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INFLATION (OR THE LACK THEREOF)

This past week the Social Security Administration announced that social security benefits for next year will not "get" a cost of living increase because the index of prices used by the government had not increased over the year. The President and Congress are now talking about giving beneficiaries a special one time payment of perhaps $250. (PS: This also means the maximum taxable earnings base for the social security portion of employment taxes will not change. It will remain at $106,800. The employer and employee each pay 6.2 percent on earnings up to this amount. The employer and employee pay another 1.45 percent on earnings with no cap. And, of course, the self-employed pay both shares.)

This state of the economy phenomenon will have an impact on a variety of other programs that are tied to a cost of living inflation index. The Internal Revenue Service (IRS) has announced that the various pension and retirement plan dollar amounts will not change. For example, the limitation for defined contribution plan contributions will remain unchanged for 2010 at $49,000. Effective January 1, 2010, the limitation on the annual benefit under a defined benefit plan remains unchanged at $195,000. The limitation regarding SIMPLE retirement account contributions remains unchanged at $11,500.

According to the IRS, more than three dozen other tax benefits are subject to inflation adjustments each year, but because recent inflation factors have been minimal, many of these benefits will remain unchanged or change only slightly for 2010. Some provisions affecting 2010 returns, filed by most taxpayers in early 2011, include the following:

* The value of each personal and dependency exemption available to most taxpayers is $3,650, unchanged from 2009.
* The new standard deduction for heads of household is $8,400, up from $8,350 in 2009. For other taxpayers, the standard deduction remains unchanged at $11,400 for married couples filing a joint return and $5,700 for singles and married individuals filing separately. Nearly two out of three taxpayers take the standard deduction rather than itemizing deductions, such as mortgage interest, charitable contributions, and state and local taxes.
* Various tax bracket thresholds will see minor adjustments. For example, for a married couple filing a joint return the taxable income threshold separating the 15 percent bracket from the 25 percent bracket is $68,000, up from $67,900 in 2009.
* The annual gift tax exclusion remains unchanged at $13,000.

The inflation adjustment may enter some legislative discussions outside of the social security arena. The annual discussion about the Alternative Minimum Tax (AMT) "patch" is upon us again. The problem is the income levels at which the AMT is applied were never indexed for inflation when the law was passed in the 1960's. It is this problem that Congress has tried to fix or "patch" on a temporary basis by raising the income levels at which the tax applies to inflation adjusted amounts.

Most recently, the American Recovery and Reinvestment Act (ARRA) extended the temporary increases in the income level at which the AMT applies. The law increased the AMT exemption amounts to $46,700 (individuals) and $70,950 (married filing jointly) for tax year 2009. The bad news is that if Congress does not do something, in 2010 the income exemption amounts revert to $33,750 (individuals) and $45,000 (married filing jointly). Presumably, if Congress does pass another patch it will use the ARRA income levels for last year again.

ESTATE TAX RELIEF

As you know, the SBLC has formed a separate coalition to convince Congress to "freeze" permanently the estate tax top rate at 45 percent and the individual exemption at $3.5 million, indexed for inflation (ironic, given my observations above). We have a fast closing window of opportunity to do this now. The window was created by the adoption of the budget resolution by Congress earlier this year. It provided for a process to allow the Senate to pass the freeze. During the discussions with the fiscally conservative "Blue Dogs" during the budget debate, the House leadership cut a deal that would allow the House to pass a version of the freeze without having to comply with a "pay-go" offset rule passed by the House. President Obama supports a freeze.

With the end of the calendar year closing in on us, there are some in Congress who just want to freeze the rate and exemption for 2010 instead of allowing the one year repeal to take place. In 2011 the rate and exemption revert to pre-2001 levels. At that time, estate tax relief will be in the same pool with more than a 100 other expired or expiring tax relief provisions such as child care, education, energy and individual rates. This is why it is absolutely urgent Congress take advantage of this unique opportunity now.