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Tax Provisions Up in the Air

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As the 2012 enters the final quarter, we are fast approaching the expiration of numerous tax provisions as a result of the expiration of the two-year extension of the provisions contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). That means that the affected Code provisions will return to their pre-EGTRRA status.

> **Note:** The change in capital gain rates beginning in 2013 is as a result of the sunset of the appropriate provisions contained in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA).

The uncertainty in the future of numerous tax provisions, makes planning very difficult. What tax policy will be beginning in 2013 turns almost entirely on the outcome of the 2012 Presidential election and the control of the U.S. Senate – with 60 votes necessary to block filibusters and get a bill to the floor.

Here's a Code section rundown of the major EGTRRA provisions that will be expiring at the end of 2012:

> **Note:** The following lists have been compiled from examining various Acts of Congress and other commentaries and tax services that have examined various portions of the expiring provisions. Special note is given to Thomson Reuters for assistance in tracking down expiring provisions.

I.R.C. Section	2012 Provision	2013 Provision If No Congressional Action
1 (income tax brackets)	Income tax brackets are 10, 15, 25, 28, 33, 35%	Income tax brackets are 15, 28, 31, 36 and 39.6% (with a marriage penalty returning – the 15% bracket for taxpayers filing joint returns as well as qualified surviving spouses being 167% of the 15% bracket rather than 200%) [**Note:** Dividends paid to individuals taxed at ordinary income rates]

1(g)(7)(B)(ii)	Inclusion of child's gross income exceeding set amount plus 10% of lesser of (a) inflation-adjusted standard deduction for dependent child or(b) excess of child's gross income over amount in (a)	10% figure changes to 15%
1(h) (capital gains)	0% for those in the 15% bracket and lower; 15% for taxpayers in higher brackets	10% for lower income taxpayers (8% for assets held more than five years); 20% (18% for assets held more than five years)
21 (credit for household and dependent care expenses)	$3,000 for 1 qualifying individual, and $6,000 for 2 or more; maximum credit percentage of 35% and AGI-based reduction starting at $15,000	$2,400 for 1 qualifying individual, and $4,800 for 2 or more; maximum credit percentage of 30% and AGI-based reduction starting at $10,000
24 (child tax credit)	$1,000 per qualifying child and is allowed against the AMT	$500 per qualifying child with no allowance against the AMT
32 (earned income tax credit)	Earned income and AGI must be less than $19,190 (MFJ) for taxpayer with no qualifying children and $50,270 (MFJ) for taxpayer with three or more qualifying children	Beginning of phaseout range lower; phaseout of credit computed with reference to MAGI rather than AGI; earned income includes exempt income; EITC reduced by AMT; credit maxes out with two dependents
36C (adoption credit)	$12,650 maximum credit	Maximum credit lower; eligible expenses limited; reduced phaseout range; inapplicable against AMT; available only for special needs child
45F (credit for employer-provided child care facilities)	Available	Unavailable
63 (standard deduction)	Married taxpayers get 200% of the standard deduction that applies for single taxpayers	Married taxpayers get 167% of the standard deduction that applies for single taxpayers
68 (overall limitation on itemized deductions)	For higher-income taxpayers, itemized deductions are reduced by 3% of AGI above a certain amount with reduction not exceeding 80%	Greater limitations apply; However, the PEASE limitation is not applicable in 2012.
127 (exclusion for employer-provided educational assistance)	Available	Unavailable; also gone is the allowance of the exclusion tied to graduate-level education; expenses paid by employer for education or training provided to the employee excluded only if qualified as working condition fringe
151(d) (phaseout of personal exemptions)	Set level	Phaseout for higher income taxpayers

221 (above-the-line deduction for student loan interest)	Available	Available, but reduced phase-out range and applicable just to interest paid during first 60 months of required interest payments
530 (Coverdell Education Savings Accounts)	Available	Contribution limit $500; lower phaeout range for MFJ; applicable only for higher education expenses; no special rules for special needs beneficiaries; no rule allowing corporations (and other entities) to make contributions; can't make contributions for current year by April 15 of following year
531 and 541 (accumulated earnings tax rate and personal holding company tax rate)	15%	39.6%
2001 (estate tax)	35% rate of tax on taxable amounts above $5.12 million	55% rate on taxable amounts above $1 million; reinstatement of Sec. 2057 family-owned business deduction; reinstatement of credit against state death tax
2505 (gift tax)	35% maximum rate; $5.12 million exemption (unified credit exemption equivalent)	55% maximum rate with $1million exemption (unified credit exemption equivalent)
2631 (generation-skipping transfer tax)	35% maximum rate	55% maximum rate above an exemption of between $1,360,000 and $1,430,000
3402 (backup withholding on gambling winnings)	25% rate	28% rate

Some provisions already expired at the end of 2011 and have yet to be reinstated:

I.R.C. Section	Provision
25C	Nonbusiness energy property credit
36C	Refundability of adoption credit
41(h)(1)(B)	Research credit
45L	Credit for construction of new energy efficient homes
45M	Energy efficient appliance credit
51(c)(4)	Work opportunity tax credit for non-veterans
62	$250 above-the-line deduction for specified expenses of elementary and secondary school teachers
163(h)(3)(E)	Ability to treat mortgage insurance premiums as deductible qualified residence interest
164(b)(5)	Election to deduct state and local general sales taxes in lieu of state and local income tax deduction
168(e)	15-year depreciation for qualified leasehold improvement property,

	qualified restaurant property and qualified retail improvement property (reverts to 39-year depreciation)
168(i)(15)(D)	7-year straight-line depreciation for motorsports entertainment complexes
168(k)(1) and (5)	100% first-year bonus depreciation (reduced to 50% for 2012)
170(b)(1)(E) and (b)(2)(B)	Tax incentives for contributions of capital gain real property for conservation purposes
170(e)(3)(C)	Enhanced charitable deduction for contributions of book inventories to government schools
170(e)(6)(G)	Corporate contributions of computer equipment for educational purposes
179	Expense method depreciation ($139,000 for 2012 with investment ceiling of $560,000)
181(f)	Election to expense production costs of qualified film and television products in the U.S.
408(d)(8)	Tax-free distributions up to $100,000 annually for taxpayers over age 70.5 from an IRA for charitable purposes
613A(c)(6)(H)(ii)	Suspension of income limitations on percentage depletion for marginal wells
1202	Exclusion of gain on certain small business stock (only 50% for 2012 and 60% for qualified business entity stock as defined by the statute)
1367(a)	Lower shareholder basis adjustments for charitable contributions by S corporations

Some Code provisions expire at the end of 2012 outside of the EGTRRA sunset.

> **Note:** These provisions were only enacted on a temporary basis and will not be renewed by a simple extension of the EGTRRA provisions. In other words, specific legislation other than an EGTRRA extension will be required to renew these provisions:

I.R.C. Section	Provision
25A(i)	American Opportunity Tax Credit – credit basically cut in half (maximum credit becomes 100% of first $1,000 of qualified tuition and related expenses, and 50% of next $1,000 of qualified tuition and related expenses; other expiring provisions include the enhanced AGI limits, the portion that is refundable is reduced, and allowing the credit for course materials is eliminated
51(c)(4)(B)	Work Opportunity Tax Credit inapplicable with respect to qualified veterans hired after 2012
53(e)	Refundable credit for unused AMT credit
108(a)(1)(E)	Exclusion for qualified principal residence debt that is discharged
168(k)(1) and (k)(4)	50% first-year bonus depreciation; election to accelerate AMT credits in lieu of claiming bonus depreciation
179	Expense method depreciation – amount will be $25,000 in 2013 and investment ceiling will be $200,000
3101 - 3111	Payroll tax cut expires – 4.2% (employee OASDI tax) becomes 6.2% and 10.4% (self-employed OASDI rate under SECA) becomes 12.4%

Alternative Minimum Tax (AMT)

There is presently no "AMT Patch" in place for 2012. Thus, the AMT exemption for 2012 is only $45,000 for MFJ and surviving spouses (down from $74,450) and $33,750 for unmarried persons (down from $48,450). In addition, unless a patch is enacted, most of the nonrefundable personal credits will not be able to be used to offset the AMT.

Health Care Act Provisions

Beginning in 2013, the Health Care Act imposes a 62.1 percent increase in the employee portion of the Medicare payroll tax – the hospital insurance tax part of FICA - (from 1.45 percent to 2.35 percent) on AGI over $200,000 (single); $250,000 (married filing jointly or surviving spouse); and $125,000 for married persons filing separately. In addition, the Health Care Act imposes a 3.8 percent tax (deceptively termed an "unearned income Medicare contribution") on "investment" income" for taxpayers with modified adjusted gross income over $250,000 (married filing joint return) or $200,000 (single return). This tax uses an all-new definition of "investment income." In addition to the items that are "investment income" under the old investment income limitations -- interest, dividends and capital gains – the 3.8% tax also applies to royalties, rents, annuity distributions, and gross income from passive activities as so defined under the Sec. 469 passive loss rules. Net investment income is computed by claiming any allocable deductions. The provision is not indexed for inflation. Also, starting in 2013, under the Health Care Act, the floor for I.R.C. §213 medical expense deductions increases to 10 percent (up from 7.5%) of AGI for regular income tax purposes (except for taxpayers (and the taxpayer's spouse) over age 65 by the end of the tax year).

Conclusion

Unless action is taken, beginning in 2013, income tax rates across all brackets go up dramatically, particularly for individuals in the lower income tax brackets, the child tax credit is halved, the marriage penalty returns, capital gain rates go up significantly, the divided tax rate increases and the payroll tax goes back up. Lower-income persons will be hit most significantly by these provisions. Also, the estate tax will reach more estates and will do so at a higher rate, and the AMT will impact significantly more taxpayers. Needless to say, there is a lot riding on the fall election. Keep checking for further updates to this article.