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## **Individual Tax Breaks Retroactively Reinstated and Extended by the 2012 Taxpayer Relief Act**

On January 1, 2013, Congress passed the American Taxpayer Relief Act (2012 Taxpayer Relief Act), which the President has signed. The 2012 Taxpayer Relief Act will prevent many of the tax hikes which were scheduled to go into effect this year and retain many favorable tax breaks which were scheduled to expire, but will also increase income taxes for some high-income individuals and slightly increase transfer tax rates from 2012 levels. Further, it extends a host of expired and expiring tax breaks for businesses and individuals.

This Hot Topic explains the individual income tax provisions that were extended, added and/or modified by the 2012 Taxpayer Relief Act. Many of the affected provisions had expired at the end of 2011, including the above-the-line deduction for educator expenses and the allowance of tax-free charitable transfers from a taxpayer's IRA, and these were retroactively resuscitated and extended through 2013.

For a Hot Topic covering key business tax breaks in the 2012 Taxpayer Relief Act, see [http://www.facpa.com/documents/Web\\_0113A.pdf](http://www.facpa.com/documents/Web_0113A.pdf).

For a Hot Topic covering key individual tax breaks in the 2012 Taxpayer Relief Act, including a continuation of the Bush-era tax rates for most taxpayers and a permanent AMT patch, see [http://www.facpa.com/documents/Web\\_0113C.pdf](http://www.facpa.com/documents/Web_0113C.pdf).

For a Hot Topic on the energy-related tax provisions in the 2012 Taxpayer Relief Act, see [http://www.facpa.com/documents/Web\\_0113D.pdf](http://www.facpa.com/documents/Web_0113D.pdf).

For a Hot Topic on the transfer tax (i.e., the estate, gift and generation-skipping transfer) provisions in the 2012 Taxpayer Relief Act, see [http://www.facpa.com/documents/Web\\_0113E.pdf](http://www.facpa.com/documents/Web_0113E.pdf).

### ■ **Above-the-Line Deduction for Educator Expenses Reinstated and Extended**

Eligible elementary and secondary school teachers may claim an above-the-line deduction for up to \$250 per year of expenses paid or incurred for books, certain supplies, computer and other equipment and supplementary materials used in the classroom. Under pre-Act law, the educator expense deduction didn't apply for tax years beginning after 2011.

**New law.** The 2012 Taxpayer Relief Act retroactively extends the educator expense deduction for two years so it applies to expenses paid or incurred in tax years 2012 and 2013.

### ■ **Exclusion for Discharged Home Mortgage Debt Extended**

Discharge of indebtedness income from qualified principal residence debt, up to a \$2 million limit (\$1 million for married individuals filing separately) is excluded

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from gross income. Under pre-Act law, this exclusion didn't apply to any debt discharged after 2012.

**New law.** The 2012 Taxpayer Relief Act extends this exclusion for one year so that it applies to home mortgage debt discharged before 2014.

- **Increase in Excludible Employer-Provided Mass Transit and Parking Benefits Reinstated and Extended**

For 2011, an employee could exclude from gross income up to \$230 per month in employer-provided mass transit and parking benefits. However, for 2012, the exclusion rose to \$240 for parking due to an inflation adjustment, but it fell to \$125 for employer-provided transit and vanpooling benefit, creating a disparity with other qualified transportation fringe benefits. Under pre-Act law, this disparity was scheduled to continue for post-2012 years, and mass transit and vanpool benefits extended to employees would only be Excludible up to \$125 per month.

**New law.** The 2012 Taxpayer Relief Act retroactively extends this increase in the monthly exclusion for employer-provided transit and vanpool benefits, so the exclusion for employer-provided transit and vanpool benefits is equal to that of the exclusion for employer-provided parking benefits, through 2013.

**Observation:** The Senate's "Summary of Provisions in the American Taxpayer Relief Act of 2012" refers to a \$240 exclusion amount. However, this figure doesn't take into account that statutory inflation mechanism. The exclusion amount is estimated to be \$245 for 2013.

It's unclear how a taxpayer could actually take advantage of these retroactively increased benefits for 2012. Presumably, this issue will be addressed in future IRS guidance.

- **Treatment of Mortgage Insurance Premiums as Deductible Qualified Residence Interest Reinstated and Extended**

Mortgage insurance premiums paid or accrued by a taxpayer in connection with acquisition indebtedness with respect to the taxpayer's qualified residence are treated as deductible qualified residence interest, subject to a phase-out based on the taxpayer's AGI. Under pre-Act law, this provision only applied to premiums paid or accrued before January 1, 2012.

**New law.** The 2012 Taxpayer Relief Act retroactively extends this provision for two years so that a taxpayer can deduct, as qualified residence interest, mortgage insurance premiums paid or accrued before January 1, 2014.

- **State and Local Sales Tax Deduction Reinstated and Extended**

Taxpayers who itemize deductions may elect to deduct state and local general sales and use taxes instead of state and local income taxes. Under pre-Act law, this

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choice was unavailable for tax years beginning after 2011.

**New law.** The 2012 Taxpayer Relief Act retroactively extends this provision for two years so that itemizers can elect to deduct state and local sales and use taxes instead of state and local income taxes for tax years beginning before January 1, 2014.

- **Liberalized Rules for Qualified Conservation Contributions Reinstated and Extended**

A taxpayer's aggregate qualified conservation contributions (i.e., contributions of appreciated real property for conservation purposes) are allowed up to the excess of 50% of the taxpayer's contribution base over the amount of all other allowable charitable contributions (100% for qualified farmers and ranchers), with a 15-year carryover of such contributions in excess of the applicable limitation. Under pre-Act law, these rules didn't apply to any contribution made in a tax year beginning after 2011, and contributions made thereafter were to be subject to the otherwise applicable 30% limit for capital gain property (50% limit for qualified farmers and ranchers).

**New law.** The 2012 Taxpayer Relief Act retroactively extends for two years the 50% and 100% limitations on qualified conservation contributions of appreciated real property so they apply to contributions made in tax years beginning before January 1, 2014.

- **Above-the-Line Deduction for Higher Education Expenses Reinstated and Extended**

A taxpayer may claim an above-the-line deduction for qualified tuition and related expenses for higher education paid by that taxpayer during the tax year, subject to applicable adjusted gross income (AGI) and dollar limits. Under pre-Act law, this deduction wasn't available for tax years beginning after December 31, 2011.

**New law.** The 2012 Taxpayer Relief Act retroactively extends the qualified tuition deduction for two years so that it can be claimed for tax years beginning before January 1, 2014.

- **Nontaxable IRA Transfers to Eligible Charities Reinstated and Extended**

Taxpayers who are age 70 ½ or older can make tax-free distributions to a charity from an Individual Retirement Account (IRA) of up to \$100,000 per year. These distributions aren't subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer's return. Under pre-Act law, these rules didn't apply to distributions made in tax years beginning after December 31, 2011.

**New law.** The 2012 Taxpayer Relief Act retroactively extends this provision for two years so it's available for charitable IRA transfers made in tax years beginning

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before January 1, 2014. The Act includes two elections to deal with the retroactive reinstatement of this provision:

- A taxpayer may elect to have a distribution made in January of 2013 be treated as if it were made on December 31, 2012.
- A taxpayer may elect to treat any portion of a distribution from an IRA to the taxpayer during December 2012 as a qualified charitable distribution, provided:
  - (i) the portion is transferred in cash after the distribution to an eligible charitable organization before February 1, 2013, and
  - (ii) except for the fact that the distribution wasn't originally transferred directly to the organization, the distribution otherwise meets Code Sec. 408(d)(8)'s requirements.

■ **False Prisoner Tax Return Disclosure Rules Modified and Made Permanent**

IRS is allowed to disclose to the head of the Federal Bureau of Prisons (Bureau) and the head of any state agency charged with the responsibility for prison administration (agency), return information for individuals incarcerated in federal prison or state prison whom IRS has determined may have filed or facilitated the filing of a false return. The disclosure is permitted to the extent that IRS determines that it is necessary to permit effective federal tax administration. Under pre-Act law, these rules didn't apply beyond December 31, 2011.

**New law.** The 2012 Taxpayer Relief Act expands the persons to whom false prisoner returns and return information can be disclosed to include officers and employees of the Bureau or agency, contractors responsible for operating a Federal or state prison on behalf of the Bureau or agency and legal representatives of the Bureau, agency, responsible contractor or prisoner. It also expands the authorized uses of the disclosed information to include administrative and judicial proceedings arising from various administrative actions. These provisions are made permanent by the 2012 Taxpayer Relief Act.

■ **Transfer of Amounts in Applicable Retirement Plans to Designated Roth Accounts**

**New law.** For transfers after December 31, 2012, in tax years ending after that date, plan provisions in an applicable retirement plan (which includes a qualified Roth contribution program) can allow participants to elect to transfer amounts to designated Roth accounts with the transfer being treated as a taxable qualified rollover contribution under Code Sec. 408A(e). Such a transfer will not be treated as violating various sections of the Code.

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