

e-Report

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2013 Capital Gains Tax Update: The American Tax Relief Act

Capital Gains Tax Increases for Some Taxpayers

To avoid the so-called “fiscal cliff”, on January 1st, 2013; Congress passed the American Tax Relief Act of 2012 (TATRA). TATRA made no changes to the 3.8% Medicare surtax¹, which went into effect – as scheduled – January 1, 2013. TATRA did, however, raise the top capital gains tax rate. Effective January 1, 2013; the top capital gains tax rate will increase from 15% to 20% for individuals with adjusted gross incomes (AGI) above \$400,000 and married couples filing jointly with adjusted gross incomes above \$450,000.

The 3.8% surtax, combined with the capital gains tax, means that taxpayers with AGI’s over \$200,000 for single persons and \$250,000 for married couples will be subject to the 3.8% surtax on their capital gains. This is in addition to paying either 15% or 20% capital gains tax, depending on one’s federal tax bracket.

How do you determine if the 3.8% surtax applies to you? Very simply, if your AGI is equal to or less than the threshold amounts specified in IRC §1411, you will not be subject to the 3.8% surtax. If your AGI is above the specified threshold amounts, you will pay the 3.8% surtax on either your investment income or the excess of your AGI over the specified threshold – whichever amount is less.

<u>Filing Status</u>	<u>Threshold amount</u>
Married filing jointly	\$250,000
Married filing separately	\$125,000
All other individual taxpayers	\$200,000
Trusts and Estates	\$11,650 (for 2012)

How do you determine your applicable capital gains tax rate?

Your applicable federal tax bracket will determine your capital gains tax.

Applicable capital gains rates are as follows:

Federal tax bracket 10% or 15% = 0 capital gains tax

Federal tax bracket 25%, 28%, 33% 35% or 39.5% = 15% capital gains tax

Federal tax bracket 39.6% = 20% capital gains tax

Examples of 3.8% surtax and capital gains tax

Example #1: Mr. Smith has an AGI of \$220,000 (\$160,000 wages and \$60,000 investment income). Thus, his AGI is \$20,000 over the \$200,000 threshold for individuals. He will pay the 3.8% surtax on the lesser of his investment income (i.e. \$60,000) or the amount over his \$200,000 threshold (i.e. \$20,000). Thus, Mr. Smith will pay the 3.8% surtax on \$20,000. Additionally, since his AGI is \$220,000, he is in the 25% federal tax bracket and will be subject to the 15% capital gains rate. His total capital gains tax is 18.8%.

Example #2: Mr. and Mrs. Green have an AGI of \$180,000 (\$140,000 wages and \$40,000 investment income). They will pay the 3.8% surtax on the lesser of their investment income (i.e. \$40,000) or their excess over the threshold (i.e. \$0). Since \$0 is the lesser, they pay \$0 surtax. However, since their AGI is \$180,000, they are in the 25% federal tax bracket and will be subject to the 15%

For more information about IRC §1031 exchanges, please visit www.orexco1031.com or call 800-738-1031.

¹ The 3.8% surtax applies to “net investment income”. In general, “net investment income” includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, income from businesses involved in trading of financial instruments or commodities, and businesses that are passive activities to the taxpayer (within the meaning of IRC section 469). See IRS website at <http://www.irs.gov/uac/Newsroom/Net-Investment-Income-Tax-FAQs>