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How Will Congress' Fiscal Cliff Compromise Impact Your Taxes?

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Although Congress' post-last-minute tax compromise managed to avert most of the ramifications of the so-called Fiscal Cliff, the actual legislation passed will result in tax increases on almost three in four Americans. Below is a high-level look at the implications of the new law for investors at all income levels.

While the new law provides some much-needed certainty around taxes, that certainty may be short-lived.

What You Should Know:

1. **The majority of Americans will pay more this year.** One of the most frequently criticized implications of the new legislation results from something that was not a part of it – the bill did not extend a 2% social security tax holiday that was enacted in 2011 and expired after 2012. Other increases specifically included in the law will take an even larger tax bite from some:

- Couples with taxable income over $450,000 and single filers over $400,000 will see that additional income taxed at 39.6% (up from 35% in 2012).
- Those same filers will pay 5% more on dividends and long-term capital gains (20% vs. 15% in 2012).
- Couples with a taxable income over $250,000 or individuals over $200,000 will be subject to an additional 3.8% Medicare tax on investment income.
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2. **Many temporary credits, deductions and exemptions were made permanent.** While paychecks will be smaller for most American workers this year, so will their overall tax liabilities thanks to the permanent extension of the Bush-era tax cuts for most taxpayers. Other extensions include:

- The child tax credit will remain at $1,000 per qualifying child, rather than falling to $500.

- The 10% and 15% tax brackets and the standard deduction for married couples will remain twice that of single individuals, reducing the so-called "marriage penalty."
- The $5 million threshold for exemption from the estate tax remains in place (though the tax on estates above that amount has increased to 40%).
- The Alternative Minimum Tax was permanently "patched" and inflation adjusted, minimizing the number of taxpayers impacted.
- Several other expired or set-to-expire provisions related to education savings, charitable giving and business costs have been extended as well.

3. "Permanent" may be a misleading term.
While the new law provides some much-needed certainty around taxes – something many investors and businesses had long been waiting for – that certainty may be short-lived:

- The new law is expected to generate $600 billion in new revenue over the next ten years – well short of the president's stated goal of $1.6 trillion.
- The United States hit its debt ceiling at the end of 2012, and Republicans have promised to fight for spending cuts before raising it again – which could bring taxes back into play if the president stands by his past insistence that new revenues accompany new cuts.

What You Should Do Now:

With what we now know, your Financial Advisor is much better positioned to help you plan. We recommend you schedule a meeting or call soon to assess the implications of new tax rules for your specific situation and investment strategy. ■

For more comprehensive information on the recent changes to U.S. tax law and their implications for investors, visit rwbaird.com and search "managing taxes."

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