CCH Tax Briefing

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FISCAL CLIFF TAX LEGISLATION

January 1, 2013

Special Update

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

Fiscal Cliff Deal Takes Shape In Senate As Bush-Era Tax Cuts Expire

After a weekend of intense negotiations between the Obama administration and Senate Republicans, the Senate voted to extend permanently the Bush-era tax cuts for lower and moderate income taxpayers after 2012. Because of the late hour of the Senate agreement, however, all Bush-era tax cuts at press time have sunset as scheduled after December 31, 2012, before a law could be enacted. Until a bill made retroactive to midnight January 1, 2013, passes both the Senate and the House, and is signed by President Obama, the Bush-era tax cuts will remain officially ended.

FRAMEWORK OF SENATE AGREEMENT

The Senate agreement includes the following provisions:

Income tax rate increase. A 39.6 percent rate (up from 35 percent) will be imposed on individuals making more than $400,000 a year and families making more than $450,000.

Payroll tax holiday ends. The two-percent cut in the Social Security tax for all earners up to the Social Security wage base ($113,700) will not be extended into 2013.

Alternative minimum tax patched. A permanent AMT patch, adjusted for inflation, will be made retroactive to 2012, promising to protect an additional 30 million taxpayers for AMT liability.

Dividends and capital gains. The maximum capital gains tax will rise from 15 percent to 20 percent for individuals making at least $400,000 and $450,000 for families.

Pease and personal exemption phaseouts. The Pease itemized deduction phase out and Personal Exemption Phase-out (PEP) will be reinstated, but with different starting thresholds: $300,000 income for the Pease limitation and $250,000 for the PEP.

Estate tax: The estate tax regime will continue to provide an inflation-adjusted $5 million exemption (effectively $10 million for married couples) but will be applied at a higher 40 percent rate (up from 35 percent in 2012).

Personal tax credits. The $1,000 child tax credit, the enhanced earned income tax credit and the enhanced American Opportunity college tuition tax credit will all be extended.

Business tax credits. The research tax credit and the production tax credits, among others, will be extended through 2013.

IMPACT. *The final outcome remains uncertain but it appears there is a greater than 50-50 likelihood that part of the so-called fiscal cliff will ultimately be avoided. If the agreement is approved by the Senate on December 31 or in the early morning hours of January 1, the bill must go to the House for its approval. The Senate GOP is unlikely to approve a bill that will not pass the House but the House could amend the bill and send it back to the Senate. The House is not expected to take up the Senate bill until January 1. Thus, as of now, the Bush-era tax cuts have officially expired. The Senate bill could then be viewed as a tax cut by House lawmakers who are opposed to any tax increases.*

COMMENT. *This Briefing reviews the Bush-era tax cuts and related incentives*

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that are scheduled to expire after 2012 or that have already expired. At the time this Briefing was posted, the Senate leadership had not yet posted the official text of its agreement. After the Senate and House approve a final bill, an updated Briefing will be posted on CCH IntelliConnect and at www.cchgroup.com.

IMPACT. *Late on December 31, the IRS instructed employers to withhold income for 2013 under new income tax withholding tables that assume that the Bush-era tax cuts expired as scheduled. These tables are now available. It also instructed employers to begin withholding Social Security tax at the 6.2 percent rate that reflects expiration of the two-percentage-point 2012 payroll tax holiday. The IRS advised employers to implement the new 2013 withholding tables as soon as possible but not later than February 15, 2013. In issuing this eleventh-hour directive, however, the IRS took note that Congress is currently considering legislation that could affect these rates. It instructed that if legislation is enacted, IRS will issue new, corresponding tables at that time.*

IMPACT. *Before January 1, 2013, those opposed to allowing the Bush-era tax cuts to expire for higher-income individuals were confronted with having to vote on what they viewed as a tax hike. Now, tax rates have increased for all income groups. Many lawmakers may be more receptive to voting for a tax cut (for lower and moderate income taxpayers) while leaving in place the pre-Bush-era rates for higher-income individuals. Several income levels have been floated as thresholds for the higher rates: $250,000 for families; $400,000; and $500,000.*

The two-percent payroll tax holiday also expired as of January 1, 2013, after giving workers an employment tax cut for the past two years. Consequently, the employee-share of OASDI taxes reverts to 6.2 percent (up from 4.2 percent for calendar year 2012), effective January 1, 2013.

Countless tax extenders also expired and their the inclusion of all of them in a final bill remains in doubt. They include the popular state and local sales tax deduction, the teachers' classroom expense deduction and the higher education tuition deduction, along with the research tax credit and other business extenders.

COMMENT. *The IRS has cautioned that late legislation will delay the start of the 2013 filing season and the lack of an AMT patch could throw the 2013 filing season into chaos for millions of taxpayers. The IRS programmed its processing systems for an AMT patch and if Congress acts quickly, any delay to the start of the filing season is likely to be short. The IRS also must adjust its operations for sequestration. Under sequestration, the IRS is facing an 8.2 percent funding reduction for 2013.*

After the Senate and House approve a final bill, an updated Briefing will be posted on CCH IntelliConnect and at www.cchgroup.com.

SUNSETS AFFECTING INDIVIDUALS

The impact of the expiration of the Bush-era tax cuts on individuals has received the most attention because its potential effect is so great. With the official expiration of the Bush-era tax cuts on January 1, 2013, the individual income tax rates have automatically increased 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.*

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 2013	
Source: Congressional Budget Office	

INCOME TAX RATES FOR INDIVIDUALS

The reduced individual income tax rates created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), accelerated by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), and extended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) have officially ended, effective January 1, 2013, due to Congressional inaction. Unless revived in whole or in part through retroactive legislation, the individual marginal tax rates, which were at 10, 15, 25, 28, 33, and 35 percent, have permanently returned to 15, 28, 31, 36, and 39.6 percent-levels not seen since 2001.

IMPACT. *All taxpayers - and not just higher-income individuals – have effectively experienced an automatic tax hike as of January 1, 2013, due to the full sunset of 2012 tax rates. The top rate has jumped from 35 percent to 39.6 percent. The lowest 10 percent rate has been 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, expired as of January 1, 2013, affecting all workers' earned income up to $113,700 (the Social Security wage base for 2013).*

IMPACT. *The expectation is the ongoing negotiations in Congress will eventually yield legislation that retroactively reinstates the Bush-era tax rates for all but "higher-income" taxpayers. The threshold for determining "higher-income" taxpay-*

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ers is yet to be set within a final agreement. In the meantime, for those taxpayers expecting retroactive reinstatement, the primary issue is how immediate take-home pay is impacted. If no withholding relief is forthcoming from the IRS, take home pay will immediately be affected, albeit in small increments:

- *First, the expiration of the two-percent payroll tax cut will mean a $40 reduction in pay each week for those with wages at or above the Social Security wage base level and about $19 each week for those earning about $50,000 each year.*
- *Second, the expiration of the Bush-era withholding rates will also take its toll each payday. For example, for a single filer with $87,000 taxable income, another $2,000 more in taxes each year would be owed because of the end of the Bush-era tax rates, or $40 each week.*

Although the individual tax rates reverted 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 has been eliminated and has been rolled into the lower portion of the 15 percent bracket.

IMPACT. *The majority of U.S. businesses are pass-through entities, such as partnerships and S corporations. Profits are passed through to their individual owners and, therefore, are taxed at individual income tax rates. 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 an increase in individual tax rates remains, if only for higher-income owners.*

President Obama, in his Blueprint for America and other proposals, called for making permanent the 10, 15, 25, and 28 percent rates for tax years beginning after December 31, 2012. However, he has insisted upon "higher-income" taxpayers paying more: having the 33 and 35 percent tax rates permanently replaced by 36 and 39.6 percent rates for incomes starting at $200,000 for single individuals and $250,000 for joint filers. At one point in fiscal cliff negotiations, the administration proposed a $400,000 level, which would only impact the income ranges for the 39.6 percent rate. The House GOP had proposed, under the banner of tax reform, later in 2013 to eventually consolidate the six current individual income tax brackets into two brackets of 10 and 25 percent. House Speaker Boehner also floated a plan to allow the Bush-era tax cuts to sunset for taxpayers with incomes over $1 million.

COMMENT. *The fate of the individual tax cuts is further complicated in the long term over disputes over annual inflation adjustments. Presently, 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 provisions would slow growth in the federal budget deficit.*

Marriage Penalty Relief

Before EGTRRA, married couples experienced the so-called marriage penalty in several areas, including the standard deduction and tax rate brackets. 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 2010 Tax Relief Act extended EGTRRA's marriage penalty relief through 2012, and it has now expired under the sunset provisions.

IMPACT. *Marriage penalty relief officially ended on January 1, 2013, along with full expiration of the Bush-era tax rates. The standard deduction for married couples is now 167 percent of the deduction for single individuals rather than 200 percent. The standard deduction for joint filers in 2013, therefore, has dropped from $12,200 to $10,150.*

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. It has now expired under the sunset provisions.

IMPACT. *The upper limit of the 15 percent bracket for joint filers had been 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. The 15 percent bracket for joint filers now ends (and the pre-EGTRRA 28 percent bracket begins) at $60,550 rather than at $72,500.*

PEASE LIMITATION

The "Pease" limitation on itemized deductions, which was eliminated by EGTRRA, as extended by the 2010 Tax Relief Act, has been officially revived. 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

SELECTED CHANGES FOR 2013 DUE TO EXPIRATION OF BUSH-ERA TAX CUTS

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

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three percent of the amount by which the taxpayer's adjusted gross income exceeds an applicable threshold. However, the amount of itemized deductions is not 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 for 2013, as adjusted for inflation, is $178,150 ($89,075 for married individuals filing separately). President Obama has also proposed to limit the value of all itemized deductions for "higher-income" taxpayers to 28 percent. Whether this proposal replaces or adds to the Pease limitation, in retroactive legislation or as part of a later tax reform bill, remains to be seen.*

PERSONAL EXEMPTION PHASEOUT

Starting in 2013, higher-income taxpayers will see their deduction for personal exemptions reduced or eliminated under the personal exemption phaseout rules that have now been revived pursuant to the sunset rules. The elimination of the phaseout was first implemented by EGTRRA 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.

IMPACT. *The applicable thresholds for the personal exemption phaseout for 2013 are $178,150 for single taxpayers and $267,200 for married couples filing a joint return.*

CAPITAL GAINS/ DIVIDENDS SUNSETS

Reduced tax rates on qualified capital gains and dividends have expired under the sunset provisions of JGTRRA and subsequent legislation. The pre-JGTRRA treatment (as extended by the 2010 Tax Relief Act) of qualified capital gains and dividends now applies.

Capital Gains

Under the sunset rules, the maximum tax rate on net capital gain of noncorporate taxpayers has reverted to 20 percent (10 percent for taxpayers in the 15 percent bracket) starting January 1, 2013.

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 had been eligible for a zero percent tax rate on qualified capital gains.

> "The IRS has cautioned that late legislation will delay the start of the 2013 filing season"

IMPACT. *President Obama campaigned on allowing the Bush-era tax cuts—including the reduced capital gains and dividend tax rates—to expire for higher-income individuals, and it is unclear if he has changed his position now. The President called for extending the zero and 15 percent capital gains and dividend tax rates for single individuals with incomes below $200,000 and families with incomes below $250,000. Those dollar thresholds may be subject to compromise in final negotiations.*

COMMENT. *Higher-income taxpayers must also start paying a 3.8 percent additional tax on Net Investment Income (NII) above a certain threshold due to implementation of the Patient Protection and Affordable Care Act (PPACA) on January 1, 2013. That tax stands virtually no chance of retroactive repeal under any agreement resulting from current Congressional negotiations.*

Under current law, the 28 and 25 percent tax rates for collectibles and recaptured Code Sec. 1250 gain, respectively, continue unchanged after 2012. Also unchanged is the application of ordinary income rates to 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 are now taxed at the 20 percent rate.*

Five-Year Holding Period for Capital Assets. Under JGTRRA, as extended by TIPRA and the 2010 Tax Relief Act, there was no special capital gain treatment from 2003 through 2012 for property held for more than five years. After 2012, the JGTRRA-based lower capital gain rates for five-year gains of individuals, estates and trusts are revived. Long-term gain on the sale or exchange of property held for more than five years generally is now taxed at 18 percent (eight percent for taxpayers in the 15 percent bracket).

IMPACT. *For higher-income taxpayers, the 15 percent rate under JGTRRA applied if the taxpayer held the asset for more than one year, but only if the taxpayer sold 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 now applies if the taxpayer 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.*

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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 was 15 percent for tax years beginning before January 1, 2013. A zero percent rate applied to qualified dividends received before January 1, 2013 by an individual in the 10 or 15 percent income tax rate brackets.

IMPACT. *Qualified dividends under the sunset rules are now taxed at the applicable ordinary income tax rates starting January 1, 2013 (with the highest rate scheduled to be 39.6 percent after 2012), despite the highest rate for net capital gains rising to 20 percent. President Obama has previously proposed to increase the dividends rate to the ordinary income tax rate for higher-income individuals only.*

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, were qualified dividends for purposes of the reduced tax rate. Certain dividends did not qualify for the reduced tax rates. They included (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 also ended after 2012 under the general sunset provisions:

- Dividends received from a regulated investment company (RIC), real estate investment trust (REIT) and other qualified pass-through entities are no longer treated as qualified dividends for purposes of the reduced tax rates through 2012;
- Temporary repeal of the collapsible corporation rule ends after 2012;
- The accumulated earnings tax rate imposed on corporations, which had been reduced to 15 percent, are now again taxed at the 39.6 percent rate; and
- The tax on undistributed personal holding company (PHC) income also rises from its temporary 15 percent rate to the highest, 39.6 percent 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, principally as the result of inflation. These 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 at the end of 2011. Under current law, there is no AMT patch for 2012; however, Congress is expected to patch the AMT in any final agreement and make that patch retroactive to January 1, 2012.

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 in a patch — are $33,750 for unmarried individuals filing a single return, and $45,000 for married couples filing a joint return and surviving spouses.*

IMPACT. *If the AMT is patched for 2012, the exemption amounts are expected to be $78,750 for married couples filing a joint return and $50,600 for unmarried individuals filing a single return.*

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. Because there is officially no patch 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 are reluctant to eliminate the AMT.*

COMMENT. *President Obama previously 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 2012, the Senate rejected the Paying a Fair Share Act, which would implement the Buffett Rule. It is unclear if Democrats will reintroduce the bill or whether it will*

TAX REFORM SOLUTION?

Since passage of 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 individual income tax rates, while both parties have struggled to strike a "grand bargain." Later in 2013, a broader, more permanent solution may be found.

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be considered within the overall framework of tax reform later in 2013.

INDIVIDUAL CREDITS/ DEDUCTIONS

Many popular individual credits and deductions, as well as popular enhancements to longstanding credits and deductions, are now expired under the sunset provisions of EGTRRA, as extended by the 2010 Tax Relief Act.

Child Tax Credit

The $1,000 child tax credit has reverted to $500 per qualifying child (dependents under age 17 at the close of the year) for 2013 and beyond under the sunset rules. Other enhancements, such as modifications to the refundable component, a special rule providing that the refundable portion of the child tax credit does not constitute income, allowing the child tax credit against regular income tax and against AMT, repeal of the AMT offset against the additional child tax credit for families with three or more children, and elimination of the supplemental child tax credit have also expired for 2013 and beyond.

IMPACT. *The $500 child tax credit is effective for 2013. For 2012, taxpayers may claim the $1,000 child tax credit and take advantage of the various enhancements.*

IMPACT. *Because the credit is reduced to $500, the smaller credit amount phases out more quickly.*

Refundability. 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, but only through 2012.

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

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. These enhancements have officially expired for 2013 and beyond.

COMMENT. *The adoption credit phases out for taxpayers above specified inflation-adjusted levels of modified adjusted gross income. For 2012, the phaseout level started 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

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IMPACT OF SUNSETS – ILLUSTRATIONS

#1: Assume a couple with 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 will be:

No Sunset: .... $17,207.50 due for 2013

Full Sunset: .... $22,878.50 tax due for 2013

Difference: $5,671*

#2: Assume a couple with 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 will be:

No Sunset: .... $76,963 tax due for 2013

Full Sunset: .... $89,922 tax due for 2013

Difference: $12,959*

#3: Assume a single filer with 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 2013 will be:

No Sunset: .... $11,828.75 tax due for 2013

Full Sunset: .... $13,367.50 tax due for 2013

Difference: $1,538.75*

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

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employment-related expenses for purposes of the dependent care credit and made other enhancements. The 2010 Tax Relief Act extended these enhancements through 2012. These enhancements have officially expired for 2013 and beyond.

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 were capped at $3,000 in the case of one qualifying individual or at $6,000 in cases of two or more qualifying individuals subject to income thresholds. Due to the sunset, these monetary amounts are reduced for 2013 and beyond to $2,400 in cases of one qualifying individual or $4,800 in cases of two or more qualifying individuals, subject to income thresholds. Also, the 35 percent credit rate has fallen to 30 percent after 2012.*

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 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. *The EIC enhancements have officially ended for 2013. The EIC phaseout is 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. Once again, the EIC becomes more complex.*

OTHER EXPIRED PROVISIONS

EGTRRA and JGTRRA provisions are not the only tax benefits that officially expired after 2012 (or that already expired after 2011). These provisions, among others, include the following:

- Payroll tax cut
- 100/50 percent bonus depreciation
- Enhanced Code Sec. 179 expensing
- Research credit (expired after 2011)
- Environmental remediation cost election (expired after 2011)
- State and local sales tax deduction (expired after 2011)
- Teacher's classroom expense deduction (expired after 2011)
- Exclusion for charitable contributions of IRA proceeds (expired after 2011)
- Enhanced charitable deduction for contribution of food inventory (expired after 2011)
- Reduced recognition period for S corp built-in gains tax (expired after 2011)
- Parity for transit benefits (expired after 2011)
- Mortgage insurance premium deduction (expired after 2011)
- Work Opportunity Tax Credit (expired generally after 2011; for veterans after 2012)
- Cancellation of mortgage indebtedness exclusion for personal residence
- Energy tax incentives (some expired after 2011; others expired after 2012).

EDUCATION SUNSETS

A number of education-related tax incentives have officially expired with the sunset of the Bush-era tax cuts.

Coverdell Education Savings Accounts

The maximum contribution amount to a Coverdell Education Savings Account (ESA) has reverted to $500 for 2013 and beyond under the sunset rules. Additionally, elementary and secondary school expenses no longer are qualified expenses for Coverdell ESAs. Post-secondary school expenses remain 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.*

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, which was not taxable to the employee, has officially expired for 2013 and beyond. Additionally, the provision allowing employers to deduct up to $5,250 annually for qualified education expenses paid on behalf of an employee has also officially expired for 2013 and beyond.

IMPACT. *As a result of the sunset of the Bush-era tax cuts, employer-paid educational assistance will be excludable from gross income (and deductible by an employer) only if it qualifies under the more stringent working condition fringe benefit 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.*

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COMMENT. *Under the enhanced provision, tax-free educational assistance benefits had included payments for tuition, fees and similar expenses, books, supplies, and equipment. The payments could be for either undergraduate- or graduate-level courses. To qualify as an educational assistance program, the plan must have been written and met 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. This treatment has officially expired for 2013 and beyond under the sunset rules.

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 phaseout. The 2010 Tax Relief Act extended these enhancements through 2012. With the sunset of the Bush-era tax cuts, the 60-month limitation is revived for 2013 and beyond.

IMPACT. *For 2012, the student loan interest deduction was reduced when modified adjusted gross income exceeded $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). Because of the sunset of the Bush-era tax cuts, the deduction officially now begins to phase out for single individuals whose modified adjusted gross income, with estimated inflation adjustments, exceeds $50,000 ($75,000 for married couples filing a joint return) and will 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 both under the Bush-era tax cuts and after the sunset of the Bush-era tax cuts.*

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 among the tax extenders for renewal. Although the deduction was renewed for 2010 and 2011, retroactive renewal for 2012 and beyond is uncertain. An extension for 2012, if approved much beyond mid-January, would create problems for the IRS in reprogramming in time for the 2013 filing season.*

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. Effective January 1, 2013, the AOTC has officially expired (although not under the amended EGTRRA sunset provision) and the HOPE credit with its lower benefits returns under the sunset rules.

IMPACT. *Before 2013, the AOTC reached up to $2,500 of the cost of tuition, fees and course materials paid during the tax year. The AOTC was 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) was refundable for lower-income taxpayers.*

Before 2013, the full AOTC credit was 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 was phased out for taxpayers with incomes above these levels.

IMPACT. *The HOPE credit is limited to the first two years of post-secondary education. Before 2013, the AOTC, in contrast, could 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 has applied. 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. Effective for the purchase of qualified small business stock on or after January 1, 2013, this enhanced treatment has expired.

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 is subject to AMT. Effective January 1, 2013, this treatment has expired.

COMMENT. *To qualify as small business stock, the stock must be issued by a C*

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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. Before 2013, the credit to which a business was entitled was 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 before 2013 was $150,000 in any given tax year.

IMPACT. *As part of the general sunset of the Bush-era tax cuts, the tax credit for employer-provided child care facilities has expired.*

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 cut costs 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 expired after 2012, unless extended or modified by Congress.

IMPACT. *Effective January 1, 2013, the maximum federal estate tax rate reverts to 55 percent with an applicable exclusion amount of $1 million (not indexed for inflation) under the sunset rules.*

COMMENT. *It is unclear if a final agreement will address the estate tax. Many lawmakers from both parties want to extend the current treatment (maximum 35 percent tax rate with a $5 million exclusion adjusted for inflation ($5.12 million in 2012). 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.*

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 decedents 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 expired after 2012, indexing for inflation is only applicable to 2012 (the estate tax applicable exclusion amount for estates of decedents dying in 2012 is $5.12).*

Portability

The 2010 Tax Relief Act introduced the concept of "portability" into the federal estate tax regime. Under portability, the estate of a decedent who is survived by a spouse can elect 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 was available to the estates of decedents dying after December 31, 2010 and before January 1, 2013.

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. Because of the sunset of the Bush-era tax cuts, the state death tax credit is restored and the state death tax deduction is not available for the estates of decedents dying after 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. Effective January 1, 2013, these provisions have officially expired.

Gift Tax

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 was reunified with the estate tax, with a tax rate through 2012 of 35 percent and a unified lifetime applicable exclusion amount of $5 million. This treatment has expired.

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COMMENT. *The gift tax annual exclusion amount, available for gifts to each donee, continues to apply for 2013. This inflation-adjusted exclusion is $14,000 per donee for 2013, up from $13,000 in 2012. Split-gift elections with a spouse effectively may increase those limits to $28,000 and $26,000, respectively.*

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 exemption amount for decedents dying after December 31, 2009 was equal to the applicable exclusion amount for estate tax purposes ($5 million for 2010), but the GST tax rate for transfers made in 2010 was 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). The modifications made by the 2010 Tax Relief Act have officially expired.

IMPACT. *Because of the sunset rules, there is a 20 point difference between the 35 percent rate applicable to transfers in 2012 and the 55 percent rate that applies after 2012.*

More GST provisions

A number of other GST tax-related provisions have expired 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 qualified severance of a trust for purposes of the GST tax; and relief from late GST allocations and elections.

TAX-EXEMPT BONDS

EGTRRA enhanced several tax-exempt bond programs and these enhancements were extended by the 2010 Tax Relief Act through 2012. For 2013 and beyond, these enhancements have expired under the sunset rules.

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 was $10 million. This treatment has expired.

IMPACT. *The arbitrage rebate requirement has decreased from $10 million to $5 million.*

Exempt Facility Bonds. Bonds used to provide "qualified public educational facilities" were treated as exempt facility bonds under Code Sec. 142(a)(13) through 2012. Effective January 1, 2013, this treatment has expired.

Qualified Zone Academy Bonds. The authority for state and local governments to issue qualified zone academy bonds (QZABs) ran through 2012. Effective January 1, 2013, this authority has expired.

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