

TAX COMPLIANCE & PLANNING TRENDS

Many Tax Questions Left Unanswered

Congress left Washington with a significant number of unfinished tax issues on the table. Under tax laws enacted in the past decade, many popular tax provisions either expired at the end of last year, or they expire at the end of 2010.

What could happen to all these tax breaks?

- In some cases, Democrats and Republicans have stated they intend to extend them -- but they just haven't gotten around to it or they can't agree on the exact amounts. But there is a good chance that preferential tax treatment will be retained or extended.
- In other cases, there is not bipartisan agreement, so the tax breaks may not be extended.
- With still other tax breaks, it's anybody's guess what is going to happen.

Here's a chart with some of the important unresolved tax issues as 2010 draws to a close:

Tax Issue	Description
Tax Brackets on Ordinary Income	Without Congressional action and presidential approval, the current tax rate brackets of 10, 15, 25, 28, 33, and 35 percent will be replaced in 2011 by the pre-Bush brackets of 15, 28, 31, 36, and 39.6 percent. That would mean across-the-board rate hikes for American taxpayers.
Long-Term Capital Gains and Dividends	The current 0 and 15 percent rates on most long-term gains are scheduled to rise to 5 and 20 percent in 2011. The current 0 and 15 percent rates on dividends will be replaced by ordinary income rates (scheduled to be as high as 39.6 percent).
Personal Exemption and Itemized Deduction Phase-Outs	For 2010, these unfavorable rules were themselves phased out, but they will come back next year unless changes are made.
Estate Tax	For wealthy individuals who die in 2010, there is no federal estate tax. For 2011, the tax is scheduled to come back and be much worse than it was last year. It is scheduled to hit estates worth more than \$1 million and the maximum tax rate will be 55 percent. Keep in mind that the value of an estate includes all assets, including a house, plus proceeds from insurance policies on the taxpayer's life (unless a person has set things up so he or she is not considered to own the policies). So as things now stand, the estate tax will pummel the heirs of lots of middle class people who happen to die next year instead of this year.
Gift Tax	For 2010, the federal gift tax hits cumulative lifetime gifts in excess of \$1 million at a flat 35 percent rate. Next year's maximum rate is scheduled to be a whopping 55 percent.

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Research and Development Tax Credit and Other Business "Extenders"	The R&D credit expired on December 31, 2009. It is available to companies that introduce new products, improve current products, and develop or enhance their processes. The R&D credit is among a number of temporary tax provisions called the extenders because they are periodically extended.
Marriage Penalty	Getting married can cause a couple's combined tax bill to be higher than when they were single. The Bush Tax Cuts eased this so-called marriage penalty by tweaking tax brackets for married folks and giving them bigger standard deductions. But these fixes will disappear after this year unless Congress extends them.
Alternative Minimum Tax	It's become an annual ritual for Congress to "patch" the AMT rules to prevent millions more households from getting socked with this add-on tax. The annual fix consists of allowing bigger AMT exemptions and allowing various personal tax credits to offset the AMT. However, we are still waiting for this year's patch. Without it, lots of taxpayers will be unhappy early next year when their 2010 returns are ready to be filed.
Child Tax Credit	Starting next year, the maximum credit is scheduled to drop from \$1,000 to only \$500.
Child Care Tax Credit	Thanks to a Bush Tax Cut provision, most parents can currently claim a credit of up to \$600 for costs to care for one under-age-13 child, or up to \$1,200 for costs to care for two or more under-age-13 kids, so the parents can go to work. Lower-income parents can claim larger credits of up to \$1,050 and \$2,100, respectively. Next year, the maximum credits are scheduled to drop to \$480 and \$960 for most parents; \$720 and \$1,440 for lower-income parents.
"Making Work Pay" Tax Credit	This credit, which was established by the stimulus legislation, can be worth up to \$400, or \$800 for a married couple. It's scheduled to expire at the end of this year.
Higher Education Tax Credit	In 2011, the "American Opportunity" credit, which can be worth up to \$2,500 and can be claimed for four years of undergraduate education, will be replaced by the less-generous Hope Scholarship credit. The Hope credit maximum is \$1,800, and it can only be claimed for the first two years of college. It also has stricter phase-out rules that reduce or eliminate the credit as income goes up.
Higher Education Tuition Deduction	This write-off, which can be as much as \$4,000, actually expired at the end of 2009.
Student Loan Interest Deduction	This write-off, which can be as much as \$2,500 (whether you itemize or not) will fall under less-favorable rules next year if all the Bush Tax Cuts are allowed to expire. There will be a 60-month limit on deductible interest, and a stricter phase-out provision will reduce or eliminate the write-off for many more middle-income taxpayers.

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Coverdell Education Savings Accounts	Starting next year, the maximum annual contribution to these federal-income-tax-free college savings accounts is scheduled to drop from \$2,000 to \$500, and a stricter contribution phase-out rule will apply to married joint filers.
Employer Educational Assistance Plans	Currently, employers can provide up to \$5,250 in annual federal-income-tax-free educational assistance payments to an eligible employee. College and graduate school costs can be covered, and the education need not be job-related. This taxpayer-friendly deal will expire at the end of this year unless Congress extends it.
Option to Deduct State and Local Sales Taxes	For 2004 to 2009, individuals who paid little or no state income taxes were given the option of claiming an alternative itemized deduction for state and local sales taxes. The option expired at the end of last year.
Real Estate Tax Deduction for Non-Itemizers	For 2008 and 2009, unmarried individuals who did not itemize could write off up to \$500 of state and local real property taxes by claiming an increased standard deduction. Married joint-filing couples could write off up to \$1,000. This add-on standard deduction expired at the end of last year.
Tax-Free Unemployment Benefits	The stimulus law granted federal-income-tax-free treatment to up to \$2,400 of 2009 unemployment compensation benefits.
Energy-Efficient Home Improvement Tax Credit	The stimulus law established a credit for 30 percent of 2009 and 2010 expenditures on energy-efficient insulation, windows, doors, roofs, and heating and cooling equipment in U.S. residences. The maximum credit allowed for 2009 and 2010 combined is \$1,500. As things now stand, the credit will expire December 31.
Charitable Donations from IRAs	For 2006 to 2009, IRA owners who reached age 70 1/2 were allowed to make annual charitable donations of up to \$100,000 directly out of their IRAs. These donations did not directly affect the IRA owner's income tax bill because no deductions were allowed. However, the donations counted as IRA required minimum distributions. So, charitably inclined seniors with more IRA money than they needed could reduce taxes by arranging for IRA donations to take the place of taxable required minimum distributions. This break for well-off seniors expired at the end of last year.
Earned Income Tax Credit	The stimulus law increased the earned income credit for families with three or more qualifying children and allowed married joint-filing couples to earn more without having their credits reduced. These changes are scheduled to expire at the end of this year.

Source: BizActions