

THE IMPLICATIONS IF THE BUSH-ERA TAX CUTS EXPIRE

Congress should vote to extend them ... but what if it doesn't?

Provided by Renita M. Owens, CPA, PFS

As 2010 draws to a close, Congress will likely act to extend the Bush-era tax cuts into 2011 or beyond. However, this is the same Congress that has done nothing about the estate tax for a year. So let's play "what if" for a moment. What if we witness an "epic fail" on Capitol Hill and the EGTRRA and JGTRRA cuts disappear?

How would the middle-class tax burden increase? Deloitte Tax LLP (a tax advisory firm) and CCH (a tax software and publishing firm) ran some numbers and came up with some model scenarios. They aren't pretty.

According to the Deloitte projections, a typical family of four earning \$50,000 would see its tax bill jump by about \$2,900 in 2011. CCH estimates that the average married couple with two kids would suffer a \$2,143 income tax increase. As for single taxpayers, Deloitte figures that a single filer earning \$50,000 in 2011 would pay about \$1,100 more to the IRS if the cuts expire.¹

These projections clearly show why the Obama administration favors preserving the cuts for the middle class, even in light of the staggering federal deficit.

If the Bush-era tax cuts sunset, the "marriage penalty" will return in 2011 with the shrinking of the 15% tax bracket. The child tax credit will also be cut in half from \$1,000 to \$500. These two factors alone would account for much of the above tax increases.¹

Don't panic just yet, because the average tax rate for a middle-class family is really much lower. As the *Wall Street Journal* noted earlier this year, a middle-income family usually ends up paying less than 10% of its gross income in federal income tax after deductions and exemptions according to the IRS.²

What would happen for the wealthy? The 33% and 35% tax brackets would rise to 36% and 39.6% next year if taxes reset to Clinton-era levels. This would affect only about 4% of taxpayers - notably, the ones most influential in job creation.^{2,3}

An analysis from the Joint Committee on Taxation finds that taxpayers with gross incomes above \$1 million would get an average tax cut of about \$6,300 in 2011 should the Bush-era cuts expire. That is peanuts compared to the \$100,000 average tax cut the JCT says they would get if the Bush-era cuts were extended. As for taxpayers whose gross incomes fall between \$500,000 and \$1 million, they would get an average tax cut of about \$6,700 in 2011 without the EGTRRA/JGTRRA extension, compared to about \$17,500 with the Bush-era tax cuts in place.^{2,3}

Capital gains rates would go up. Investors in the 10% and 15% brackets don't have to pay taxes on long-term capital gains in 2010, but a 10% capital gains tax would return for them in 2011. The rest of us would see capital gains taxes rise from 15% to 20%.⁴

So would estate tax rates. If the Bush-era tax cuts aren't preserved, estate tax rates will go back to 2001 levels - that means a 55% tax on individual estates greater than \$1 million (\$2 million for married couples). The non-profit Tax Policy Center estimates that if the exemption drops to \$1 million next year, it will force seven times as many estates to file estate tax returns in 2011 as in 2009. The TPC figures that 44,000 estates will pay tax next year if we go back to the 2001 limits, compared to just 5,500 in 2009.⁵

You might see a temporary tax hike - even if lawmakers act in time. The IRS finalizes its withholding tables for the coming tax year in November of the current year. This gives employers enough lead time to integrate the information into paycheck withholding systems.

Well, guess what: November is almost over and the IRS still has no answer from Congress on income taxes. So the IRS could direct employers to increase paycheck deductions starting on January 1, as the withholding tables must be based on the present tax law which states that the EGTRRA and JGTRRA cuts will vanish in 2011.¹

You may want to adjust your withholding on that first paycheck or two of 2011. If an EGTRRA and JGTRRA extension is approved in December, your paychecks may be smaller until new withholding tables are implemented. Congress should have known better: with consumer spending so fragile, this was not a good time to take a bite out of after-tax income.^{1,6}

Renita M. Owens, CPA, PFS may be reached at (864)233-4163 or renita@cpawork4u.com or www.cpawork4u.com.

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Citations

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