
  - Includes family businesses (LLC's, FLP's, etc.) where an owner is not actively involved in the business
- Net gain to the extent taken into account in computing taxable income
  - Includes capital gain
    - But not gain on the sale of a principal residence or like-kind exchange (not taken into account in computing taxable income)

NET INVESTMENT INCOME

- Exception for retirement plan distributions from
  - Qualified pension, profit-sharing and stock bonus plans,
  - Qualified annuity plans,
  - IRA’s,
  - Roth IRA’s
- Although retirement plan distributions, wages, salary and other compensation income are not NII they are used to compute MAGI and could affect your exposure to the tax

Example

- Husband and wife earn $200,000 and harvest $50,000 worth of timber
  - Since the total is not over the threshold amount ($250,000) there will be no additional tax
- Suppose husband and wife receive a $40,000 distribution from their IRA
  - Even though the IRA distribution is not part of NII it does add to MAGI
  - Since MAGI is now $290,000, $40,000 of the timber is taxable at the 3.8% rate or $1,520 in tax

SHOULD YOUR TIMBER BE AN INVESTMENT OR A BUSINESS?

- How does the IRS know which you are?
  - If you file a Schedule D you are holding your timber for investment
  - If you file a Schedule C you are operating your property as a business

SHOULD YOUR TIMBER BE AN INVESTMENT OR A BUSINESS?

- If you are holding your timber as an investment then any expenses are miscellaneous itemized deductions subject to 2% of AGI deduction
  - If your AGI was $100,000 and you spent $10,000 planting trees, you can deduct the $10,000 but you will lose the benefit of the first $2,000 (2% of $100,000) and since you are in the 25% tax bracket you lost $500
  - You would also be subject to the Additional Medicare Tax if your income exceeded the threshold
- Calling your timber operation a business does not solve the problem
  - If you do not materially participate then the income is NII and losses can only offset income from the passive activity, not other income

CAPITAL GAINS

- Capital gains rates for individuals for 2013 are:
  - 0% to the adjusted net capital gains of individuals if the gain would otherwise be subject to the 10- or 15-percent ordinary income tax rate
  - 15% to adjusted net capital gains of individuals if the gain would otherwise be subject to the 25-, 28-, 33- or 35-percent ordinary income tax rate
  - 20% to adjusted net capital gains of individuals if the gain would otherwise be subject to the 39.6-percent ordinary income tax rate
- Capital gains rates for trusts and estates are:
  - 0% if subject to 15% ordinary rate
  - 20% if subject to 39.6% ordinary rate, otherwise
  - 15%

QUALIFIED DIVIDENDS

- The taxation of qualified dividends of noncorporate taxpayers at capital gains rates has been made permanent and will continue to apply in tax years beginning after 12/31/2012

PHASEOUT OF ITEMIZED DEDUCTIONS

- The phaseout of itemized deductions for higher-income individuals is reinstated for tax years beginning after 12/31/2012
- Threshold amounts
  - $300,000 in the case of married taxpayers filing a joint return
  - $250,000 for an unmarried individual
- The reduction is the lesser of
  - 3% of the amount of the taxpayer’s AGI in excess of the threshold, or
  - 80% of the itemized deduction otherwise allowable

PHASEOUT OF PERSONAL AND DEPENDENCY EXEMPTIONS

- The phaseout of personal and dependency exemptions for higher-income individuals is reinstated for tax years beginning after 12/31/2012
- Threshold amounts
  - $300,000 in the case of married taxpayers filing a joint return
  - $250,000 for an unmarried individual
- The reduction is
  - 2% for each $2,500 or fraction thereof by which the taxpayer's AGI in exceeds the threshold amount, or
  - The deduction will be fully eliminated when AGI exceeds the threshold amount by $122,500

Alternative Minimum Tax (AMT)

- The AMT exemption amounts for individuals has been increased retroactive to 2012 and have been made permanent
  - $78,750 for married individuals filing jointly
  - $50,600 for unmarried individuals
- Many of the dollar amounts used in the AMT calculations will be indexed for inflation after 2012
- The threshold levels for the exemption phaseout generally remain unchanged and start at:
  - $150,000 for married individuals filing jointly and
  - $112,500 for unmarried individuals

Other Changes

- The 50% bonus depreciation allowance has been extended for one more year (2013)
- The enhanced deduction for charitable contributions of real property for conservation purposes has been extended through 2013
  - The amount of the deduction is not increased, just the amount that can be taken each year
- The election to claim an itemized deduction for State and local general sales tax in lieu of State and local income taxes has been extended through 2013

Other Changes

- The nonbusiness energy property credit has been extended through 2013
  - The lifetime credit limit remains at $500 with no more than $200 for exterior windows and skylights
- The exclusion from gross income for qualified charitable distributions of up to $100,000 from a traditional or Roth IRA has been extended through 2013