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In what would be considered a "photo finish" in the sport of politics, the House of Representatives passed a version of new tax legislation that the Senate had already agreed to. The President could sign this Bill into law very early in the New Year.

The major issue that congress was faced with is that there were a number of tax laws enacted during 2000-2008 that weathered a difficult time during the legislative process. One method of compromised used was that the reductions would be temporary and expire after a certain amount of time. Of course each party surmised it would gain a majority in the houses of congress and make their vision permanent.

Fortunately, or unfortunately (depending on your political ideology), the legislation never became permanent and was just moved along with a series of extenders for short periods at a time. December 31, 2012 was the latest day these laws or extenders expire and thus necessitate additional legislation.

Without another extender or permanent legislation, the tax laws that were enacted during that period would vanish and for many areas, the law that would be in effect would have been the last permanent law which could go back to as far as 1999.

During the late 1990's the maximum federal tax rate was 39.6%, dividends were taxed at the ordinary rate (39.6%) and capital gains were taxed at over 20%. The estate tax was as high as 55% and the allowable credit $1,000,000 (recently raised from $600,000).

In the past decade any extenders were usually done in enough time to ensure tax planning could happen though there were some years where the government going right to the wire to pull a bill through in December in enough time to not cause uncertainty for taxpayers or planners.

For the December 31, 2012 deadline however, congress has been quite divided. The bills drafted throughout the year gained no support from the opposite party or even from within each party. Time dragged on with no agreed upon extenders or permanent legislation.

When faced against the changing calendar, a compromised was reached.

The difficulty with passing legislation at this late date was of course the unbelievable stress upon taxpayers, planners and the uncertain markets. From a more practical perspective though is that the IRS won't be able to issue the forms or update their computer system in time to start the 2012 tax season in January.

One of the main issues that needed to be addressed was the alternative minimum tax amendments that expired on January 1, 2012. Without these amendments, up to 34 million taxpayers would be subject to the AMT that is higher than the usual approximate 4 million taxpayers subject to this additional tax.

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Waiting until January to fix this problem though will mean that up to 100 million taxpayers will not be able to file their tax returns until mid February at the earliest when the forms and IRS computers are updated.

From a cross-border perspective, such as US citizens living in Canada, there should be little effect to the total worldwide tax such individuals pay. Because the Canadian tax rate is still much higher than the new maximum US rate, provided an individual is paying Canadian tax at a higher rate on their world wide income, then the global total tax an individual would pay won't be affected by this increase.

However in instances where the US tax ends up being higher than the Canadian rate, such as capital dividends, lottery winnings, and individuals with only a small amount of dividend income, then this change will have an increase in total worldwide tax for those individuals specifically as the maximum federal rate for dividends will rise from 15% to 20%. For example if a US citizen living in Canada has $30,000 of a Canadian capital dividend (and otherwise has income over $400,000), their Canadian tax could be $0 on this dividend, but their US tax would raise from $4,500 to $6,000.

One major tax deduction for US taxpayers which congress has let expire is a reduction in payroll taxes that taxpayers enjoyed in 2012. This would result in an employee earning approximately $100,000 would pay an additional $200 per month in tax deductions from their pay.

Other notable changes in this new law:

- The tax rate would rise to 39.6% for those married households with taxable income over $450,000. ($400,000 for single taxpayers).
- The "phase-out" of certain itemized deductions and exemptions for high income individuals would be put back after they had been reduced or removed in the prior laws.
- For capital gains or dividends, the rate will increase from 15% to 20% if the taxpayer is at the new 39.6% ordinary rate bracket.
- The AMT calculation patch will be permanently enacted.
- Some of the prior legislation given another "extender" (some to 2018), is the bonus depreciation on new equipment, tuition expenses, and a deduction for state and local sales tax.

Of major concerns to most US citizens or other Canadians who own US real property or shares of US corporations are the transfer taxes.

The allowable credit for the estate/gift tax will permanently remain at $5,000,000 indexed for inflation; however the rate of estate/gift tax will rise from 35% to 40% for any transfers not covered by the exemption. Of course if proper planning is in place, Canadians can enjoy additional estate tax credits found in the US-Canada tax treaty.

There may be some estate planning review needed for those who made rash transfers based on a fear of the estate tax credit moving back to $1,000,000 at year end.

As always, the US tax law changes constantly so people with complex cross-border tax situations should be talking with their advisor.

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