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Expiring Provisions Affect Year-End Tax Planning



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Many provisions enacted in 2001 and 2003 (the "Bush tax cuts") expire at the end of the year, complicating planning efforts. Here are some of the major changes that could affect you.

Income tax rates to increase in 2011 (maybe)

Federal income tax rates are scheduled to increase in 2011. After December 31, 2010, we'll go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). Will it actually happen? It's difficult to predict--the President has called for all but the top two current tax rates to be extended, with provisions put in place that would result in only those earning more than roughly \$200,000 (\$250,000 for married couples filing jointly) being subject to the new, higher 36% and 39.6% rates. But Republican members of Congress have generally insisted on extending the existing rates for everyone.

Higher maximum tax rate for long-term capital gains (maybe)

Currently, long-term capital gain is generally taxed at a maximum rate of 15%. And, if you're in the 10% or 15% marginal income tax bracket, a special 0% rate generally applies. Like the regular income tax rates, that's scheduled to change on January 1. In 2011, the maximum rate on long-term capital gains will generally increase to 20%, with a 10% rate applying to those in the lowest (15%) tax bracket, though slightly lower rates might apply to qualifying property held for five or more years. As with the regular income tax rates, it remains to be seen if the current rates will be extended, and, if they are, whether they'll be extended for everyone or just those who earn under a certain amount.

...And dividends, too

Since 2003, the same maximum rates that have applied to long-term capital gains have also applied to qualifying dividends. That, too, changes in 2011; starting January 1, qualifying dividends will once again be taxed as ordinary income.

Wealthy face reduction in itemized deductions and exemptions

For 2010, itemized deductions and personal and dependency exemptions are not reduced for higher-income individuals. But beginning in 2011, these deductions will be subject to a phaseout based on adjusted gross income (AGI). Although the AGI thresholds for phaseout in 2011 aren't yet available, in 2009--the last year that the phaseout applied--itemized deductions were reduced for those with AGIs exceeding \$166,800 (\$83,400 if married filing separate returns) and exemptions were reduced for those with AGIs exceeding \$250,200 if married filing jointly (\$166,800 if filing as single, \$125,100 if married filing separately).

"Marriage penalty" returns

Changes that were made to address a perceived "marriage penalty" expire at the end of 2010. You'll see the effect in a reduced 2011 standard deduction amount for married couples filing jointly. Married couples filing jointly will also see the effect reflected in 2011 tax rate tables in the form of lower tax bracket thresholds (lower tax bracket thresholds mean that couples move into higher rate brackets at lower levels of income).

Credit and deduction changes

The Making Work Pay tax credit disappears in 2011, and both the child tax credit and the Hope education tax credit (known as the American Opportunity tax credit for 2009 and 2010) revert to old, lower limits and (less generous) rules of application. Also gone for 2011 is the ability to deduct mortgage insurance premiums, and the ability to deduct interest on student loans after the first 60 months of repayment.

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