SUNSET OF 2001 & 2003 TAX CUTS AND BENEFITS

The year 2012 began with the fate of the Bush-era tax cuts uncertain, and no resolution appears in sight at this time. With all the politics involved in a presidential election year, 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.

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** of the Bush-era tax cuts expiring provisions will be rolled over for one or two more years is highly unlikely. Therefore, a strategy that accelerates into 2012 whatever tax benefits are now available deserves careful consideration.

INCOME TAX RATES FOR INDIVIDUALS

If the Bush-era tax cuts expire as scheduled, the individual income tax rates will increase across-the-board for all taxpayers.

Unless Congress acts, all taxpayers – not just higher income individuals – will effectively experience a tax hike after 2012. The top tax 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 bracket.

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 top corporate tax of 35 percent (which may drop if recent corporate tax reform proposals are adopted), may become more attractive if individual tax rates rise.

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.

MARRIAGE PENALTY RELIEF

Prior to the Bush-era tax cuts a married couple would in many instances pay more tax than if the couple were not married and filed as single individuals. The Bush-era tax cuts phased this penalty out. If marriage penalty relief is not extended then it will again be tax advantaged for a couple that earns about the same in income to not marry.

LIMITATION OF ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

The Bush-era tax cuts phased out the limitation on itemized deduction and personal exemption. This limitation would return for those taxpayers in higher tax brackets.

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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). Taxpayers with qualifying dependent children should consider being ready in early 2013 to adjust withheld income tax (or estimated tax payments) to account for the reduction in the credit. It is important to note that both President Obama and the GOP have expressed support for extending or making permanent the $1,000 child tax credit after 2012.

CAPITAL GAINS / DIVIDENDS SUNSET

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.

Absent extension, qualified dividends will be taxed at 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.

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.

HIGHER EDUCATION TUITION DEDUCTION

The above-the-line deduction for higher education tuition and related expenses expired after 2011.

AMERICAN OPPORTUNITY TAX CREDIT (AOTC)

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.

FEDERAL ESTATE TAXES

The estate tax exclusion for people dying in 2012 is $5,120,000. In other words if your estate is valued at less than that amount then no federal estate tax will be due. The current top estate tax rate is 35 percent. Absent extension of current rules, the maximum federal estate tax rate is scheduled to revert to 55 percent after 2012 with an applicable exclusion amount of $1,000,000.