Can Post-election Politics Break the Congressional Tax Jam?

The post-election tax climate can be best characterized by its extreme uncertainty. Although year-end tax planning issues are nothing new, the implications as we approach 2013 are unusually significant.

We're at the brink of the so-called "fiscal cliff" . . . the pending onset of federal tax increases and spending cuts that are slated to take effect on January 1st and are expected to have a substantial impact on the economy.

Unless Congress acts, many of us who based our withholding and/or estimated taxes on our 2011 income taxes are likely to owe additional 2012 tax or end up with smaller refunds. In 2013, new tax provisions in the *Affordable Health Care Act* kick in and so does the end of the Bush tax cuts. Our taxes are also increasing because of the loss of more than one hundred tax provisions that expired after 2011 or are set to expire at the end of 2012.

Consider how you might be affected by just a few of those expired or expiring tax provisions:

- Without an "exemption patch" the 2012 alternative minimum tax will impact an additional 30 million taxpayers;
- The option to deduct state and local sales and use taxes instead of state and local income taxes is gone;
- The above-the-line deduction for qualified higher education expenses has expired;
- Tax-free distributions from IRAs for charitable purposes by those who are age 70 1/2 or older is gone;
- The Child Tax Credit will be cut in half next year;
- In 2013, tax rates revert to the much higher pre-2001 rates;
- Next year the Education Tax Credits will decrease both in amount and in years of eligibility;
- Liberalized benefits related to Coverdell Education Accounts will no longer apply after 2012.
- Business's 50% bonus first-year depreciation for most new machinery, equipment and software will be not be available in 2013;
- Next year, the $139,000 Section 179 asset expensing limit for businesses drops to $25,000 and dollar-for-dollar reduction starts when qualified assets acquired pass $200,000 instead of 2012's very high $560,000.
- The research tax credit for businesses has expired.

Today's uncertainty makes doing nothing and adopting a "wait and see attitude" very tempting. On the other hand, doing some year-end tax planning and considering a variety of scenarios can provide a win-win combination irrespective of what happens.

What's New in 2012?

Payroll Tax Holiday. In 2012, employees paid only 4.2% (instead of the usual 6.2%) OASDI (Social Security) tax on compensation received during 2012 up to $110,100 (the wage base for 2012). Similarly, for tax years beginning in 2012, self-employed persons paid only 10.4% Social Security self-employment taxes on self-employment income up to $110,100. The reductions expire at the end of 2012.

As we go to press, prospects for a renewal of the payroll tax cuts are not promising. Unless Congress Acts, in 2013 taxpayers will pay an additional 2% more payroll tax on their earnings ***up to a maximum of $2,202 more tax*** *than paid in 2012.* If both spouses earn at least as much as the 2012 wage base, the maximum additional payroll tax will be $4,272.

Mileage Reimbursement Rates for 2012. The optional mileage allowance for owned or leased autos (including vans, pickups or panel trucks) for business travel taking place in **2012** is **55.5¢** per mile.

The 2012 rate for using a car to get medical care or in connection with a move that qualifies for the moving expense deduction is **23¢** per mile.

The rate for using a car for 2012 charitable purposes remains at **14¢** per mile.

Reduced alternative minimum tax (AMT) exemption amounts. Absent another AMT "patch," the AMT exemption amounts for tax years beginning after 2011 revert to the significantly lower "permanent" amounts of $33,750 for unmarried taxpayers, $45,000 for joint filers, and $22,500 for marrieds filing separately.

Reduced adoption credit. For 2012, the total expenses that may be taken as a credit for all tax years with respect to the adoption of a child by the taxpayer will be limited to $12,650 (down from $13,360 for 2011), and the credit for the adoption of a special-needs child will also be $12,650 (down from $13,360 for 2011). Furthermore, the adoption credit will no longer be refundable.

No parity for exclusion from income for employer-provided mass transit and parking benefits. For 2012, unless Congress changes the rules, the exclusion for qualified parking rises from $230 to $240 due to an inflation adjustment, but falls from $230 to $125 for employer-provided transit and vanpooling benefits.

Reporting foreign assets. Beginning in 2012, U.S. taxpayers who have an interest in certain specified foreign financial assets with an aggregate value exceeding $50,000 must report those assets to IRS on Form 8938, Statement of Specified Foreign Financial Assets, with their tax return.

Other Provisions that expired on Dec. 31, 2011. The following are some of the business and individual provisions expired at the end of last year. Note that Congress may retroactively reinstate some or all of these rules:

Individuals:

• Election for itemizers to deduct State and local general sales taxes under Code Sec. 164(b)(5) in lieu of state and local income taxes

• Above-the-line deduction for qualified tuition and related expenses under Code Sec. 222

• Treatment of mortgage insurance premiums as qualified residence interest under Code Sec. 163(h)(3)(E)

• Above-the-line deduction for up to $250 of certain expenses of elementary and secondary school teachers under Code Sec. 62

• Nonbusiness energy property credit under Code Sec. 25C

• Tax credit for first-time District of Columbia homebuyers under Code Sec. 1400C(i)

• Adoption assistance programs under Code Sec. 137

• Allowance of personal tax credits against regular tax and AMT under Code Sec. 26(a)(2)

• Exclusion of 100% of gain on certain small business stock under Code Sec. 1202(a)(4)

• Energy efficient appliance credit under Code Sec. 45M)

• Tax-free distributions (up to $100,000 annually for taxpayers 70½ and older) from individual retirement plans for charitable purposes under Code Sec. 408(d)(8)

Businesses:

• Election to expense environmental remediation costs under Code Sec. 198(h)

• Research credit under Code Sec. 41(h)(1)(B)

• Income tax credits for biodiesel and renewable diesel under Code Sec. 40A

• Alternative fuel and fuel mixture tax credits under Code Sec. 6426(d)(5) and Code Sec. 6426(e)(3)

• Credit for construction of new energy efficient homes under Code Sec. 45L

• Enhanced charitable deduction for contributions of food inventory under Code Sec. 170(e)(3)(C)

• Enhanced charitable deduction for contributions of book inventories to public schools under Code Sec. 170(e)(3)(D)

• Enhanced deduction for corporate contributions of computer equipment for educational purposes under Code Sec. 170(e)(6)(G)

• 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)