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Navigating the Tax Landscape: A New Frontier?

January 2013

Congress provided us with an early New Year's gift in the form of the "American Tax Relief Act of 2012" (the Act), which was passed by the House of Representatives on New Year's Day and signed into law by President Obama the following day. The Act provides us with fortunate clarity concerning our tax laws while Congress waits to meet another day over its postponed budget, spending and entitlement spending discussions.

Understanding that we have heard and read much about the Act already, this is designed to summarize the highlights of the Act in more simple terms.

Who Will Pay More Tax?

The Act was presented as a means to provide relief for most taxpayers; however, in practice it will increase taxes paid by most taxpayers to some extent. The name "Relief" title remains a misnomer, since the Act increases taxes for:

- **Everyone Who Earns Wages** - 2% Payroll Tax "Holiday" Ends and 0.9% Additional Tax on Earned Income as Provided Under the Health Care Act
- **Everyone Subject to AMT** - $50,600 (Single or Head of Household), $78,750 (Married Filing Jointly) and $39,375 (Married Filing Separately)
- **Everyone Subject to Health Care Act Surtax of 3.8%** - Net Investment Income of Taxpayers With MAGI Over $250,000 (Married Filing Jointly), $125,000 (Married Filing Separately) and $200,000 (All Other Taxpayers)

» **Everyone Subject to Phase Out of Personal Exemptions and Itemized Deductions** - Adjusted Gross Income Over $250,000 (Single), $275,000 (Head of Household), $300,000 (Married Filing Jointly) and $150,000 (Married Filing Separately)

» **Everyone Subject to Highest Income (39.6%), Qualified Dividends and Capital Gains Tax Rates (20%)*** – Taxable Income Over $400,000 (Single), $425,000 (Head of Household) and $450,000 (Married Filing Jointly)

INCOME TAX RATES AND BRACKETS

RATE	SINGLE	MARRIED (JOINT)	HEAD OF HOUSEHOLD	CAPITAL GAINS* QUALIFIED DIVIDENDS
10%	>$0	>$0	>$0	0%
15%	>$8,950	>$17,900	>$12,750	0%
25%	>$36,250	>$72,500	>$48,600	15%
28%	>$87,850	>$146,400	>$125,450	15%
33%	>$183,250	>$223,050	>$203,150	15% to 18.8%
35%	>$398,350	>$398,350	>$398,350	18.8%
39.6%	>$400,000	>$450,000	>$425,000	23.8%

Other Tax "Extenders"

» American Opportunity Tax Credit (Education) Extended Through 2017

» Expanded Earned Income Tax Credit (EITC) Extended Through 2017

» Child Tax Credit ($1,000) Extended Permanently; Refundable Through 2017

» 50% Bonus Depreciation Rules Extended Through 2013

» Extends Emergency Unemployment Compensation (EUC) and Extended Benefits (EB) Unemployment Insurance Programs Through 2013

» Extends Prior Temporary Deductions, Credits and Incentives for Individuals: State and Local General Sales Taxes, Tuition, IRA Charitable Rollovers, Mortgage Insurance and Mortgage Insurance Debt Relief

» Qualified Plan Participants Can Convert to Roth Retirement Plan

Planning Ahead

The Act accomplishes tax increases by:

» Increasing income taxes of all wage earners;

» Increasing income and capital gains taxes of "wealthy" taxpayers;

» Collecting the additional Surtax on the net investment income of some taxpayers as provided by the Health Care Act; and

» Collecting additional income taxes from other taxpayers by phasing out their personal exemptions or deductions (either due to their income level or by means of the AMT).

*Including the Surtax, this combined rate would equal 23.8%.
*Note that 28% capital gains rate for collectibles and 25% IRC Section 1250 unrecaptured capital gains rate continue without change.

The last three tax triggers will affect taxpayers who exceed different income levels, so individual specific facts and circumstances will affect tax planning opportunities.

The Act also promotes easier access to Roth Conversions to generate more short term income tax revenue. These conversions still may provide some taxpayers with long term benefits as they control the timing of their retirement income distributions from these new Roth accounts thereafter.

In the past, taxpayers could lower their taxes more effectively through personal exemptions and itemized deductions. The Act makes this more difficult, so taxpayers now may consider how the timing and amount of income they earn may trigger:

» A reduction of personal exemptions;
» Loss of itemized deductions in part under the AMT; or
» Phase out of itemized deductions.

Taxpayers also may consider the timing, amount and category of investment income they earn to minimize the effect of the Surtax under the Health Care Act.

Finally, taxpayers (especially retired) may consider how their choice of state residency impacts their separate state tax liability.

In essence, the Act promotes proactive tax planning by taxpayers who may feel the effects of the increases it imposes.

TRANSFER TAXES

	2012	2013
Federal Estate	$5.12M	$5.25M
Federal GST	$5.12M	$5.25M
Federal Gift Tax Exemption (Lifetime)	$5.12M	$5.25M
Gift Tax Annual Exclusion Amount	$13,000	$14,000
Federal Tax Rate	35%	40%
Estate/Tax Portability	Yes	Yes

Safe at Last? . . . Perhaps Not . . .

Recall that Congress still may eliminate benefits of successful wealth transfer planning techniques involving:

» Trusts that allow transfers with little to no resulting gift;

» Transfers of assets to family members with valuation discounts; and

» Dynasty gift trusts that avoid future transfer taxes in perpetuity.

If Congress eliminates the benefits of these techniques, it could generate revenue by:

» Discouraging lifetime gifts;

» Trapping wealth within older generations; and

» Subjecting wealth to tax at higher rates.

Sources: The American Taxpayer Relief Act of 2012

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Calamos Wealth Management LLC
2020 Calamos Court | Naperville, IL 60563-2787
800.582.6959 | calamos.com | caminfo@calamos.com

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