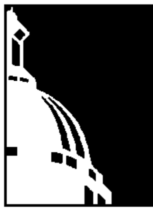

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TAX POLICY, ANYONE?

When Congress returns we know Congress and the President will be faced with the February expiration of the temporary payroll tax relief. Numerous other tax relief provisions have already expired. In addition, a "boatload" of relief provisions expire at the end of 2012. It sure would be nice if Congress and the President could deal with them in a timely and orderly fashion.

So here's our primer on the major tax relief items "in play" this year.

As you read this, the acronym TRUIRJCA is going to appear a lot. It stands for the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-312. It is the law that created the payroll tax relief but it also was the last law to extend and/or modify many of the temporary tax relief provisions that we have been stacking up since 2001.

Payroll Tax Relief

Under "permanent" law, the federal payroll tax consists of two parts. Employees pay a 1.45 percent "Medicare" tax on all wages and a 6.2 percent Social Security tax on all wages earned up to $110,100 (the indexed amount for 2012) and self-employed individuals pay a 2.9 percent Medicare tax on all self-employment income and a 12.4 percent Social Security self-employment taxes of on all their self-employment income up to the same threshold. TRUIRJCA provided temporary relief, until the end of 2011, which reduced that social security part by two points. This means employees paid only 5.65 on the first $106,800 (the indexed amount for 2011) of wages (The employer share of the tax was not reduced) and self-employment individuals paid only 13.3 percent on the first $106,800 of self-employment income in 2011.

The Temporary Payroll Tax Cut Continuation Act of 2011 extended the relief until February 29, 2012.

<u>EXPIRED</u>

Alternative Minimum Tax

TRUIRJCA included the latest extension of the temporary increases in the income levels at which the Alternative Minimum Tax (AMT) applies through 2011. This "rolling" extension is referred to as the AMT "patch."

The law provided that the individual AMT exemption amounts for taxable years beginning in 2011 were $74,450, in the case of married couples filing a joint return and surviving spouses and $48,450 in the case of individuals.

In 2012, the exemption amounts have reverted to $45,000 for married couples filing jointly and $33,750 for individuals. (*This is one relief fix that can be rectified in 2012 and even in early 2013 with minimal taxpayer harm, since for most, the ramifications occur when tax returns are filed*.)

Research and Development Credit

Internal Revenue Code (IRC) Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year. There is also an alternative simplified credit. There was also an alternative incremental credit that has been repealed. While most business owners and Washington policy makers use the phrase "research and development" or "R&D," Section 41 relies on IRC Section 174 for definitions. IRC Section 174 provides for a deduction for "research and experimentation (R&E)" expenditures

TRUIRJCA extended the credit through December 31, 2011.

As a result, currently there is no credit for 2012. From an incentive perspective, the idea is to have it in place at the beginning of a tax year. For those businesses that take the credit regularly, the day of reckoning will not be an issue until tax time next year, if it is not renewed.

There are some five dozen credits, deductions and other tax items that expired at the end of 2011. The R&D credit and AMT patch are just two of the more visible business items.

EXPIRING AT THE END OF 2012

Individual Marginal Rate Reduction

TRUIRJCA extended the tax relief provided by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) for two years. Under EGTRRA, the top individual marginal income tax rate was reduced to 35 percent.

It will return to its pre-EGTRRA level of 39.6 percent in 2013.

Under the current structure, married individuals filing joint returns for 2012 tax year, if their income is:

•Not over $17,400, will pay 10 percent of the taxable income;
•Over $17,400 but not over $70,700, will pay $1,740 plus 15 percent of the excess over $17,500;
•Over $70,700 but not over $142,700, will pay $9,735 plus 25 percent of the excess over $70,700;
•Over $142,700 but not over $217,450, will pay $27,735 plus 28 percent of the excess over $142,700;
•Over $217,450 but not over $388,350, will pay $48,665 plus 33 percent of the excess over $217,450;
•Over $388,350, will pay $109,229 plus 35 percent of the excess over $388,350

Capital Gains Tax Rate

TRUIRJCA extended the capital gains tax rate relief provided by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) for taxable years beginning before January 1, 2013. Generally, (*I cannot help but note that when a tax lawyer uses the term "generally" it means there are more exceptions to the rule than you can shake a stick at.*) the maximum rate of tax on net capital gain of a non-corporate taxpayer is 15 percent. In addition, any net capital gain which otherwise would have been taxed at a 10 or 15 percent rate generally is taxed at a zero-percent rate.

For taxable years beginning after December 31, 2012, generally the rates on net capital gain will be 20 percent and 10 percent, respectively. Any gain from the sale or exchange of property held more than five years that would otherwise be taxed at the 10-percent rate will be taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, which would otherwise be taxed at a 20-percent rate will be taxed at an 18-percent rate.

Dividends Tax Rate

Under rules enacted in JGTRRA and extended by TRUIRJCA, dividends received by a non-corporate shareholder from domestic corporations and qualified foreign corporations generally are taxed at the same rates that apply to net capital gain. Thus, dividends received by an individual, estate, or trust are taxed at rates of zero and 15 percent. This treatment applies to taxable years beginning before January 1, 2013.

For taxable years beginning after December 31, 2012, dividends received by a non-corporate shareholder will be taxed at the same rates as ordinary income.

Estate Tax Relief

TRUIRJCA extended the estate tax relief provisions of EGTRRA with modified amounts and created some new provisions. ***All of the extensions, modifications, and new provisions expire December 31, 2012.***

EGTRRA phased-out the estate and generation-skipping transfer taxes so that they were fully repealed in 2010, and lowered the gift tax rate to 35 percent and increased the gift tax exemption to $1 million for 2010. TRUIRJCA set the exemption at $5 million per person and $10 million per couple and a top tax rate of 35 percent for the estate, gift, and generation skipping transfer taxes for two years, through 2012. The exemption amount is indexed beginning in 2012 and is $5,120,000. (As a practical matter, given the new expiration date, the inflation indexing is token, but the theory is having it in place might make it easier to secure as part of a permanent solution.)

Under prior law, couples had to do complicated estate planning to

claim their entire exemption. TRUIRJCA allows the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse without such planning, effective for estates of decedents dying after December 31, 2010.

Prior to the EGTRRA, the estate and gift taxes were unified, creating a single graduated rate schedule for both. That single lifetime exemption could be used for gifts and/or bequests. The EGTRRA decoupled these systems. TRUIRJCA reunified the estate and gift taxes. TRUIRJCA made it effective for gifts made after December 31, 2010.

The system will revert to pre-EGTRRA status at the end of 2012 instead. The new changes (inflation indexing and the spousal exemption portability) will expire as well. Since the estate, gift, and generation skipping taxes were unified pre-EGTRRA, they would remain so. The estate, gift, and generation skipping transfer tax provisions of EGTRRA sunset (extended by TRUIRJCA) at the end of 2012, such that those provisions (including repeal of the estate and generation skipping transfer taxes) do not apply to estates of decedents dying, gifts made, or generation skipping transfers made after December 31, 2012. As a result, in general, the estate, gift, and generation skipping transfer tax rates and exemption amounts that would have been in effect had EGTRRA not been enacted apply for estates of decedents dying, gifts made, or generation skipping transfers made in 2013 or later years. A single graduated rate schedule with a top rate of 55 percent and a single effective exemption amount of $1 million applies for purposes of determining the tax on cumulative taxable transfers by lifetime gift or bequest.

Direct Expensing Allowance

On September 27, 2010, President signed into law the "Small Business Jobs Act" (SBJA) as Public Law 111-240 that increased the allowance and phase out threshold for the direct expensing provision to $500,000 and $2,000,000, respectively, for the taxable years beginning in 2010 and 2011.

TRUIRJCA stopped the direct expensing allowance from dropping down all the way to mid-pre-2003 levels at the end of 2011. TRUIRJCA permits taxpayers to use a direct expensing allowance in 2012 of $125,000. The $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts are indexed for inflation. ***As a result, for 2012, the adjusted allowance is $139,000 and the phase out is $560,000***.

At the beginning of 2013, the amounts revert to pre-2003 levels of $25,000 and $200,000 without inflation indexing**.**

Depreciation Bonus

An additional first-year depreciation deduction had been in place equal to 50 percent of the adjusted basis of qualified property placed in service during 2008, 2009, and 2010 (2009, 2010, and 2011 for certain longer-lived and transportation property).

TRUIRJCA extended and expanded the additional first-year depreciation to equal 100 percent of the cost of qualified property placed in service after September 8, 2010 and before January 1, 2012 (before January 1, 2013 for certain longer-lived and transportation property), and provides for a 50 percent first-year additional depreciation deduction for qualified property placed in service after December 31, 2011 and before January 1, 2013 (after December 31, 2012 and before January 1, 2014 for certain longer-lived and transportation property.)

Bottom line: ***we are in the 50 percent depreciation bonus year for most assets in 2012.*** The depreciation bonus disappears at the end of the year for most assets.

Plenty More

Same comment applies here to the expiring at the end of this year as noted about the expired already situation: This is just the tip of the iceberg. Plenty of other expiring provisions. If you are curious, the Joint Committee on Taxation publishes a list at www.jct.gov: publication JCX-1-12 (January 06, 2012), List Of Expiring Federal Tax Provisions 2011-2022.