

# Individual Income & Estate Tax Outlook

“On the Edge?”  
Lunch-n-Learn Seminar



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# Disclaimer

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# Objectives

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- n Consider the current economic environment
- n Identify changes to current tax law
- n Explore tax reform ideas

# The Current Environment

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- n From cliff to ceiling...

- n Fiscal cliff averted with passing of American Taxpayer Relief Act of 2012

- n The Act will:

- n increase the deficit by \$4.0 trillion over next 10 years (Current Law Baseline)

- n decrease the deficit by \$.6 trillion over next 10 years (Current Policy Baseline)

- n FY 2012 deficit estimated at \$1.100 trillion

- n 2009 - \$1.413T

- n 2010 – \$1.294T

- n 2011 - \$1.299T

- n FY 2013 deficit is projected to be \$901 billion

# The Current Environment

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## FY 2012 Budget Deficit Figures

- n Tax revenue: \$ 2,600,000,000,000 (up 2.3% from 2011)
- n Spending: \$ 3,700,000,000,000 (down 2.7% from 2011)
- n New debt: \$ 1,100,000,000,000 (deficit 7.0% GDP)
- n Total debt: \$16,470,000,000,000 (as of 1/22/13)
- n GDP: \$15,558,000,000,000 (as of 1/22/13)
- n Debt/GDP: 106%

# The Current Environment

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Now, remove 8 zeros and pretend it's your budget:

- n Annual income: \$26,000
- n Money spent: \$37,000
- n New debt on credit card: \$11,000
- n Outstanding balance on credit card: \$164,700
  
- n Annual interest paid: \$2,400

# The Current Environment

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- n National Debt is currently \$16.5 trillion (\$16,500,000,000,000)
- n Perspective:
  - n In January 2000 the National Debt was \$5.8 trillion
  - n Debt ceiling currently at \$16.4 trillion

# The Current Environment

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- n January 23, 2013 - House voted to suspend debt limit
  - n Suspends enforcement of debt ceiling through May 18, 2013
    - n Estimated that debt will increase \$450 billion during this period
  - n Automatically resets debt limit at higher level on May 18, 2013
    - n Date of potential default extended until end of July at earliest
  - n Will withhold paychecks of lawmakers in a chamber of Congress
    - n Unless they adopt their own budget
    - n Senate has not adopted a budget since 2009
- n Expected to pass into law: Senate and Obama expected to accept bill



# The Current Environment

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## Sequestration Cuts looming

- n Intended to be painful
- n Originally set to begin January 1, 2013
- n Postponed to March 1, 2013 by “fiscal cliff” deal
- n \$1.2 trillion of “across the board” cuts to domestic and military spending over 10 years
- n 2013 cuts
  - n Military - 9.4%
  - n Domestic - 8.2%
  - n Medicare - 2% (but not beneficiaries)
- n Spared – Social Security, Medicaid, food stamps, veterans’ benefits

# The Current Environment

Other significant issues to note:

- n The Tax Gap: 83.1% compliance

Type of Noncompliance (in Billions)	Individual Income Tax	Corporate Income Tax	Other	Total
Underreporting	\$235	\$67	\$74	\$376
Underpayment	36	4	6	46
Nonfiling	25	N/A	3	28
<b>Total</b>	<b>\$296</b>	<b>\$71</b>	<b>\$83</b>	<b>\$450</b>

- n Most recent study from 2006 tax year as released in January 2012

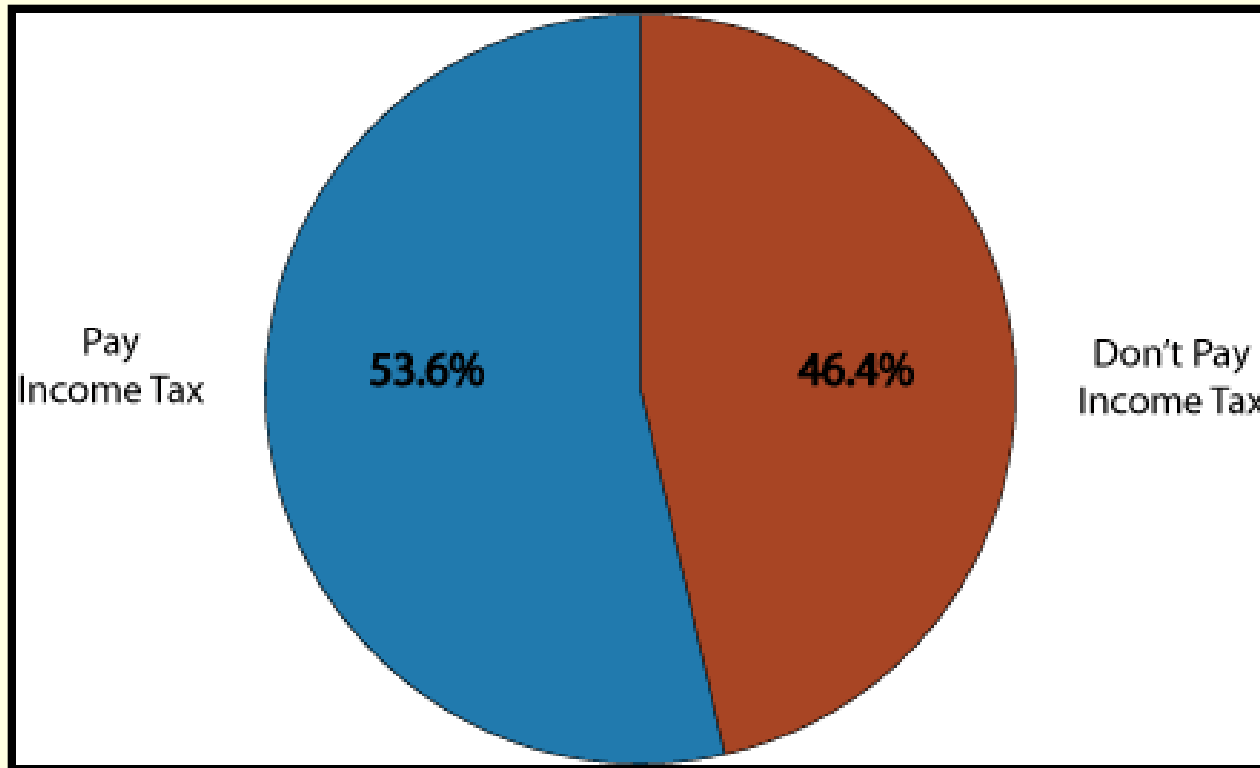
- n Other includes: employment tax, estate and excise taxes

- n Estimated underreported sole proprietor income: \$122 B  
(57% of sole proprietorship income is not reported)

- n Initiatives – Worker Classification and 1099 reporting

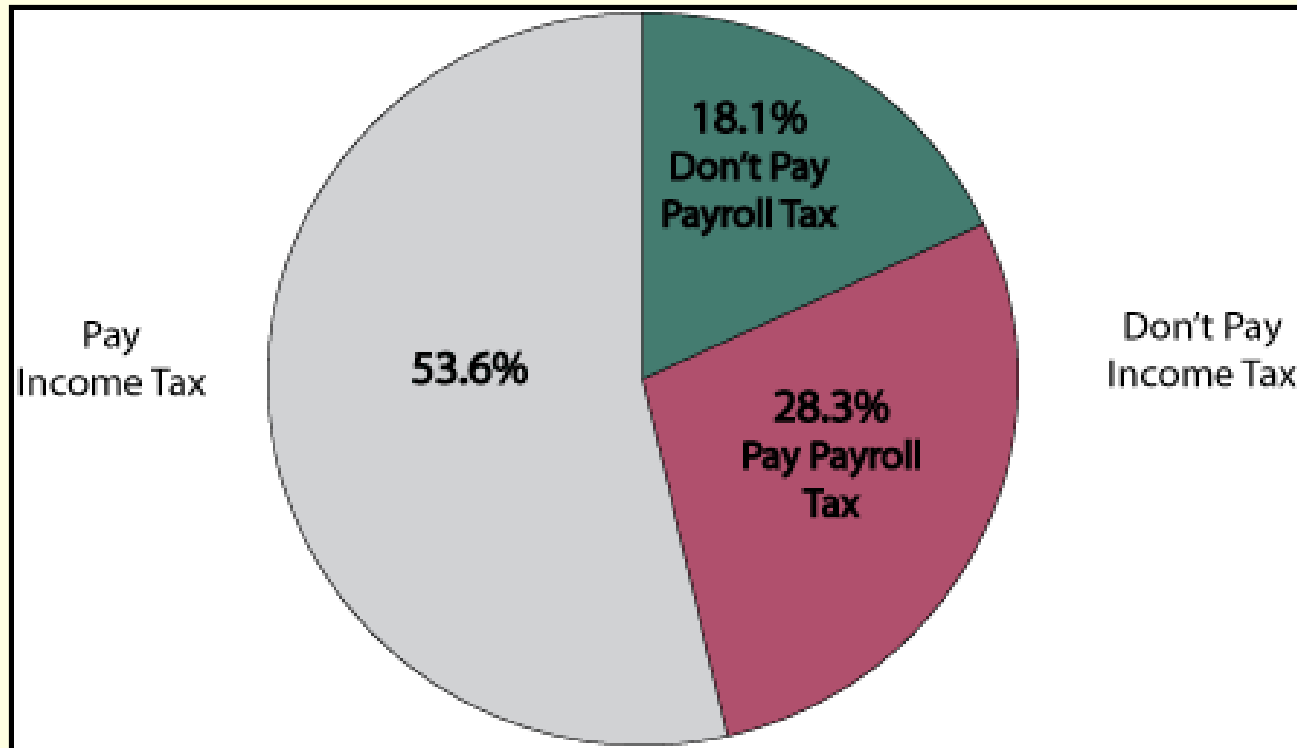
# The Current Environment

## Who Pays Income Tax?

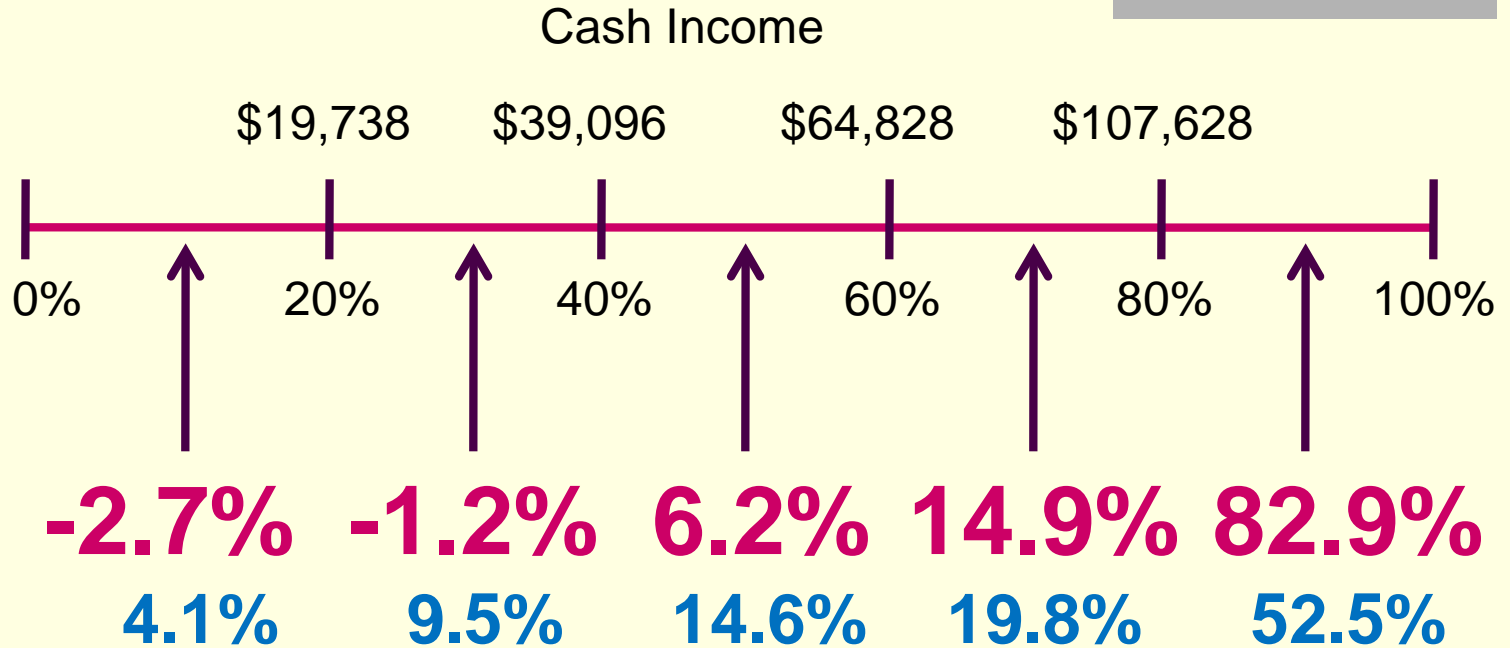


# The Current Environment

## Who Pays Payroll Tax?



# Tax Policy Center 2012 Statistics

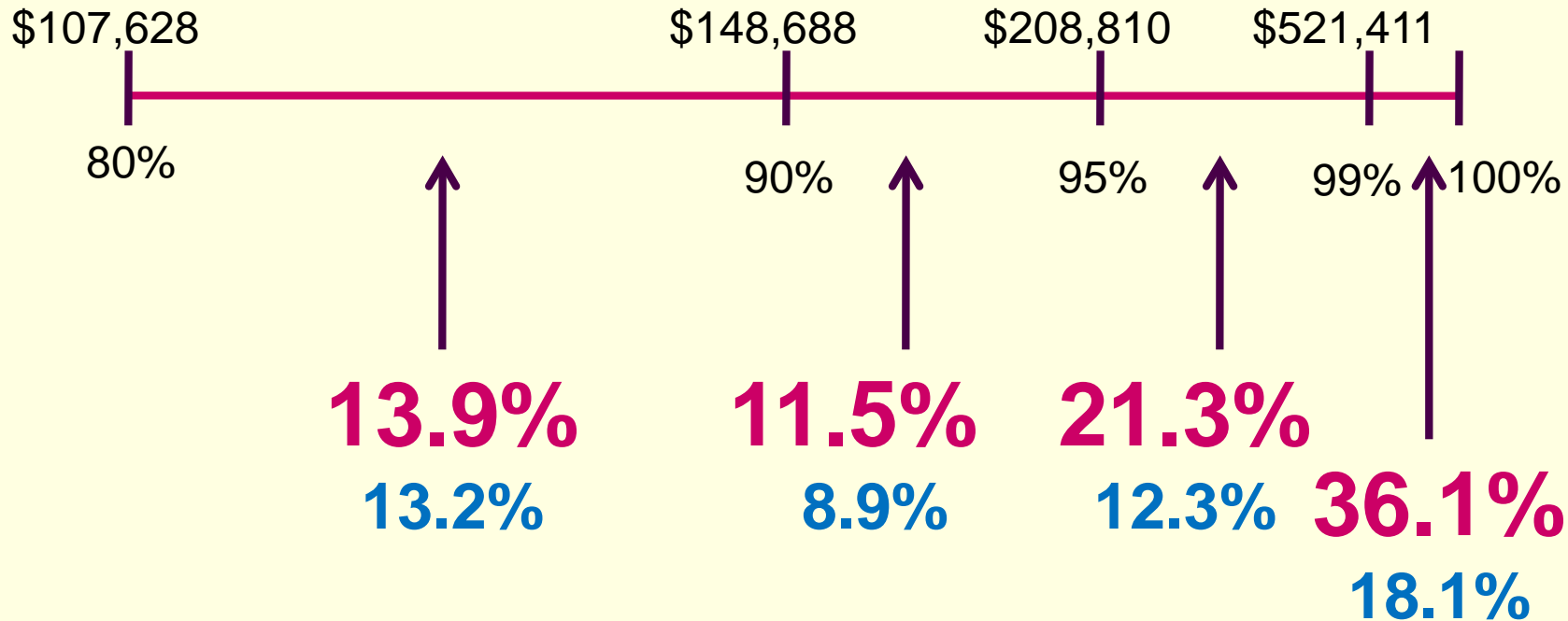


Percentage of Total Federal Income Tax Paid  
Percentage of Cash Income

# Tax Policy Center 2012 Statistics

## Cash Income

### Top 20% Income, 90.5% Income Tax Paid Breakdown



Percentage of Total Federal Income Tax Paid

Percentage of Cash Income

# The Outlook

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- n American Taxpayer Relief Act of 2012
- n Additional Tax Issues to Note
- n Obama Care
- n Estate Tax Provisions and Planning
- n What Lawmakers are Talking About
- n The Fix

# American Taxpayer Relief Act

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- n Signed into law by President Obama January 2, 2013
- n Generally extended the “Bush Tax Cuts”
- n Made some tax provisions permanent
- n Extended many temporary provisions



# American Taxpayer Relief Act

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Effective January 1, 2013:

## n Personal Exemption Phaseout

- n Personal exemption (\$3,900 for 2013) phased out over certain thresholds
- n AGI thresholds are:
  - n \$300,000 for married individuals filing a joint return
  - n \$250,000 for single individuals
  - n \$150,000 for married individuals filing a separate return

## n Itemized Deduction Phaseout

- n Deductions reduced by 3% of the amount AGI exceeds the threshold
  - n Cannot reduce itemized deductions more than 80%
- n Same AGI thresholds as above

# American Taxpayer Relief Act

n Bunching of itemized deductions (assume no phase-out)

Without Bunching	2011	2012	2013	Total
Standard Deduction	\$11,600	\$11,900	\$12,200	
Itemized Deduction:				
Char. Contrib.	5,000	5,000	5,000	
RE Taxes	2,000	2,100	2,200	
Medical (over 10% limit)	3,000	3,000	3,000	
Total Itemized Deduction	10,000	10,100	10,200	
Larger of Std. or Itemized	11,600 (std.)	11,900 (std.)	12,200 (std.)	= \$35,700

# American Taxpayer Relief Act

n Bunching of itemized deductions (assume no phase-out)

With Bunching	2011	2012	2013	Total
Standard Deduction	<b>\$11,600</b>	\$11,900	<b>\$12,200</b>	
Itemized Deduction:				
Char. Contrib.	-	15,000	-	
RE Taxes	-	4,100	2,200	
Medical (over 10% limit)	1,000	7,000	1,000	
Total Itemized Deduction	1,000	<b>26,100</b>	3,200	
Larger of Std. or Itemized	11,600 (std.)	26,100 (itm.)	12,200 (std.)	<b>= \$49,900</b>

n \$14,200 additional deductions from bunching

# American Taxpayer Relief Act

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## n Alternative Minimum Tax (AMT)

- n Effective 1/1/2012, permanently indexes the AMT exemption for inflation
- n 2012 exemption amounts changed from:
  - n \$45,000 to \$78,750 for married individuals filing joint return
  - n \$33,750 to \$50,600 for single individuals
  - n \$22,500 to \$39,375 for married individuals filing separate return
- n Removed 34.4 million individuals from AMT tax

## n Qualified rollovers of retirement plans

- n Retirement plans may allow participants to make taxable qualified rollover Roth contributions in tax years ending after December 31, 2012

# American Taxpayer Relief Act

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- n Extension of temporary provisions: 2012 thru...
  - n American Opportunity tax credit for qualified tuition and expenses: 2017
  - n Eased rules for the refundable child tax credit: 2017
  - n Higher phaseout thresholds for earned income tax credit (EITC): 2017
  - n Educator expenses for teachers: 2013
  - n Qualified tuition and fees deduction: 2013
  - n Exclusion for loan forgiveness for qualified principal residence: 2013
  - n Itemized deduction for state and local general sales tax: 2013
  - n Itemized deduction for mortgage insurance premiums: 2013
  - n Energy-efficient home and appliance credits: 2013
  - n Tax free retirement distributions for charitable purposes: 2013

# American Taxpayer Relief Act

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- n Tax free retirement distributions for charitable purposes
  - n Extended for 2012 and 2013
  - n Must be over age 70½
  - n For 2012 Distributions:
    - n Distributions taken prior to December 2012 remain taxable distributions
    - n Distributions in December 2012 may be treated as qualified charitable distributions
      - § If transferred in cash to a qualifying organization before February 1, 2013
  - n For 2013 Distributions:
    - n Distributions from January 1 through January 31, 2013 may be deemed made in 2012
  - n Talk to your tax advisor
  - n Must act quickly!

# American Taxpayer Relief Act

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- n Extension of temporary business provisions: 2012 thru...
  - n 50% bonus depreciation extended: 2014
  - n S-corporation built-in gain recognition period of 5 years: 2013
  - n Research and development tax credit: 2013
  - n Work opportunity tax credit: 2013
  - n Increased Section 179 expensing
    - n \$500,000 limit on expensing of amounts extended to 2013
    - n \$25,000 limit on expensing of amounts after 2013

# American Taxpayer Relief Act

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Effective January 1, 2013

- n Marginal income tax rate increase

- n Brackets: 10%, 15%, 25%, 28%, 33%, 35%, & **39.6%**

- n New bracket applies to filers over certain taxable income thresholds:

- n \$450,000 for married individuals filing a joint return

- n \$400,000 for single individuals

- n \$225,000 for married individuals filing a separate return

- n Capital gain and qualified dividend tax rates increase

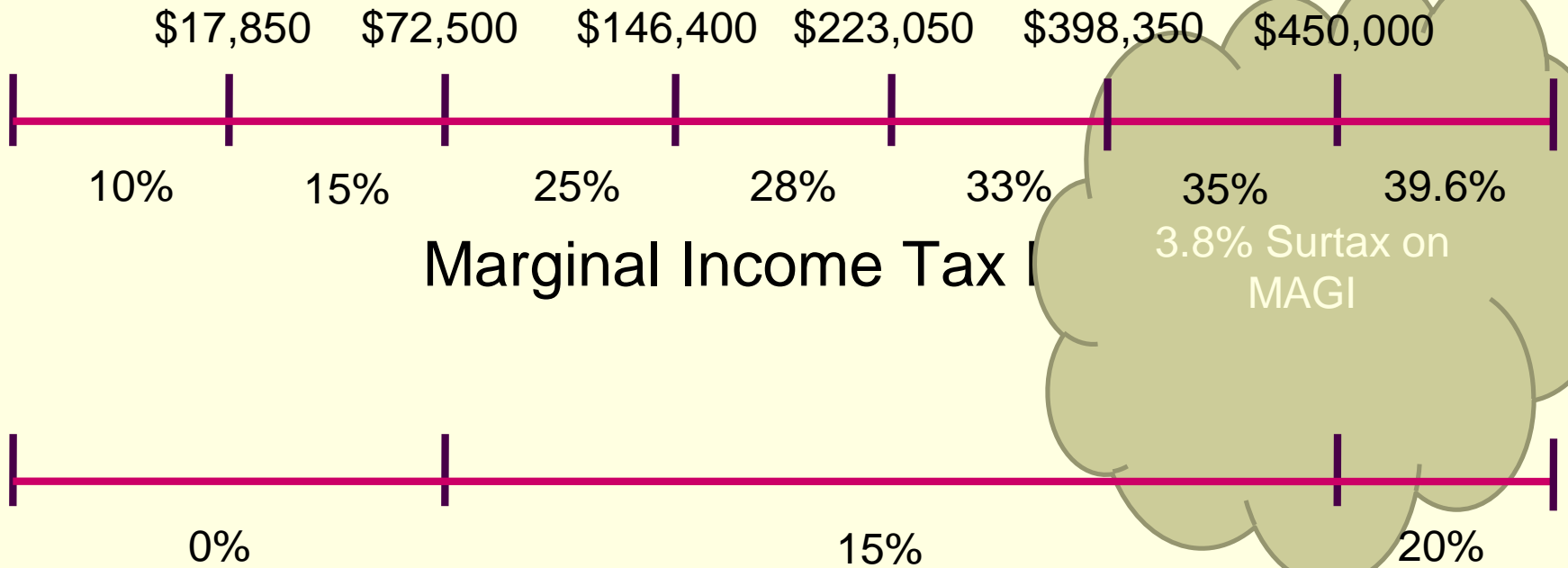
- n Capital gain and dividend rates: 0%, 15%, & **20%**

- n 20% rate applies to filers in the 39.6% marginal bracket



# American Taxpayer Relief Act

Married Filing Joint – 2013



## Capital Gain and Qualified Dividend Tax Rates

# American Taxpayer Relief Act

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- n New higher tax rate (39.6%) on high-income taxpayers
  - n Raises \$18 billion\* in new taxes for 2013; \$447\* billion over 10 years
  - n Projected FY 2013 deficit is \$901 billion
  - n Approximately 0.4% of filers affected by these rates
  - n Taxing the rich is a “fairness” issue; not a solution to the deficit/debt problem

\*Current policy baseline prior to ATRA assuming permanent extension of Bush tax cuts, AMT patch, and business tax extenders; includes increase in income tax rate to 39.6% and capital gains rates to 20%

# Additional Tax Issues

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- n Be aware of health insurance rebates received during 2012
  - n Must have been sent by July 31, 2012
  - n Estimated 92% of policyholders in Texas received rebates
  - n Includes Medi-Gap policies
  - n These rebates *may be* taxable

# Additional Tax Issues

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- n Business Use of Home deduction simplified
  - n Effective for 2014 calendar year
  - n Optional simplified calculation
  - n May elect a different method each year
  - n Simplified deduction capped at \$1,500
  - n Based on \$5 a square foot for up to 300 square feet
  - n No depreciation is permitted
  
- n Reduction in itemized deduction for medical expenses
  - n Beginning 2013 threshold is 10% of AGI (formerly 7.5%)
  - n Does not apply to individuals 65 or older until 2017

# Additional Tax Issues

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## n Charitable Deduction Substantiation

- n IRS disallows deductions for contributions that do not meet the substantiation requirements (*Durden*, TCM 2012-140)
- n For contributions of \$250 or more, contemporaneous written acknowledgement is required to substantiate the contribution
- n Receipt must state the amount contributed
- n Receipt must state “No goods or services were provided in consideration for the contribution” or identify the value of goods or services provided
- n For goods or services, receipt must provide a description and good faith estimate of the value of the goods or services determined by a qualified appraisal

# Additional Tax Issues

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- n 2013 inflation adjustments
  - n Social security wage base increased to \$113,700
  - n Social security benefits increased 1.7%
  - n Medicare Part B premium increased to \$104.90 per month
  - n Gift tax annual exclusion \$14,000
  
- n Payroll tax holiday has expired as of January 1, 2013
  - n Employee FICA rates went from 4.2% back to 6.2%

# The Patient Protection and Affordable Care Act

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- n “Obama Care” – who pays?
  - n 64% from individuals
  - n 36% from employers, health insurers, healthcare business
- n Taxes taking effect in 2013
  - n Medicare hospital insurance tax increase of 0.9% on earned income over threshold
    - n Wages, self-employment income
    - n \$250,000 for married individuals filing joint return, \$200,000 for single individuals

# The Patient Protection and Affordable Care Act

## n Taxes taking effect in 2013 (continued)

### n 3.8% surtax on lesser of:

#### n Net investment income

§ Interest, dividends, net capital gains, rent, royalties, passive activity income

§ Does not include: distributions from qualified retirement plans and IRAs, tax-exempt interest income, or Social Security benefits

OR

#### n AGI over threshold

§ \$250,000 for married individuals filing joint return, \$200,000 for single individuals

### n Limit flexible spending arrangement (FSA) annual contributions to \$2,500



# The Patient Protection and Affordable Care Act

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## n Taxes taking effect in 2014

- n Employer responsibility to offer full-time employees coverage
  - n Employers with less than 50 full-time employees on average are exempt
- n Premium-assistance credit
- n Shared responsibility payment

# American Taxpayer Relief Act

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## Estate implications

- n Estate/Gift/GST tax provisions made permanent
  - n Exemptions are indexed for inflation: \$5,250,000 for 2013
  - n Exemptions are unified
  - n 40% rate (from 35%) on taxable estate in excess of the exemption
  
- n Portability
  - n Made permanent
  - n Transfer of unused exemption to surviving spouse
  - n Elect by filing Form 706
  - n Extends statute of limitations on deceased spouse's Form 706

# American Taxpayer Relief Act

## Portability of Exemption

- n Husband dies in 2011 with \$3M taxable estate (\$5M exemption)
- n Form 706 Estate Tax Return filed for husband to elect portability
- n Wife now has \$7M exemption she may gift during her life or shelter from estate tax after her death

**Husband**

\$5 mil

Dies with  
\$3M assets

**Wife**

\$5 mil  
2 mil  

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\$7 mil

Portability  
of \$2M

**Estate**

Exemption \$5 mil

Used 3 mil

Remaining \$2 mil

# Estate Tax Planning

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- n Revise documents to consider new estate tax law
  - n Even if not subject to estate tax, old documents could result in unintended outcomes
  - n Flexibility is important
- n Check beneficiary designations and bank ownership records
- n Plan for real estate owned in another state to avoid need to probate
  - n Gift prior to death (drawback is carryover basis versus step-up)
  - n Transfer asset to an LLC
- n “Good things come to those who wait” is bad advice for estate tax planning

# What Lawmakers are Talking About

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- n “[T]he serious money needed to make appreciable changes in tax rates and the federal deficit will come about only if Congress takes a chain saw to the big five individual tax breaks: the exclusion for employer-provided health insurance, the mortgage interest deduction, the charitable deduction, the deduction for state and local taxes, and the 15 percent rate on capital gains and dividends.” Martin Sullivan, *Tax Analysis* (10/9/2012)
- n “At some point, tax reform demands that we have certainty and permanence.” Evan Liddiard, former tax policy advisor to Senate Finance Committee member Orrin Hatch, R-Utah (2/27/2012)

# What Lawmakers are Talking About

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- n Lowering corporate income tax rate
- n Subjecting some S-Corporation income to SE tax
- n Taxing “carried interests” at ordinary income tax rates
- n Taxing municipal bond interest
- n Tax Reform
  - n The so-called “Buffet Rule”
  - n Imposing a financial transaction tax (FTT) or financial activity tax (FAT)
  - n Enacting a consumption tax, or value-added tax (VAT)
  - n Enacting a pollution tax

# Tax Reform

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## n Cost of tax preparation and compliance to Americans

- n 6.1 billion hours each year, or
- n 3 million full-time workers, or
- n \$168 billion
- n 59% of individual taxpayers pay professionals to prepare returns
- n 30% of individual taxpayers purchase software to prepare returns

## n Current tax law statistics

- n 4,680 changes to the tax code since 2001, or more than 1 daily on average
- n The tax code is nearly 4 million words long, or about 5x length of the Bible

# Outlook

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- n How Do We Fix the Debt and Deficit Crisis?
  - n Long-term solution
  - n Shared sacrifice
  - n Adopt “War on Debt” mindset; Top priority
  - n Spiritual/Moral renewal
    - n Personal responsibility
    - n Everyone contributes to society
    - n Assist the poor and helpless (outside of government)
  - n Spending reductions (including entitlements)
  - n Tax increases
  - n Congressional reform (budget process)
  - n Tax reform (fairness and simplicity)



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# Questions?

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