CCH Tax Briefing

CCH a Wolters Kluwer business

SUNSET OF 2001 & 2003 TAX CUTS AND BENEFITS

May 4, 2012

Special Report

HIGHLIGHTS

- Sunset of EGTRRA's Reduced Individual Income Tax Rates
- Lower AMT Exemption Amounts
- Sunset of JGTRRA's Reduced Capital Gains/Dividends Tax Rates
- Expiration of Marriage Penalty Relief
- Return of Pease Limitation/ Personal Exemption Phaseout
- $500 Child Tax Credit
- Expiration of American Opportunity Tax Credit
- $1 Million Estate Tax Exclusion With 55 Percent Top Tax Rate

INSIDE

Uncertainty Grows Over Fate Of Bush-Era Tax Cuts

The year 2012 began with the fate of the Bush-era tax cuts uncertain, and no resolution appears in sight. Democrats and Republicans remain far apart on whether to extend all or some of the Bush-era tax cuts and other tax incentives scheduled to sunset after 2012. Two years ago, President Obama and the GOP agreed to extend the Bush-era tax cuts along with the so-called tax extenders in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act). Today, prospects for any agreement between Democrats and Republicans before the November elections are murky at best. The likelihood of a lame-duck Congress deciding the fate of the Bush-era tax cuts increases daily. Also growing daily is the uncertainty many taxpayers face in tax planning for 2013 and beyond.

IMPACT. *The Congressional Budget Office (CBO) has estimated that extending all of the "Bush-era" tax cuts would cost $2.84 trillion over 10 years. Unlike 2010, Congress is now confronted with mandatory reductions in federal spending under the Budget Control Act of 2011 (2011 Budget Control Act), which the CBO has estimated will total approximately $109 billion per year starting in January 2013. Moreover, the 2011 Budget Control Act provides for enforcing the spending limits through sequestration. This added demand on resources, together with a still-fragile economy and a ticking clock on entitlement reform, is creating what has been termed a "fiscal cliff" by some, and "taxmageddon or "taxopocalypse" by others. By any name, they present difficult choices for Congress.*

What's Involved: The "Bush-era" tax cuts is the collective term for the tax measures enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). In addition to the individual, capital gains, dividends and estate tax rates that remain the focus of the attention, EGTRRA made over 30 other major changes to the Tax Code, which are now about to sunset. The 2010 Tax Relief Act extended all these measures through 2012. EGTRRA also made many changes to retirement and pension rules in the Tax Code. These changes were made permanent by the Pension Protection Act of 2006 (PPA).

IMPACT. *Rather than just waiting for Congress to act, taxpayers should consider implementing certain protective tax strategies now. To maximize benefits, advance planning that considers a number of "what ifs" should be undertaken soon. With budget pressures looming, the likelihood that all EGTRRA and JGTRRA expiring provisions will be rolled over for one or two more years into 2013 and 2014 is highly unlikely. Therefore, a strategy that accelerates into 2012 whatever tax benefits are now available deserves careful consideration.*

Tax Reform Solution? Since the two-year extension of EGTRRA and JGTRRA by the 2010 Tax Relief Act, several proposals for comprehensive tax reform have been unveiled in Washington that may hold promise for a more permanent solution. A presidential panel developed the so-called Simpson-Bowles plan. The GOP has put forward several proposals for comprehensive tax reform, also calling for reduced individ-

Click to continued on next page

ual income tax rates, while both parties have struggled to strike a "grand bargain." After the November elections, a broader, more permanent solution may be found.

COMMENT. *IRS Commissioner Douglas Shulman and other officials have warned that late legislation will likely delay the start of the 2013 filing season. The IRS delayed the start of the 2011 filing season to February 14, 2011 after passage of the 2010 Tax Relief Act. The delay affected taxpayers claiming itemized deductions on Form 1040, Schedule A; the higher education tuition deduction; and other tax benefits.*

SUNSETS FACING INDIVIDUALS

The impact of the looming expiration of the Bush-era tax cuts on individuals has received the most attention because its effect is so great. If the Bush-era tax cuts expire as scheduled, the individual income tax rates will increase across-the-board. *See also Alternative Minimum Tax, Capital Gains/Dividends Sunsets, Education Sunsets, and Federal Estate, Gift and GST Taxes in this Tax Briefing for additional provisions affecting individuals.*

Income Tax Rates for Individuals

Under current law, the reduced individual income tax rates created by EGTRRA, accelerated by JGTRRA, and extended by the 2010 Tax Relief Act are scheduled to sunset after 2012. Unless extended, the individual marginal tax rates, currently at 10, 15, 25, 28, 33, and 35 percent, are scheduled to revert to 15, 28, 31, 36, and 39.6 percent, effective for tax years beginning after December 31, 2012.

IMPACT. *Unless Congress acts, all taxpayers – and not just higher income individuals – will effectively experience a tax hike after 2012. The top rate will jump from the current 35 percent to 39.6 percent. The lowest 10 percent rate will be eliminated. Even those taxpayers who may remain in the 15 percent bracket will pay more by not realizing the advantage of having their first dollars of income subject to the 10 percent rate bracket. Additionally, the two percent employee-side payroll tax cut, as enacted under the Middle Class Tax Relief and Job Creation Act of 2012, is scheduled to expire after 2012, affecting all workers in 2013 up to $113,700 of their earned income (the projected Social Security wage base for 2013).*

IMPACT. *By far, the costliest provisions to extend are the reduced individual tax rates. According to the Congressional Budget Office (CBO), they account for over half of the total revenue loss. And according to the Congressional Research Service (CRS), the extension of the reduced income tax rates in the 2010 Tax Relief Act for two years alone reduced federal revenues by $363.55 billion.*

> "The likelihood of a lame-duck Congress deciding the fate of the Bush-era tax cuts increases daily."

Although the individual tax rates are scheduled to revert to the levels in place prior to EGTRRA, the bracket amounts to which each rate is applied will continue to reflect annual inflation adjustments. However, the entire 10 percent rate bracket will be eliminated and become the lower portion of the 15 percent bracket.

IMPACT. *The majority of U.S. businesses are passthrough entities, such as partnerships and S corporations. If the provisions expire, passthroughs will be hit hard, since profits are passed through to their individual owners. A "C" corporation, with its current corporate level tax of 35 percent (which may drop if recent corporate tax reform proposals are adopted), may become more attractive if individual tax rates rise.*

President Obama, in his Blueprint for America and other proposals, has called for making permanent the 10, 15, 25, and 28 percent rates for tax years beginning after December 31, 2012. However, the 33 and 35 percent tax rates would sunset as scheduled after 2012, and would be replaced by 36 and 39.6 percent rates starting at $200,000 for single individuals and $250,000 for joint filers. Additionally, President Obama has proposed to widen the tax bracket for the 28 percent rate. The House GOP has proposed to consolidate the six current individual income tax brackets into two brackets of 10 and 25 percent.

IMPACT. *Individuals who anticipate the possibility of being subject to a higher income tax rate after 2012 should explore shifting the timing of income or deductible expenses. Deferring deductions into 2013 may help to offset income that would be subject to a higher rate of tax. Accelerating income into 2012 likewise might lower overall tax liability. Acceleration techniques include billing earlier, selling appreciated property, avoiding installment sales that defer gain, and accelerating bonuses.*

COMMENT. *The fate of the individual tax cuts is further complicated over disputes about annual inflation adjustments. The Consumer Price Index for all Urban Consumers (CPI-U) is used to calculate annual inflation adjustments to personal income tax brackets. Some lawmakers have called for using the Chained Consumer Price Index for all Urban Consumers (C-CPI-U) instead of the CPI-U. According to the Congressional Research Service, the C-CPI-U has increased more slowly than the CPI-U and applying the C-CPI-U to individual tax*

COST OF EXTENDING SELECTED TAX CUTS

Bush-era tax cuts:	$2.84 trillion*
AMT patch	$804 billion*
Tax extenders:	$839 billion*
Payroll tax cut:	$117 billion**
*Through 2022 **Through 2012	
Source: Congressional Budget Office	

Click to continued on next page

provisions would slow growth in the federal budget deficit.

Marriage Penalty Relief

Before EGTRRA, some married couples experienced the so-called marriage penalty. EGTRRA gradually increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The 2011 Tax Relief Act extended EGTRRA's marriage penalty relief through 2012.

IMPACT. *If marriage penalty relief is not extended, the deduction for married couples will be 167 percent of the deduction for single individuals rather than 200 percent. Based on 2012 amounts, the standard deduction for joint filers is estimated to drop from $11,900 to $9,950 (with rounding).*

EGTRRA also gradually increased the size of the 15 percent income tax bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. The 2010 Tax Relief Act extended this treatment through 2012.

IMPACT. *Under current law, the upper limit of the 15 percent bracket for joint filers is equal to 200 percent of the upper limit for single individuals; after 2012 the upper limit of the 15 percent bracket for joint filers is scheduled to be equal to 167 percent of the upper limit for single individuals. Based on 2012 amounts, the 15 percent bracket for joint filers is estimated to end (and the pre-EGTRRA 28 percent bracket is estimated to begin) at $59,000 rather than at $70,700.*

COMMENT. *The fate of marriage penalty relief remains uncertain since it likely will be considered with more politically controversial parts of the sunsetting provisions. As a result, married couples may want to be ready to increase their withholding or make larger estimated tax payments starting in 2013 to avoid any adverse impact from the sunset of the increased 15 percent rate bracket and standard deduction for married couples.*

Pease Limitation

The "Pease" limitation on itemized deductions, which was eliminated by EGTRRA and extended by the 2010 Tax Relief Act, is scheduled to be revived after 2012. The Pease limitation, named after the member of Congress who sponsored the original provision, reduces the total amount of a higher-income taxpayer's otherwise allowable itemized deductions by three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. However, the amount of itemized deductions would not be reduced by more than 80 percent. Certain items, such as medical expenses, investment interest, and casualty, theft or wagering losses, are excluded.

COMMENT. *The applicable threshold for the Pease limitation, if it was in effect in 2012, would have been $173,650.*

Personal Exemption Phaseout

Higher income taxpayers may see their deduction for personal exemptions reduced or eliminated under the personal exemption phaseout rules, should the phaseout be revived after 2012. The elimination of the phaseout was first implemented by EGTRRA for certain years and extended by the 2010 Tax Relief Act through 2012. Under the phaseout, the total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500, or portion thereof (two percent for each $1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income exceeds the applicable threshold. The 2010 Tax Relief Act repealed the phaseout for 2010 and 2011 only.

IMPACT. *The applicable thresholds for the personal exemption phaseout, had it remained in effect in 2012, would have been $173,650 for single taxpayers and $260,500 for married couples filing a joint return.*

Earned Income Credit

EGTRRA gradually increased the beginning and end points of the earned income credit (EIC) phaseout for married couples filing a joint return over and above annual inflation adjustments. EGTRRA also simplified the definition of earned income, eliminated the rule that reduced a taxpayer's EIC by the amount of alternative minimum tax (AMT) liability, reformed the relationship test, modified the tie-breaking rule, and gave the IRS additional authority with respect to mathematical errors. The Working Families Tax Relief Act of 2004 (WFTRA) and the American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) further enhanced the EIC. The 2010 Tax Relief Act extended the enhanced EIC through 2012.

IMPACT. *If the enhancements to the EIC sunset after 2012, the EIC phaseout would be determined by reference to modified adjusted gross income rather than adjusted gross income. One reason EGTRRA made the switch to adjusted gross income was to reduce the number of calculations needed to compute the EIC.*

COMMENT. *Under EGTRRA, as extended by the 2010 Tax Relief Act, the*

SELECTED CHANGES IF BUSH-ERA TAX CUTS EXPIRE AFTER 2012

Top individual income tax rate:	39.6 percent
Child tax credit:	$500
Maximum contribution Coverdell ESA:	$500
Top estate tax rate:	55 percent
Top gift tax rate:	55 percent

Click to continued on next page

EIC is not reduced by AMT liability through 2012.

Child Tax Credit

The $1,000 child tax credit under current law is scheduled to revert after 2012 to $500 per qualifying child (dependents under age 17 at the close of the year). In addition to increasing the amount of the credit, EGTRRA also modified the refundable component, provided that the refundable portion of the child tax credit does not constitute income, provided that the child tax credit is allowable against regular income tax and allowable against AMT, repealed the AMT offset against the additional child tax credit for families with three or more children, and eliminated the supplemental child tax credit. These enhancements to the child tax credit were extended by the 2010 Tax Relief Act through 2012 only.

IMPACT. *Taxpayers with qualifying dependent children should consider adjusting withheld income tax (or estimated tax payments) to account for the reduction from $1,000 to $500. Current divorce settlements in which child credits and other EGTRRA-sensitive benefits are allocated may need to be recalibrated to accommodate the lower amounts.*

IMPACT. *The child tax credit is reduced by $50 for each $1,000, or fraction thereof, of modified adjusted gross income above threshold amounts. Those thresholds are $110,000 for joint filers, $55,000 for married individuals filing separately, and $75,000 for other taxpayers. If the credit is reduced to $500 after 2012, the smaller credit will phase out more quickly.*

The 2009 Recovery Act lowered the refundability threshold for the child tax credit from $8,500 to $3,000 (not adjusted for inflation) for 2009 and 2010. The $3,000 threshold (not adjusted for inflation) was extended by the 2010 Tax Relief Act, again, only through 2012.

COMMENT. *President Obama and the GOP have expressed support for extending or making permanent the $1,000 child tax credit after 2012.*

COMMENT. *The maximum amount of credit a taxpayer can receive is equal to the number of qualifying children times $1,000. If the value of the taxpayer's child tax credit is greater than his/her actual tax liability, the taxpayer may be eligible to receive the difference as a refund. In April 2012, the House Ways and Means Committee approved a bill that would require taxpayers claiming the additional child tax credit to provide a Social Security number.*

> "Passthroughs will be hit hard, since profits are passed through to their individual owners."

Adoption Credit/Adoption Assistance Programs

EGTRRA increased the dollar limitation for the adoption credit and the income exclusion for employer-paid or reimbursed adoption expenses to $10,000 (indexed for inflation) (both for non-special needs adoptions and special needs adoptions). The 2010 Tax Relief Act extended the enhancements to the adoption credit under EGTRRA through 2012. In addition, the Patient Protection and Affordable Care Act made the adoption credit refundable for 2010 and 2011.

COMMENT. *The adoption credit phases out for taxpayers above specified inflation-adjusted levels of modified adjusted gross income. For 2012, the phase-out level starts at $189,710.*

Child and Dependent Care Credit

The child and dependent care credit is intended to help individuals pay child and dependent care expenses so the taxpayer (and spouse if filing jointly) can work or look for work. A child, for purposes of this tax benefit, must be under 13 years of age at the close of the tax year. A qualifying dependent who is disabled, however, may be of any age if he or she is a dependent, or spouse, who lives with the taxpayer for more than half the year. EGTRRA and subsequent legislation increased the maximum amount of eligible employment-related expenses for purposes of the dependent care credit and made other enhancements. The 2010 Tax Relief Act extended these enhancements through 2012.

COMMENT. *Expenses qualifying for the child and dependent care credit must be reduced by the amount of any dependent care benefits provided by the taxpayer's employer that are excluded from the taxpayer's gross income. Total expenses qualifying for the dependent credit are capped at $3,000 in cases of one qualifying individual or at $6,000 in cases of two or more qualifying individuals subject to income thresholds. Absent extension, these monetary amounts are scheduled to be reduced to $2,400 in cases of one qualifying individual or $4,800 in cases of two or more qualifying individuals subject to income thresholds. The current 35 percent credit rate is scheduled to fall to 30 percent after 2012.*

CAPITAL GAINS/ DIVIDENDS SUNSETS

Under current law, reduced tax rates on qualified capital gains and dividends are scheduled to sunset after 2012. The pre-JGTRRA treatment (as extended by the 2010 Tax Relief Act) of qualified capital gains and dividends would apply thereafter.

Capital Gains

The 2010 Tax Relief Act extended the reduced maximum tax rate of 15 percent on adjusted net capital gains through 2012. The 15 percent rate had originally been enacted in JGTRRA and was extended by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). Additionally, taxpayers in the 10 and 15 percent tax brackets are

Click to continued on next page

eligible for a zero percent tax rate on qualified capital gains through 2012.

IMPACT. *Absent extension, the maximum tax rate on net capital gain of noncorporate taxpayers will revert to 20 percent (10 percent for taxpayers in the 15 percent bracket) after 2012. Thus, the acceleration of capital gains into 2012 while the tax rates are lower is one strategy for taxpayers to consider. Accelerating the sale of capital assets is the general means by which taxpayers effectuate this strategy. As long as the sale is bona fide, and the proceeds are received in 2012, capital gains can be accelerated. The "wash sale" rules that apply to claiming losses do not apply to gains. Accordingly, capital gains can be recognized at any time and, immediately thereafter, the identical asset can be repurchased, with a new tax basis established in the amount of the purchase price.*

COMMENT. *Under current law, the 28 and 25 percent tax rates for collectibles and recaptured Code Sec. 1250 gain, respectively, are scheduled to continue unchanged after 2012. Also unchanged are the ordinary income rates paid on short-term capital gains; only long-term capital gains realized on assets held for more than one year can benefit from the reduced net capital gain rate.*

CAUTION: *Installment payments received after 2012 are subject to the tax rates for the year of the payment, not the year of the sale. Thus, the capital gains portion of payments made in 2013 and later may be taxed at the 20 percent rate.*

Five-Year Holding Period for Capital Assets. Under the 2010 Tax Relief Act, there is no special capital gain treatment in 2011 or 2012 for property held for more than five years. After 2012, the JGTRRA-based lower capital gain rates for five-year gain of individuals, estates and trusts are scheduled to be revived. Long-term gain on the sale or exchange of property held for more than five years generally will be taxed at 18 percent (eight percent for taxpayers in the 15 percent bracket).

IMPACT. *For higher-income taxpayers, the 15 percent rate under the 2010 Tax Relief Act applies if the taxpayer has held the asset for more than one year, but only if the taxpayer sells the asset by no later than December 31, 2012. The 18 percent rate for qualified five-year property applies if the taxpayer acquired the asset in 2001 or later, has held the asset for more than five years, and sells it after December 31, 2012. The 20 percent rate applies if the taxpayer acquired the asset in 2001 or later, sells the asset after December 31, 2012 and has held the asset for more than one but not more than five years; or has held the asset for more than five years but acquired the asset by exercising an option, right or obligation to acquire the property and the taxpayer has held such since before 2001.*

Dividends

The 2010 Tax Relief Act extended the reduced net capital gains tax rates for qualified dividends through 2012. These rates had originally been enacted by JGTRRA and were extended by TIPRA. The maximum tax rate for qualified dividends received by an individual is 15 percent for tax years beginning before January 1, 2013. A zero percent rate applies to qualified dividends received by an individual in the 10 or 15 percent income tax rate brackets.

IMPACT. *Absent extension, qualified dividends will be taxed at the applicable ordinary income tax rates after 2012 (with the highest rate scheduled to be 39.6 percent after 2012), despite the highest rate for net capital gains rising to 20 percent. Qualified corporations may want to explore declaring a special dividend to shareholders before January 1, 2013. President Obama's proposed fiscal year (FY) 2013 federal budget recommended increasing the dividends rate to the ordinary income tax rate for higher-income individuals.*

COMMENT. *Generally, dividends received from a domestic corporation or a qualified foreign corporation, on which the underlying stock is held for at least 61 days within a specified 121-day period, are qualified dividends for purposes of the reduced tax rate. Certain dividends do not qualify for the reduced tax rates. They include (not an exhaustive list) dividends paid by credit unions, mutual insurance companies, and farmers' cooperatives.*

Other Dividend-Related Provisions

The following business-entity related tax breaks associated with dividends are also scheduled to sunset after 2012:

- Dividends received from a regulated investment company (RIC), real estate investment trust (REIT) and other qualified pass-through entities are treated as qualified dividends for purposes of the reduced tax rates through 2012;
- Temporary repeal of the collapsible corporation rule would end after 2012;

HEALTH CARE REFORM IMPACT ALSO LOOMS

Along with uncertainty over the fate of the Bush-era tax cuts is uncertainty over numerous individual and business tax provisions in the Patient Protection and Affordable Care Act (PPACA) and the Health Care and Education Reconciliation Act of 2010 (HCERA). The Supreme Court is expected to hand down its decision in litigation challenging the constitutionality of the PPACA in June. Beginning in 2013, the PPACA imposes a 0.9 percent additional Medicare tax on higher income individuals and a 3.8 percent Medicare contribution tax on unearned income. These additional taxes would be a tax cost to be figured on top of the capital gains tax.

Click to continued on next page

- The accumulated earnings tax rate imposed on corporations which had been reduced to 15 percent would rise to 39.6 percent after 2012; and
- The tax on undistributed personal holding company (PHC) income would also rise from its temporary 15 percent rate to the highest individual tax rate.

ALTERNATIVE MINIMUM TAX

EGTRRA and subsequent laws enacted so-called AMT "patches." The patches increased exemption amounts for the growing number of taxpayers subject to the AMT. The patches also allowed nonrefundable personal credits to the full amount of the individual's regular tax and AMT. The most recent patch, in the 2010 Tax Relief Act, expired after 2011.

IMPACT. *For 2011, the exemption amounts were $48,450 for unmarried individuals filing a single return, and $74,450 for married couples filing a joint return and surviving spouses. Under current law for 2012, the exemption amounts — unless changed by Congress — drop precipitously to $33,750 for unmarried individuals filing a single return, and $45,000 for married couples filing a joint return and surviving spouses.*

IMPACT. *The "patch" in the 2010 Tax Relief Act provided that all nonrefundable personal credits are allowed to the full extent of the taxpayer's regular tax and AMT liability. If a similar patch is not enacted for 2012, only certain nonrefundable credits would be allowed against AMT liability; including (not an exhaustive list) the child tax credit, the American Opportunity Tax Credit (AOTC) and the retirement savings contribution credit (saver's credit).*

COMMENT. *The House GOP has proposed to eliminate the AMT. However, proposals to abolish the AMT have stalled in Congress, largely due to the projected loss of revenue. The AMT is a "cash cow" for the federal government and lawmakers under tight budgetary constraints in the 2011 Budget Control Act are reluctant to eliminate the AMT. However, they are expected to patch the AMT for 2012 and possibly 2013, until a more permanent solution is found. The Joint Committee on Taxation (JCT) has estimated that an AMT patch for 2012 would cost $92 billion over 10 years.*

COMMENT. *President Obama has proposed to replace at least part of the AMT with the so-called Buffett Rule under comprehensive tax reform. The White House has explained the Buffett Rule in general terms as ensuring that taxpayers making over $1 million annually would pay an effective tax rate of at least 30 percent. In April 2012, the Senate rejected the Paying a Fair Share Act, which would implement the Buffett Rule. Democrats are expected to reintroduce the bill.*

IMPACT OF SUNSETS – ILLUSTRATIONS

#1: Assume a couple, two children eligible for the child tax credit, filing a joint return and taking the standard deduction, with $130K wage income, $10,000 net capital gains, and $2,000 dividend income. Their tax liability for 2013 (all figures are estimates and, for illustration, assume no inflation adjustments between 2012 and 2013):

No Sunset: .... $19,485 tax due for 2013

Full Sunset: .... $25,898 tax due for 2013

Difference: $6,413*

#2: Assume a couple, no children, filing a joint return and taking the standard deduction, with $300K wage income, $50,000 net capital gains, and $5,000 dividend income. Their tax liability for 2013 (assuming for illustration, no inflation adjustments between 2012 and 2013):

No Sunset: .... $77,721 tax due for 2013

Full Sunset: .... $89,934 tax due for 2013

Difference: $12,213*

#3: Assume a single filer, no children, taking the standard deduction, with $70K wage income, $5,000 net capital gains, and $1,000 dividend income. The individual's tax liability for 2011 (assuming for illustration, no inflation adjustments between 2012 and 2013):

No Sunset: .... $11,992.50 tax due for 2013

Full Sunset: .... $13,606.50 tax due for 2013

Difference: $1,614*

** Loss of Current 2% Payroll Tax Reduction up to Social Security Wage Base (anticipated to be $113,700 in 2013) not included.*

EDUCATION SUNSETS

A number of education-related tax incentives are scheduled to expire, or be significantly reduced, after 2012.

Click to continued on next page

Coverdell Education Savings Accounts

The maximum contribution amount to a Coverdell Education Savings Account (ESA) is $2,000 but is scheduled to revert to $500 after 2012. Current law also treats elementary and secondary school expenses, in addition to post-secondary school expenses, as qualified expenses for Coverdell ESAs.

IMPACT. *Contributions to a Coverdell ESA are not tax-deductible, but amounts deposited in the account grow tax free until distributed for qualified distributions. Total contributions for the beneficiary of a Coverdell ESA under current law cannot be more than $2,000 in any year, no matter how many accounts have been established.*

Educational Assistance Exclusion

The 2010 Tax Relief Act extended the $5,250 exclusion from income and employment taxes of employer-provided education assistance through 2012. The benefit is not taxable to the employee. Employers may deduct up to $5,250 annually for qualified education expenses paid on behalf of an employee through 2012.

IMPACT. *After the sunset, employer-paid educational assistance will be excludable from gross income only if it qualifies under the more stringent working condition fringe rules. Under the fringe benefit rules, the employee must be able to meet the business expense requirements that call for a direct relationship between the course and the employee's current job.*

COMMENT. *Tax-free educational assistance benefits include payments for tuition, fees and similar expenses, books, supplies, and equipment. The payments may be for either undergraduate- or graduate-level courses. To qualify as an educational assistance program, the plan must be written and must meet certain other requirements.*

Federal Scholarships

The 2010 Tax Relief Act extended the exclusion from income for the National Health Service Corps Scholarship Program and the Armed Forces Scholarship Program though 2012. These scholarships carry obligatory service requirements.

Student Loan Interest Deduction

EGTRRA eliminated a 60-month rule for the $2,500 above-the-line student loan interest deduction and expanded the modified AGI range for phase-out. The 2010 Tax Relief Act extended these enhancements through 2012.

IMPACT. *For 2012, the student loan interest deduction is reduced when modified adjusted gross income exceeds $60,000 for single individuals ($125,000 for married couples filing a joint return) and is completely eliminated when modified adjusted gross income is $75,000 or more for single individuals ($155,000 for married couples filing a joint return). If the enhancements to the deduction sunset after 2012, the deduction would begin to phase out for single individuals whose modified adjusted gross income, estimated with inflation adjustments, exceeds $50,000 ($75,000 for married couples filing a joint return) and would be completely eliminated when modified adjusted gross income is $65,000 or more for single individuals ($90,000 for married couples filing a joint return).*

COMMENT. *The student loan interest deduction is taken as an adjustment to income and is available to non-itemizers.*

Higher Education Tuition Deduction

The above-the-line deduction for higher education tuition and related expenses expired after 2011. The higher education tuition deduction was created by EGTRRA and extended by subsequent laws, most recently by the 2010 Tax Relief Act, but only through the end of 2011.

IMPACT. *In 2011, the last year in which the deduction was available under current law, the deduction reached a maximum of $4,000 for taxpayers whose modified AGI did not exceed $65,000 ($130,000 for joint filers), and $2,000 for taxpayers whose modified AGI exceeded $65,000 but did not exceed $80,000 ($160,000 for joint filers).*

COMMENT. *The higher education tuition deduction is typically included*

Click to continued on next page

OTHER SUNSETTING PROVISIONS

EGTRRA and JGTRRA provisions are not the only tax benefits scheduled to expire after 2012 (or that already expired after 2011). Among these provisions (not an exclusive list) are the following:

- Payroll tax cut
- 100 percent bonus depreciation
- Enhanced Code Sec. 179 expensing
- Research credit
- State and local sales tax deduction
- Teacher's classroom expense deduction
- Exclusion for charitable contributions of IRA proceeds
- Parity for transit benefits
- Mortgage insurance premium deduction
- Cancellation of mortgage indebtedness exclusion for personal residence
- Energy tax incentives

among the tax extenders for renewal. Although the deduction was renewed for 2010 and 2011, renewal for 2012 and beyond is uncertain.

American Opportunity Tax Credit

The 2009 Recovery Act enhanced and renamed the Hope education credit as the American Opportunity Tax Credit (AOTC). For qualified taxpayers, the AOTC is partially refundable. The 2010 Tax Relief Act extended the AOTC through 2012. After 2012, the Hope credit, with its lower benefits would return.

IMPACT. *The AOTC reaches up to $2,500 of the cost of tuition, fees and course materials paid during the tax year. The AOTC is based on 100 percent of the first $2,000, plus 25 percent of the next $2,000. Forty percent of the AOTC (up to $1,000) is refundable for lower-income taxpayers.*

The full credit is available to individuals whose modified adjusted gross income is $80,000 or less, or $160,000 or less for married couples filing a joint return. The credit is phased out for taxpayers with incomes above these levels.

IMPACT. *The Hope credit was limited to the first two years of post-secondary education. The AOTC may be claimed for all four years of post-secondary education.*

BUSINESS-SPECIFIC SUNSETS

Small Business Stock

Non-corporate investors may exclude a percentage of the gain they realize on the sale or exchange of qualified small business stock. Generally, the stock must have been issued after a certain date by a qualified C corporation and held by the taxpayer for more than five years. Since 1993, a 50-percent exclusion of gain applies. The exclusion, however, is increased to 75 percent for stock acquired after February 17, 2009, and on or before September 27, 2010, and to 100 percent for stock acquired after September 27, 2010, and before January 1, 2012.

Under JGTRRA, seven percent (rather than 42 percent) of the excluded gain is treated as a tax preference item subject to the AMT for tax years beginning before January 1, 2011. The Tax Relief Act of 2010 extended this exclusion through 2012 and, at the 100 percent exclusion level, none of the gain will be subject to AMT.

COMMENT. *To qualify as small business stock, the stock must be issued by a C corporation that invests 80 percent of its assets in the active conduct of a trade or business and that has assets of $50 million or less when the stock is issued.*

Employer-Provided Child Care Credit

The 2010 Tax Relief Act extended through 2012 the credit for employer-provided child care facilities and services created by EGTRRA. The credit to which a business is entitled is the sum of 25 percent of the qualified child care expenses and 10 percent of the qualified child resource and referral expenses incurred by the employer for the tax year. The maximum amount of the credit allowable is $150,000 in any given tax year.

IMPACT. *The tax credit for employer-provided child care facilities will disappear under the sunset provision of EGTRRA (as extended by the 2010 Tax Relief Act) for tax years beginning after December 31, 2012.*

IMPACT. *Employers that terminate child-care services may have to recapture a portion of the credit. While employers would be reluctant to eliminate child-care services, they could seek to save money by spending less or by charging employees more for child-care services which they may be able to fund, at least partially, through a pre-tax dependent care spending account.*

FEDERAL ESTATE, GIFT AND GST TAXES

When Congress passed EGTRRA in 2001, many lawmakers believed that the federal estate tax would be permanently repealed after 2009 and its stepped-up basis rules would be replaced with a modified carried over basis regime. Instead, the 2010 Tax Relief Act revived the estate tax for decedents dying after December 31, 2009 (but gave estates of decedents dying in 2010 the option to opt out of the estate tax and apply EGTRRA's rules). Because the 2010 Tax Relief Act is temporary, its estate tax regime is scheduled to expire after 2012.

Estate Tax Rates/Exclusion Amount

Under EGTRRA, the estate tax would have been abolished for decedents dying in 2010 and then revived at its pre-EGTRRA levels after 2010. The 2010 Tax Relief Act modified EGTRRA's timeframe. First, the 2010 Tax Relief Act provides 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 for decedents dying after December 31, 2009 and before January 1, 2013. Second, the 2010 Tax Relief Act allowed estates of decedent's dying in 2010 to opt out of the revived estate tax. Estates of decedents dying after December 31, 2009 and before January 1, 2011 have the option to elect not to apply the estate tax regime under the 2010 Tax Relief Act. Estates may elect to apply either (1) the estate tax based on the 2010 Tax Relief Act's 35 percent top rate and $5 million applicable exclusion amount, with stepped-up basis or (2) no estate tax and modified carryover basis rules under EGTRRA.

IMPACT. *Because the 2010 Tax Relief Act sunsets after 2012, indexing for inflation is only applicable to 2012 (the estate tax applicable exclusion amount for estates of decedents dying in 2012 is $5,120,000).*

IMPACT. *Absent extension, the maximum federal estate tax rate is scheduled to revert to 55 percent after 2012 with an ap-*

Click to continued on next page

plicable exclusion amount of $1 million (not indexed for inflation).

COMMENT. *The election to opt out of the estate tax for 2010 is known as the "Code Sec. 1022 election."*

COMMENT. *Property with a stepped-up basis receives a basis equal to the property's fair market value on the date of the decedent's death (or on an alternate valuation date). Under EGTRRA's modified carryover basis regime for estates of decedents dying in 2010, an executor may increase the basis of estate property only by a total of $1.3 million, with other estate property taking a carryover basis equal to the lesser of the decedent's basis or the fair market value of the property on the decedent's death. An executor may increase the basis of assets passing to a surviving spouse by an additional $3 million (for a total of $4.3 million).*

COMMENT. *President Obama has proposed to extend the federal estate tax after 2012 with a top tax rate of 45 percent and an applicable exclusion amount of $3.5 million.*

Portability

The 2010 Tax Relief Act introduced the concept of "portability" into the federal estate tax regime. Portability allows the estate of a decedent who is survived by a spouse to make a portability election to permit the surviving spouse to apply the decedent's unused exclusion (the deceased spousal unused exclusion amount (DSUE)) to the surviving spouse's own transfers during life and at death. Portability is available to the estates of decedents dying after December 31, 2010 and before January 1, 2013.

COMMENT. *The IRS described portability in Notice 2011-82 and updated its guidance in Notice 2012-21. The IRS explained that the estate of a decedent who is survived by a spouse will be deemed to have elected portability by the timely filing of Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, pending further guidance.*

State Death Tax Credit/Deduction

Before 2005, a credit was allowed against the federal estate tax for state estate, inheritance, legacy, or succession taxes. EGTRRA repealed the state death tax credit for decedents dying after 2004 and replaced the credit with a deduction. The state death tax credit as it existed pre-EGTRRA was scheduled to revive after 2010. The 2010 Tax Relief Act extended the deduction through 2012.

More Estate Tax Provisions

The 2010 Tax Relief Act also extended, through 2012, EGTRRA's provisions affecting qualified conservation easements, qualified family-owned business interests (QFOBIs), and the installment payment of estate tax for closely-held businesses for purposes of the estate tax. Additionally, the 2010 Tax Relief Act extended repeal of the five percent surtax on estates larger than $10 million through 2012. Absent extension, the pre-EGTRRA rules for these respective provisions will apply.

Gift Tax

Under EGTRRA, the gift tax for 2010 was scheduled to be 35 percent with a $1 million applicable exclusion amount. After 2010, the pre-EGTRRA rules were scheduled to be revived. The 2010 Tax Relief Act provided a 35 percent tax rate and a $1 million exemption for gifts made in 2010. However, the 2010 Tax Relief Act also provided that for gifts made after December 31, 2010, the gift tax is reunified with the estate tax, with a tax rate through 2012 of 35 percent and an applicable exclusion amount of $5 million.

COMMENT. *Before 2004, the estate and gift taxes were fully unified, such that a single graduated rate schedule and a single applicable exclusion amount of the unified credit applied for purposes of determining the tax on cumulative transfers made by a taxpayer during his or her lifetime and at death. The estate and gift tax continued to be determined using a single rate schedule for 2004 through 2009, but the estate tax applicable exclusion amount was higher than the gift tax applicable exclusion amount.*

IMPACT. *Some estate planners have recommended utilizing the full lifetime $5 million unified estate and gift tax exclusion before it may sunset at the end of 2012. While there is concern that any exclusion amount in excess of a future exclusion may be "clawed back" into an eventually taxable estate, the worst case in that situation will not prevent any appreciation within the gift from escaping estate tax at that later date.*

GST Tax

Under EGTRRA, the generation-skipping transfer (GST) tax was scheduled to be repealed for 2010, after which the pre-EGTRRA GST rules would return. The 2010 Tax Relief Act modified this timeframe. The GST tax applicable exclusion amount for decedents dying or gifts made after December 31, 2009 is equal to the applicable exclusion amount for estate tax purposes ($5 million for 2010) but the GST tax rate for transfers made in 2010 is zero. After 2010, the GST tax rate is equal to the highest estate and gift tax rate in effect for 2011 and 2012 (35 percent for each year). Under the 2010 Tax Relief Act, the pre-EGTRRA GST rules are scheduled to return after 2012.

IMPACT. *If the GST provisions in the 2010 Tax Relief Act are not extended, there will be a 20 point difference between the 35 percent rate applicable to transfers in 2012 and the 55 percent rate that would apply after 2012.*

More GST provisions

A number of other GST tax-related provisions are scheduled to sunset after 2012. They include the GST deemed allocation and retroactive allocation provisions; clarification of valuation rules with respect to the determination of the inclusion ratio for GST tax purposes; provisions allowing for a quali-

Click to continued on next page

fied severance of a trust for purposes of the GST tax; and relief from late GST allocations and elections. The 2010 Tax Relief Act extended these provisions through 2012.

TAX-EXEMPT BONDS

EGTRRA enhanced several tax-exempt bond programs and these enhancements were extended by the 2010 Tax Relief Act.

School Construction Bonds. Through 2012, the additional amount of bonds for public schools that small governmental units may issue under Code Sec. 148 without being subject to arbitrage rebate requirements is $10 million.

IMPACT. *The arbitrage rebate requirement is scheduled to decrease from $10 million to $5 million after 2012.*

Exempt Facility Bonds. Bonds used to provide "qualified public educational facilities" are treated as exempt facility bonds under Code Sec. 142(a)(13) through 2012. Under current law, this treatment is scheduled to sunset after 2012.

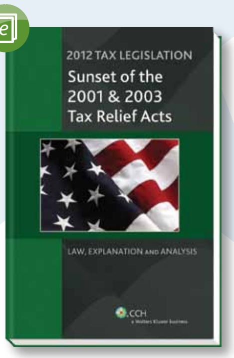
Qualified Zone Academy Bonds. The authority for state and local governments to issue qualified zone academy bonds (QZABs) runs through 2012. Under current law, this authority is scheduled to sunset after 2012.

Click to continued on next page

CCH Provides the Analysis You Can Trust

What are the Consequences… and the Opportunities for You, Your Business and Your Clients? Do You Have the Resources You Need?

Sunset of the 2001 & 2003 Tax Relief Acts: Law, Explanation & Analysis —



CCH provides the critical explanation and analysis to help readers make sense of federal tax provisions enacted in 2001 and 2003 that are scheduled to expire December 31, 2012, so they can plan, respond and advise with confidence.

CCH's *Law, Explanation and Analysis of the Sunset of the 2001 & 2003 Tax Relief Acts* provides tax professionals with timely and practical guidance on the impending sunset of the tax cuts and benefits originally enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Act of 2003 (JGTRRA), CCH editors, together with leading tax practitioners and commentators, have created a complete practical analysis, guidance, examples and planning tips.

The Internal Revenue Code provisions impacted by the sunset provisions of EGTRRA and JGTRRA are arranged in Code section sequence with caution language. CCH also provides several special tables and lists to facilitate quick and thorough understanding of how the sunset works, impacts the Internal Revenue Code, and how it affects taxpayers. *Pub: May 2012 • About 450 pages.*

eBook/Softcover Combo — Price: $62.43

eBook only — Price: $49.95

Softcover only — Price: $49.95 •
Offer #: 04004501

Buy Now ›

Buy the eBook, Get the Softcover for Only 25% More!
Simply add the eBook and Softcover to your shopping cart and the discount will apply automatically.

More Industry Leading Resources from the Experts in Legislative Coverage

Internal Revenue Code: Income, Estate, Gift, Employment and Excise Taxes, Summer 2012 — Reflects all new statutory tax changes through May 1, 2012, and provides the full, unabridged text of the complete Internal Revenue Code, dealing with income, estate, gift, employment, excise taxes and more. *Pub: July 2012 • About 4,968 pages.*

eBook/Softcover Combo — Price: $162.50

eBook only — Price: $130.00

Softcover only — Price: $130.00 •
Offer #: 04367501

Buy Now ›

Income Tax Regulations, Summer 2012 — The standard reference for serious tax professionals, it reproduces the mammoth Treasury regulations that explain the IRS's position, prescribe operational rules, and provide the mechanics for compliance with the Internal Revenue Code. *Pub: June 2012 • About 13,800 pages.*

eBook/Softcover Combo — Price: $237.44

eBook only — Price: $189.95

Softcover only — Price: $189.95 •
Offer #: 04368501

Buy Now ›

U.S. Master Tax Guide®, 2013* — The industry's leading tax guide provides reliable answers and explanations to tax questions affecting 2012 federal individual and business income tax returns. It is designed for speed and comprehensive coverage and is loaded with time-savers such as the Quick Tax Facts Card, taxpayer specific return flowcharts, rate tables and depreciation tables. Bonus copy of *Top Federal Tax Issues CPE course* (grading fee additional. Visit **CCHGroup.com/CPE** for details.) *Pub: Nov. 2012 • About 1,008 pages.*

eBook/Softcover Combo — Price: $113.69

eBook only — Price: $90.95

Softcover only — Price: $90.95 •
Offer #: 05953501

Hardbound only — Price: $117.00 •
Offer #: 05883501

Buy Now ›

SAVE 20% when you buy both Summer 2012 editions of *Internal Revenue Code* and *Income Tax Regulations*.

eBook Bundle — Price: $255.95

Softcover Bundle — Price: $255.95 •
Offer #: 04366501

Buy Now ›

Special savings is available on select eBook/Softcover combos. eBooks and eBook combinations can be purchased online only. eBooks cannot be returned for credit, or put on standing order. Visit **CCHGroup.com/eBooks** to learn more about ordering eBooks online and to review the CCH end-user agreement.

2012-0248-1

Visit **CCHGroup.com/Legislation**
for the latest updates as it happens.

CCH
a Wolters Kluwer business