TAXMAGEDDON

How Looming Tax Law Changes May Affect You

by Jerry Gaddis

"The plans of the diligent lead to profit as surely as haste leads to poverty." —Proverbs 21:5

You probably don't have tax planning on your bucket list. However, the Bible encourages us to plan. With Taxmageddon on the horizon, now is a good time to start.

"Taxmageddon" describes the simultaneous sunset of the Bush-era tax cuts, the expiration of the payroll tax holiday and the implementation of new taxes mandated by the Affordable Care Act (Obamacare), all scheduled to take place on January 1, 2013. If all these changes happen as scheduled, your taxes are going up, so planning now can save you hard-earned money later.

Here are a few things that will impact individual income tax returns for tax year 2013:

- **The 2 percent payroll tax holiday is set to expire at the end of this year. Social Security taxes withheld from employee wages will revert back to 6.2 percent, up from the 4.2 percent it was this year, and take-home pay will decline accordingly.**

- **Individual marginal tax rates are scheduled to increase, reverting back to 15, 28, 31, 36 and 39.6 percent from the 10, 15, 25, 28, 33 and 35 percent rates in 2012.**

- **Favorable rates for qualified capital gain and dividend income are scheduled to expire as well. The zero percent rate for capital gains will be eliminated, and the maximum rate will increase from 15 percent to 20 percent. Rates on**

dividends could increase from as low as zero percent to as high as 39.6 percent or more in 2013.

- **The Child Tax Credit will be cut in half from $1,000 per child to $500 per child, resulting in a tax increase of $1,000 for middle-income families with two dependent children in tax years after 2012.**

- **The threshold for deducting medical expenses will increase from 7.5 percent of Adjusted Gross Income (AGI) to 10 percent of AGI for most taxpayers starting in tax year 2013.**

- **The Pease limitation on itemized deductions comes back in 2013, which means that higher-income taxpayers will not realize the full benefit of their itemized deductions as they will in tax years 2011 and 2012.**

- **The itemized deduction for state and local sales taxes will expire, meaning taxpayers in states with no income tax, like Texas and Florida, will lose that deduction for 2013.**

- **The marriage penalty returns in 2013, so married couples who file together and do not itemize will receive a smaller standard deduction than singles or those couples who file separately.**

- **The outstanding American Opportunity Education Tax Credit is set to expire, but the less-outstanding and non-refundable Hope and Lifetime Learning Credits will still be available.**

- **For higher-income taxpayers ($200,000 plus), there are two new Medicare taxes—compliments of the Affordable Care Act: a 0.9 percent tax on wages and self-employment income, and a 3.8 percent tax on unearned income. It is likely that these taxes will not be subject to withholding, resulting in a bigger bill at tax time.**

And this is just a partial list of *some* of the things that will impact *individual* income tax returns. Business, estate and gift taxes are also affected by Taxmageddon, and the Alternative Minimum Tax (AMT) continues to affect more taxpayers each year.

So What's the Good News?

Most of these tax provisions begin in 2013 and affect returns filed in 2014. Many in both the political and tax communities believe that Congress will act before the end of 2012 to prevent all of these things from happening at once, but there is no consensus about what will change or when those changes will be effective.

In the interim, based on the laws as written today, here are some planning tips for 2012:

The best thing to do is schedule an appointment with your tax and/or financial advisors for the first week of December. That will allow for the November election and a lame duck session of Congress, where some of these changes may be delayed or eliminated.

Some of the Topics to Cover with Your Advisors Include:

- **How much will my taxes go up in 2013? Should I increase my withholding and/or my estimated tax payments to avoid a big balance due? Remember, balances due can be subject to penalties and interest even if paid by the filing deadline.**

- **Would it be beneficial to sell appreciated assets in 2012 before the capital gains tax rates rise in 2013? Conversely, would it be beneficial to hold devalued assets until after 2012 so the losses can be used in a year with higher rates? Does it make financial sense to invest in dividend-producing stocks if dividends are taxed as ordinary income?**

- **For self-employed individuals, should income be accelerated into 2012 and taxed at current rates? Should expenses be deferred past 2012 to offset revenue taxed at higher rates? What other business-related tax increases can be expected?**

- **For taxpayers in college or with dependents in college who qualify for the American Opportunity Credit, would paying spring tuition and other related expenses in 2012 be more beneficial than paying them in 2013 and taking a different credit? For taxpayers who haven't used all the qualifying expenses in 2012, this could produce a significant tax savings.**

- **Since unreimbursed medical expenses can be an itemized deduction in the year paid, are there expenses that can be paid in 2012 before the deduction threshold goes up?**

- **For low- and middle-income taxpayers not subject to the Pease limitation, would deferring itemized deductions into 2013, when they could be applied against higher rates, lower the overall tax burden? Checks for some deductions, like property taxes and charitable contributions, can be written in either December or January and are deductible in the year paid.**

- **For higher-income taxpayers subject to the Pease limitation on itemized deductions, things are even more complicated. Would it be beneficial to take deductions in 2012 before the limitation kicks back in or wait until 2013 when limitations apply but allowable deductions will offset income taxed at higher rates?**

Unfortunately there are no simple answers to these questions. The only way to know the best course of action is to plan ahead and run the numbers for your specific situation. As for those who normally go it alone, don't forget that seeking wise counsel is a biblical concept. This is not a normal year so don't be afraid to ask for help.

While Taxmageddon is on the horizon, like anything else in life, it will be easier to take with a dose of preparation. Taxes are a big part of any budget, and planning for them will allow you to keep more of your hard-earned money and leave more to spend on things that really are on that bucket list.

Tax law updates will be available on www.irs.gov and www.crown.org later this year, as they are updated and implemented. Check back often for updates.

In our next issue we'll address the question, "What do you really know about your tax guy?" We'll look at the different certifications available to tax preparers and review the new regulations placed on those who prepare income tax returns for compensation. DW

The advice given here is general in nature and must be closely analyzed to see how it applies to each taxpayer's specific situation.

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