


Tax Update



ANRC Symposium & Awards Banquet

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Tax Update



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American Taxpayer Relief Act of 2012

- Eliminated EGTRRA (2001) sunseting
- For higher income taxpayers
 - Tax rate increase
 - Capital gain and dividend tax rate increase
 - Reinstate personal exemption phaseout
 - Reinstate Pease limitations on itemized deductions

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**American Taxpayer Relief Act of 2012
 MORE**

- Permanent AMT relief
- Retain \$5MM exemption for estate and gift taxes
- Increase E&G tax rate 35% to 40%
- Maintains exemption portability
- Recovery Act extenders
- Individual extenders
- Depreciation change with extenders

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**American Taxpayer Relief Act of 2012
STILL MORE**

- Business tax breaks
- Energy related tax breaks
- Qualified plan transfer to Roth accounts may be allowed by plans

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**Other Goodies Added by
Reconciliation Act of 2010**

- Chapter 2A of Internal Revenue Code of 1986: Unearned Income Medicare Contribution
- Section 1411: Imposition of Tax [Beginning 2012]

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**WHAT CHANGES CAN
AFFECT TIMBER
OWNERS?**

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Tax Change Summary

- Clients with higher incomes (MFJ, HOH, S, MFS)
 - Lose exemptions: \$300K, \$275K, \$250K, \$150K
 - Lose deductions: \$300K, \$275K, \$250K, \$150K
 - Have higher rates: \$450K, \$425K, \$400K, \$225K
 - Capital Gain 20%: \$450K, \$400K others
 - Surtax 3.8%: Generally above \$250 MAGI
 - Estate and Gift Tax increase from 35% to 40%

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Selected Extenders Not Passed

- Biofuel producer credit
- Biodiesel incentives
- New energy efficient homes credit
- Work opportunity credit
- DOI exclusion home mortgages
- Mortgage insurance premium deduction
- 50% Bonus depreciation
- Sect 179 enhanced limit
- Conservation contributions real property
- Qualified tuition deductions

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Anatomy of the Medicare Surtax

- Review the structure of the law—last two pages of the outline
- How it works—see pages 21 and 22 of outline
- Example

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Medicare Surtax Ex 1

A, an unmarried U.S. citizen, has MAGI of \$190,000 for the tax year, which includes \$50,000 of NII. A isn't liable for the NIIT because the threshold amount for a single individual is \$200,000.



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Medicare Surtax Ex 2

B, an unmarried U.S. citizen, has MAGI of \$220,000 for the tax year, which includes \$50,000 of NII. B pays a NIIT on only the \$20,000 amount by which his MAGI exceeds his threshold amount of \$200,000, because that is less than his NII of \$50,000. B's NIIT is \$760 ($\$20,000 \times 3.8\%$).



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Medicare Surtax Ex 3

Assume that the taxpayer in Ex 2 had MAGI of \$260,000. Because taxpayer's MAGI exceeds his threshold amount by \$60,000, he would pay a NIIT on his full \$50,000 of NII. Thus, taxpayer's NIIT would be \$1,900 ($\$50,000 \times 3.8\%$).



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If Tax Increases Apply to Income?

- Reducing income reduces the application of tax increases
- Invest in assets that don't create "taxable income"
- Heightened use of Section 1031 Tax Free Exchanges
- Utilize Installment Sales to spread gains over tax years to reduce the impact, remember the limitations.

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Passive/Active Income Trap Lurking in Medicare Surcharge

- §1411(c)(2)(A) Tax applies to passive activities
- Many own timber/timberland and other real estate in partnership (LLC/LLP) format
- Surprise lurking when the increased tax and surtax is applied to the limited partners of the businesses even if the income is Section 1231 income. **Passive**

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Active/Passive Rules

- More than 500 hours test
- Substantially ALL Participation
- More than 100 hours and no one participates more
- Significant participation activity: over 100 hours and all SPA's are over 500 hours
- Prior Year Material Participation: 5 out of last 10 years qualified.
- Personal service activity 3 prior years
- Facts and circumstances

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Facts and Circumstances

- Taxpayer participates on a
 - Regular
 - Continuous AND
 - Substantial
 - Basis during the year
 - If less than 100 hours, Temp Regs make this unavailable
 - Management participation not allowed if paid for that participation or any individual spent more hours than the taxpayer.

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Suggestion

- Maintain a log of activity
 - When
 - How long
 - What was done
 - With whom
 - Where

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Hobby Loss and Passive Activities

- Currently, IRS is conducting audits to challenge the “Trade or Business” assumption under Section 165
- Treatment of
 - Trade or business activity
 - Investment activity
 - Hobby
- Consult Audit Techniques Guide for IRS approach and questions.

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Characteristics of Trade or Business

- Profit motive?
- Books and records commensurate with activity?
- Stationery, business cards, advertising?
- T/P time and effort. Documented?
- Qualified advisors?
- Business plan?
- Expectation for profit reasonable?
- Elements of personal pleasure outweighed

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Review of Typical Forestry Expenses

- Treatment by Trade or Business
- Treatment by Investor
- Reforestation Costs
- Treatment by Individuals, Partnerships, Estates and Trusts
- Reforestation Amortization recapture!

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Importance of Tax at Long Term Capital Gain Rate for Forestry

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Questions

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