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TAX PLANNING LETTER

TAX INCENTIVES SCHEDULED TO EXPIRE AT YEAR-END 2012

More than 10 years ago, Congress passed a far-reaching tax cut law – the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The 2001 tax cuts continue to impact virtually every taxpayer: individuals, businesses, exempt-organizations, and more. The tax cuts were also temporary and were scheduled to expire after 2010. As you know, 2010 arrived and Congress could not decide whether to make the tax cuts permanent or not; so they extended them for two more years. Now, the expiration date moves closer every day and any quick resolution is doubtful. In the meantime, taxpayers are left with many questions about tax planning for 2012 and beyond.

▶WHAT'S EXPIRING?

A host of tax incentives are scheduled to expire after 2012. Some, such as the reduced individual tax rates, have received much attention; others have not been in the spotlight. This email (letter) highlights some of the tax cuts scheduled to expire after 2012 and what might happen if they are not extended.

Individual tax rates. Unless extended, the current individual marginal income tax brackets of 10, 15, 25, 28, 33, and 35 percent are scheduled to expire after 2012. In their place, the pre-EGTRRA rates will be revived; that is, the rates are scheduled to revert to 15, 28, 31, 36, and 39.6 percent effective for tax years beginning after December 31, 2012. Both President Obama and the GOP have indicated their opposition to allowing the rates to revert for middle-income taxpayers after 2012. However, the White House and the GOP differ sharply on whether to extend the top two current rates (33 and 35 percent) or not. At this time, it is increasingly unlikely that the White House and the GOP will reach an agreement before the November elections. The fate of the rate cuts may be left to the lame duck Congress that will meet after the elections. Recently, there

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has been talk of Congress passing a short-term extension (six months) of the rate cuts and punting the fate of the cuts (and many of the incentives discussed below) to 2013.

Alternative minimum tax (AMT). For many taxpayers, the AMT is their regular tax because of a combination of factors (such as living in an area with high state/local taxes and high home values). To prevent the AMT from encroaching on middle-income taxpayers, Congress has routinely "patched" the AMT. The patch provides higher exemption amounts along with other targeted relief. The most recent patch in the 2010 Tax Relief Act expired at the end of 2011. President Obama and some Republicans have proposed to repeal the AMT. They differ, strongly, on what would replace it. The President has proposed the so-called "Buffett Rule," which would ensure that taxpayers making over $1 million annually would pay an effective tax rate of at least 30 percent. House Republicans have proposed to eliminate the AMT along with consolidating the individual tax rates from six to two. The most likely outcome is another patch for 2012, followed by a more permanent solution found within broader efforts toward "tax reform" in general.

Capital gains/dividends. Taxpayer-friendly tax rates on qualified capital gains and dividends are also scheduled to expire after 2012. Under current law, the maximum tax rate on qualified capital gains and dividends is 15 percent (zero percent for taxpayers in the 10 and 15 percent income tax brackets). After 2012, the maximum capital gains tax rate is scheduled to revert to 20 percent (10 percent for taxpayers in the 15 percent bracket) and dividends will be taxed at the ordinary income tax rates (potentially up to 39.6 percent). Like the individual rate cuts, the White House and Republicans are far apart on the fate of the capital gains/dividends rate cuts. Some taxpayers are accelerating capital gains into 2012 while the tax rates are lower as one strategy to deal with the uncertainty.

Federal estate tax. No provision in the Tax Code has been subject to more uncertainty in recent years than the federal estate tax. Under EGTRRA, the federal estate tax was scheduled to be repealed for 2010 and replaced with a modified carryover basis regime for that year only. The 2010 Tax Relief Act made some significant changes, providing for a maximum estate tax rate of 35 percent for decedents dying after December 31, 2009 and before January 1, 2013 and an applicable exclusion amount of $5 million. In addition, estates of decedents dying after December 31, 2009 and before January 1, 2011, have the option to elect not to apply the basic estate tax regime under the 2010 Tax Relief Act. These 2010 estates may elect to apply the estate tax based on the 2010 Tax Relief Act's 35 percent top rate and $5 million exclusion amount, with stepped-up basis or no estate tax and modified carryover basis rules under EGTRRA. The complex rules under the 2010 Tax Relief Act are scheduled to expire after December 31, 2012. Under current law, the federal estate tax is scheduled to revert to a maximum tax rate of 55 percent with a $1 million exclusion amount after 2012.

Along with the federal estate tax, many taxpayer-friendly changes to the federal gift tax and the generation-skipping transfer (GST) tax are scheduled to expire after 2012. Please contact our office for more details about the federal gift and GST taxes.

Child tax credit. The $1,000 child tax credit for dependents under age 17 could be cut to $500 after 2012 if the scheduled reduction takes place. EGTRRA raised the credit to $1,000 and the 2010 Tax Relief Act extended the $1,000 amount through 2012. Additionally, the 2010 Tax Relief extended other enhancements to the credit, which also are scheduled to expire after 2012. The likelihood of Congress extending the $1,000 child tax credit is high; the question is when. Individuals will claim the credit on their 2012 returns filed in 2013, which gives lawmakers some time to extend the credit without taxpayers being adversely affected.

More expiring incentives. A lengthy list of tax cuts in the 2010 Tax Relief Act are scheduled to expire after 2012. They include (and this is not an exhaustive list):

1. Marriage penalty relief;
2. Limitation on itemized deduction for higher income taxpayers;
3. Phaseout of personal exemptions for higher income taxpayers;
4. Enhanced child and dependent care credit;
5. Repeal of 60-month restriction on student loan interest deduction;
6. Enhanced Coverdell Education Savings Accounts;
7. Special rules for certain tax-exempt bonds;
8. Repeal of the state death tax credit; and
9. Enhanced adoption credit and adoption assistance programs

Along with all of these, Congress must decide the fate of the so-called "extenders." These are popular but temporary tax incentives, many of which expired after 2011. They include the research tax credit, the optional state and local sales tax deduction and many more. The lame duck Congress may also decide the fate of the employee-side payroll tax cut, which is also scheduled to expire after 2012.

▶PLANNING CHALLENGES

Uncertainty is always a factor in tax planning. Life brings countless changes, such an increase or reduction in income, birth of a child, death of a spouse, and so on. In 2012, uncertainty is magnified by the unknown fate of countless tax provisions on which taxpayers have relied in recent years. The uncertainty is expected to continue until after 2012 elections; and maybe even into 2013. Our office can help you plan for all of this uncertainty, by adopting strategies that allow you to remain flexible for as long as possible while being prepared to act on opportunities before they are lost to time and changing laws. Making plans now to accelerate certain income, defer specific deductions, realize capital gains, and take advantage of current gift tax rules are only some of the strategies that might fit your situation. Please contact us and we can discuss your tax plans in detail.

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