Scorecard of Expired and About to Expire Tax Rules

Post-2012 Changes if EGTRRA/JGTRRA Sunsets Take Effect

Here's a capsule review of what's in store after 2012 if the EGTRRA/JGTRRA sunsets go into effect.

Tax brackets (Code Sec. 1(f), Code Sec. 1(i)). Three fundamental changes occur:

(1) The 10% bracket disappears (the lowest bracket is 15%).
(2) The size of the 15% tax bracket for joint filers & qualified surviving spouses is 167% (rather than 200%) of the 15% tax bracket for individual filers.
(3) The top four brackets rise from 25%, 28%, 33% and 35% to 28%, 31%, 36% and 39.6%.

Taxation of capital gains and qualified dividends (Code Sec. 1(h)). Long-term capital gain is taxed at a maximum rate of 20% (18% for assets held more than five years). For lower-income taxpayers, the maximum rate will be 10% (8% for assets held for more than five years).

Dividends paid to individuals are taxed at the same rates that apply to ordinary income.

Coverdell Education Saving Accounts (CESAs), *formerly called education IRAs (Code Sec. 530).* A number of changes apply:

- The annual per-beneficiary contribution limit drops to $500.
- There's a lower phase out range for married persons filing jointly.
- A restricted definition of qualifying education expenses (e.g., only for higher education) goes into effect.
- There are no special rules for special needs beneficiaries.
- The rule allowing corporations and other entities to make CESA contributions sunsets.
- The rule permitting contributions for a tax year to be made as late as April 15 of the following year sunsets.

Exclusion for employer-provided educational assistance under *Code Sec. 127.* The exclusion ends after 2012 (so does the rule that allows the exclusion for graduate level education). Instead, under Code Sec. 132(j)(8), expenses paid by an employer for education or training provided to the employee is excluded from income only if it qualifies as a working condition fringe benefit.

Payments for teaching or research *(Code Sec. 117(c)).* The exemption from the payments-for-services rule for amounts received under certain Government health professions scholarship programs sunsets after 2012.

Above-the-line student loan interest deduction *(Code Sec. 221).* The deduction (1) phases out over lower modified adjusted gross income (AGI) ranges and (2) applies only to interest paid during the first 60 months in which interest payments are required.

Adoption credit under *Code Sec. 23 and employer-provided adoption assistance exclusion under Code Sec. 137.* All of the following rules sunset: increase to $10,000 (as inflation adjusted) for maximum credit and maximum exclusion, special needs adoptions deemed to have $10,000 (as inflation adjusted) eligible expenses for purposes of credit and exclusion, increase in the beginning and ending points of phase-out range for credit and exclusion, and allowing the credit against AMT. (See related change in individual provisions that expired after 2011, below.) Also the Code Sec. 23 credit will be available only for a special needs child.

Standard deduction *(Code Sec. 63).* The standard deduction for married taxpayers filing jointly (and qualified surviving spouses) is 167% (rather than 200%) of the standard deduction for single taxpayers.

Reduction in itemized deductions *(Code Sec. 68).* Most itemized deductions of higher-income taxpayers are reduced by 3% of AGI above an inflation-adjusted figure, but the reduction can't exceed 80%.

Phase out of personal exemptions *(Code Sec. 151(d)).* A higher-income taxpayer's personal exemptions are phased out when AGI exceeds an inflation-adjusted threshold.

Parent's election to include child's unearned income on parent's return *(Code Sec. 1(g)(7)(B)(ii)).* The parent includes child's gross income in excess of an inflation-indexed figure, plus 15% (up from 10%) of the lesser of (a) the inflation-adjusted standard deduction for dependent child, or (b) the excess of the child's gross income over the amount in (a).

Credit for employer-provided child care facilities *(Code Sec. 45F).* This credit sunsets after 2012.

Earned income tax credit (EITC) *(Code Sec. 32).* There are multiple changes: the beginning of phase out range for joint returns drops; phase out of the credit is computed with reference to modified AGI (rather than AGI); earned income for EITC purposes includes exempt income; and EITC is reduced by the AMT.

Credit for household and dependent care expenses *(Code Sec. 21).* Creditable expenses drop from $3,000 (1 qualifying individual) and $6,000 (2 or more) to $2,400 and $4,800, respectively. The maximum credit percentage drops from 35% to 30%, and the AGI-based percentage reduction begins at $10,000 (instead of $15,000).

Child credit *(Code Sec. 24).* The maximum credit drops from $1,000 to $500 and the credit is not allowed against AMT. Also, more restrictive rules apply to the refundable child credit.

Who must file individual income tax returns *(Code Sec. 6012).* Standard deduction (1) for joint filers (and qualified surviving spouses) is 167% (rather than 200%) of the standard deduction for single taxpayers, and (2) for marrieds filing separately is one half of the joint filer amount. This affects minimum gross income thresholds for married taxpayers (filing jointly or separately) and for qualifying surviving spouses.

Accumulated earnings tax rate *(Code Sec. 532) and personal holding company tax rate (Code Sec. 541).* Both rise from 15% to 39.6%.

Minimum withholding rate on supplemental wages under flat rate method *(Code Sec. 3402).* This rate rises from 25% to 28%. (For supplemental wage payments totaling more than $1 million for a calendar year, the rate rises from 35% to 39.6%).

Backup withholding rate on gambling winnings *(Code Sec. 3402).* This rate rises from 25% to 28%.

Backup withholding rate on reportable payments *(Code Sec. 3406).* This rate rises from 28% to 31%.

Voluntary withholding rate on certain federal payments (e.g., Social Security benefits) *(Code Sec. 3402).* The rates rise from 7%, 10%, 15%, or 25%, to 7%, 15%, 28%, or 31%.

Voluntary withholding rate on unemployment benefits *(Code Sec. 3402).* This rate rises from 10% to 15%.

Collapsible corporation rules *(former Code Sec. 341).* The collapsible corporation rules are reinstated.

Estate tax *(Code Sec. 2001 et seq.).* The principal changes are as follows: The top rate is 55%. A 5% surtax on the wealthiest of estates phases out the benefit of graduated rates, with (1) a unified credit exemption equivalent of $1 million, (2) a reinstated Code Sec. 2057 deduction for family-owned businesses, and (3) a credit against State death taxes.

Generation skipping transfer (GST) tax *(Code Sec. 2631).* Various changes apply to the GST tax. The principal changes are that the top rate is 55%, and the GST exemption amount is set at $1 million (plus inflation adjustment). Based on inflation data, RIA projects that the GST exemption will be $1,430,000 for 2013.

Gift tax *(Code Sec. 2505).* The top rate increases to 55%.

Installment payment of estate tax *(Code Sec. 6166).* Installment payment rules are modified.

2012 AMT Rules if There is No Retroactive "Patch"

Far more restrictive AMT rules already are in effect for 2012, and will remain so unless Congress passes a "patch" that amends the rules effective retroactively as of Jan. 1, 2012.

AMT exemption amount *(Code Sec. 55(d)(1)).* For individuals, the AMT exemption amounts for 2012 falls to $45,000 (joint filers & surviving spouses), $33,750 (unmarried individuals), and $22,500 (marrieds filing separately). By contrast, the AMT exemption amounts for 2011 were $74,450 (joint filers & surviving spouses), $48,450 (unmarried individuals), and $37,225 (marrieds filing separately).

Treatment of personal credits *(Code Sec. 26(a)(2)).* For 2012, individuals can no longer use most nonrefundable personal credits to offset the AMT.

Other Tax Rules That Expired at the End of 2011

A host of favorable tax rules for businesses and individuals expired at the end of 2011, but some of them may be extended, retroactively effective to the beginning of 2012. This has happened before. In fact, on August 2, the Senate Finance Committee favorably reported out a bill (the Family and Business Tax Cut Certainty Act of 2012) that would revive a number of already expired and soon to expire tax breaks.

Following is a list of key tax rules that expired at the end of 2011, grouped by business and individual provisions.

Business Provisions That Expired After 2011

- Research credit under Code Sec. 41(h)(1)(B).
- 15-year write off for specialized realty assets, including qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property under Code Sec. 168(e). Thus, for property placed in service after 2011, a 39-year write off generally applies.
- 100% bonus first-year depreciation allowance for qualified property under Code Sec. 168(k)(1) and Code Sec. 168(k)(5) (but certain aircraft and long-production-period property can continue to qualify if placed in service before 2013).
- Increased $500,000 expensing election under Code Sec. 179, with $2 million investment ceiling.
- Election to expense environmental remediation costs under Code Sec. 198(h).
- Work opportunity tax credit (WOTC) for non-veterans under Code Sec. 51(c)(4).
- Credit for construction of new energy efficient homes under Code Sec. 45L.
- Energy efficient appliance credit under Code Sec. 45M.
- Enhanced charitable deductions for: contributions of food inventory under Code Sec. 170(e)(3)(C); contributions of book inventories to public schools under Code Sec. 170(e)(3)(D); and corporate contributions of computer equipment for educational purposes under Code Sec. 170(e)(6)(G).

- Empowerment Zone tax breaks, including: the designation of an empowerment zone and of additional empowerment zones under Code Sec. 1391(d)(1)(A)(i) and Code Sec. 1391(h)(2); increased exclusion of gain on the sale of qualified business stock of an empowerment zone business under Code Sec. 1391(d)(1)(A)(i); tax-exempt bond financing under Code Sec. 1394; the 20% wage credit under Code Sec. 1396; liberalized Code Sec. 179 expensing rules; and deferral under Code Sec. 1397B of capital gains tax on sale of qualified assets sold and replaced.
- District of Columbia Enterprise Zone (DC Zone) tax breaks, including: the designation of DC Zone, the employment tax credit, and additional expensing under Code Sec. 1400(f); tax-exempt bond financing under Code Sec. 1400A(b) ; and eligibility for 0% capital gains rate for investment in DC under Code Sec. 1400B(b)(2)(A)(i).
- The inclusion of Puerto Rico as “within the U.S.” for purposes of determining a taxpayer's domestic production gross receipts (DPGR) under Code Sec. 199(d)(8)(C).
- The exclusion from a tax-exempt organization's unrelated business taxable income (UBTI) of interest, rent, royalties, and annuities paid to it from a controlled entity under Code Sec. 512(b)(13)(E)(iv).
- The ability of a regulated investment company (RIC) to designate all or a portion of a dividend as an “interest-related dividend” under Code Sec. 871(k)(1)(C) and Code Sec. 871(k)(2)(C).
- Inclusion of a RIC in the definition of a “qualified investment entity” under Code Sec. 897(h)(4).
- Lower shareholder basis adjustments for charitable contributions by S corporations under Code Sec. 1367(a).
- Reduced S corporation recognition period for built-in gains tax under Code Sec. 1374(d)(7).
- Exception under subpart F for certain income from the active conduct of a banking, financing, insurance, or similar business under Code Sec. 953(e)(10) and Code Sec. 954(h)(9).
- Look-through treatment for payments between related controlled foreign corporations (CFCs) under the foreign personal holding company rules under Code Sec. 954(c)(6).

Individual Provisions That Expired After 2011

- Election to deduct State and local general sales taxes under Code Sec. 164(b)(5) in lieu of a state and local income tax deduction.
- Above-the-line deduction under Code Sec. 222 for qualified tuition and related expenses.
- Treatment of mortgage insurance premiums as deductible qualified residence interest under Code Sec. 163(h)(3)(E).
- Above-the-line deduction under Code Sec. 62 for up to $250 of certain expenses of elementary and secondary school teachers.
- Nonbusiness energy property credit under Code Sec. 25C.
- Tax credit for first-time District of Columbia homebuyers under Code Sec. 1400C(i).
- Refundability of adoption credit under Code Sec. 36C, and $1,000 increase in the maximum Code Sec. 36C credit and in the exclusion for adoption assistance programs under Code Sec. 137.
- Exclusion of 100% of gain on certain small business stock under Code Sec. 1202(a)(4). After 2011, an exclusion applies for only 50% of gain (60% for qualified business entity stock).
- Parity for exclusion from income for employer-provided mass transit and parking benefits under Code Sec. 132(f). The exclusion was $230 per month for each of these breaks in 2011; for 2012, the exclusion is $240 for qualified parking due to an inflation adjustment but falls to $125 for employer-provided transit and vanpooling benefits.
- Tax-free distributions (up to $100,000 annually for taxpayers 70- 1/2 and older) from individual retirement plans for charitable purposes under Code Sec. 408(d)(8).
- Special rules to encourage contributions of capital gain real property for conservation purposes under Code Sec. 170(b)(1)(E) and Code Sec. 170(b)(2)(B).
- Look-through treatment of certain RIC stock in determining nonresidents' gross estates under Code Sec. 2105(d).

Tax Rules That Will Expire at the End of 2012

Still other beneficial tax rules for businesses and individuals will end on Dec. 31, 2012, because they were enacted on a temporary basis. Here's a review of the key provisions.

- The work opportunity credit for hiring qualified veterans under Code Sec. 51(c)(4)(B) won't be available for individuals hired after Dec. 31, 2012.
- The 50% bonus first-year depreciation allowance for qualified property under Code Sec. 168(k)(1). The bonus depreciation break applies only for qualified property acquired and placed in service after 2011 and before 2013 (after 2012 and before 2014 for aircraft and long-production period property). Also ending is the Code Sec. 168(k)(4) election to accelerate AMT credits instead of claiming additional first-year depreciation.
- For tax years beginning in 2012, the maximum amount that can be expensed under Code Sec. 179 is $139,000, and the investment ceiling is $560,000. For tax years beginning in 2013, the maximum expensing amount is $25,000 and the investment ceiling is $200,000.
- The temporary payroll tax cut will no longer apply. The two percentage point cut in employee OASDI tax under FICA (from 6.2% to 4.2%) and in the self-employed OASDI tax rate under SECA (from 12.4% to 10.4%) expires at the end of this year. Thus, after 2012, the OASDI rates for employees and for the self-employed will revert to 6.2% and 12.4% respectively.
- The expanded Hope credit (American Opportunity Tax Credit, or AOTC) under Code Sec. 25A(i) comes to an end on Dec. 31, 2012. Under the AOTC, eligible taxpayers can claim a credit equal to 100% of the first $2,000 of qualified tuition and related expenses, and 25% of the next $2,000 of qualified tuition and related expenses (for a maximum tax credit of $2,500 for the first four years of post-secondary education). After 2012, the credit will fall to 100% of the first $1,000 (as inflation adjusted) of qualified tuition and related expenses, and 50% of the next $1,000 (as inflation adjusted) of qualified tuition and related expenses. Other, favorable credit rules that expire at the end of this year: increased AGI limits for qualification; refundability for a portion of the credit; and allowance of the credit for course materials.
- The refundable credit for unused AMT credit under Code Sec. 53(e) is coming to an end. For tax years beginning after Dec. 20, 2006, if an individual has a “long-term unused minimum tax credit” for any tax year beginning before Jan. 1, 2013, a taxpayer's minimum tax credit can't be less than a complex “AMT refundable credit” amount for that tax year.
- The Code Sec. 108(a)(1)(E) exclusion for discharge of qualified principal residence debt does not apply for debt discharged after Dec. 31, 2012.