Canadian Tax Highlights

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Bush-Era Tax Cuts Sunset

Absent congressional action, the Bush-era tax cuts will sunset on December 31, 2012. Those tax cuts consist of over 30 major Code changes enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). Originally set to expire after the 2010 tax year, the tax cuts were extended to the end of 2012 by Congress's 2010 enactment of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act. Whether Congress will avoid the so-called fiscal cliff and extend some or all of the tax cuts for 2013 is unknown; for all taxpayers subject to US tax, proper planning begins with understanding which tax laws will change. Given the increase in rates, US taxpayers who reside in Canada should consider selling appreciated capital gain assets and gifting in 2012.

Individual income tax changes. Most notably, the Bush-era tax cuts reduced the individual, capital gains, and qualified dividend income tax rates. For individual income tax, in 2013 higher rates of 15, 28, 31, 36, and 39.6 percent replace the current 10, 15, 25, 28, 33, and 35 percent rates: the 10 percent bracket is entirely eliminated. The capital gains tax rate increases from 15 to 20 percent; for property held for more than five years, an 18 percent capital gains tax rate applies. For 2013, dividends are taxed at ordinary income tax rates and not at the capital gains tax rate; the preferential tax rate for qualified dividend income is eliminated.

Also set to expire at year-end is the payroll tax holiday, which provides employees and self-employed individuals with a 2 percent rate reduction for the old age, survivors, and disability insurance (OASDI) portion of payroll taxes. The Middle Class Tax Relief and Job Creation Act of 2012 extended the rate reduction through 2012. Congress has not further extended the reduction, and thus after 2012 the employee-side OASDI tax rate reverts to 6.2 percent and the self-employment OASDI tax rate to 12.4 percent.

The Bush-era tax cuts also increased the alternative minimum tax (AMT) exemption to $48,450 for single filers and $74,450 for married couples filing jointly. That AMT patch enacted in 2010 expired after 2011. Congress did not enact another patch, and the exemption amount dropped drastically for 2012 and will continue into 2013: $33,750 for single filers and $45,000 for married couples filing jointly. The 2010 AMT patch also allowed all non-refundable personal credits to the full extent of the taxpayer's regular tax and AMT liability; since the patch expired after 2011, only certain non-refundable credits can offset an AMT liability.

To further complicate the 2013 tax outlook, two new surtaxes take effect on January 1, 2013. In 2010, Congress passed the Patient Protection and Affordable Care Act, more commonly known as "Obamacare," and levied two new surtaxes to fund the health-care legislation that begin in 2013: (1) the 3.8 percent unearned income medicare contribution and (2) a 0.9 percent increase in the hospital insurance (HI) portion of the Medicare tax. The 3.8 percent unearned income Medicare contribution applies to the lesser of (1) net investment income and (2) the excess of modified adjusted gross income over threshold amounts. NII generally includes most unearned income of higher-income individuals, trusts, and estates such as dividends, interest, royalties, and passive activity income. The HI Medicare tax increase imposes an additional 0.9 percent tax on the earned income of higher-income employees and self-employed persons that exceeds a threshold. For both surtaxes, the 2013 threshold amounts are $200,000 for single taxpayers and $250,000 for married couples filing jointly.

Estate and gift tax changes. Unless Congress intervenes, starting in 2013 the highest estate tax rate increases from 35 percent to 55 percent. The 55 percent tax rate also applies to the generation-skipping transfer tax (GSTT) and to the gift tax. The estate tax rate increase is compounded by a decrease in the exclusion amount from $5 million to $1 million (not indexed for inflation); the GSTT exclusion amount is also $1 million but is indexed for inflation. Unrelated to the Bush-era tax cuts but equally important, the annual exclusion for gifts increases to $14,000 for 2013 and remains indexed for inflation.

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CTF Canadian Tax Foundation
FCF Fondation canadienne de fiscalité