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Re: 2011 Mid-Year Tax Update

Dear Clients, Colleagues, and Friends:

This Newsletter has two parts. It begins with a discussion of what may be on the horizon for U.S. taxation. The second section lists some tax benefits that are scheduled to expire in 2011 and 2012. Taxpayers may want to capitalize on them while they exist.

With Congress and the President working on deficit reduction through spending cuts and talk of revenue increases, there is little consensus on the best approach. However, the "Gang of Six", which is a group of three Democrat and three Republican Senators, including Oklahoma's Tom Coburn, who was an original member, has achieved some bipartisan support with their tax suggestions. They are proposing the following:

- A single corporate tax rate between 23% and 29% and shift to a competitive territorial tax system.
- Tax simplification that involves reducing the number of tax expenditures (i.e., tax breaks) and reducing individual tax rates. There would be three tax brackets with rates in the range of 8%–12%, 14–22%, and 23%–29%. To the extent future Congresses find that the dynamic effects of tax reform result in additional revenue beyond initial targets, this revenue would go to additional rate reductions and deficit reduction, not to new spending.
- Permanent repeal of the alternative minimum tax (AMT).
- Reform, rather than elimination, of tax breaks for health, charitable giving, homeownership, and retirement.
- Retention of the earned income tax credit and child tax credit, or creation of an alternative that would provide at least the same level of support for qualified beneficiaries.

Time will tell us if U.S. taxation moves toward the "Gang of Six's" proposal. An interesting observation about their plan is that it is Reaganesque. Ronald Reagan's 1986 tax code overhaul had similar characteristics. In 1986 tax rates were lowered, many deductions were eliminated, and some tax simplification was achieved.

As the years passed though, ordinary rates were increased, favorable capital gains rates were enacted and many deductions and credits crept back into the tax code leaving us today with a

complex set of tax laws. In fact, just in the last couple of years several nice benefits have been enacted increasing the complexity of the tax code. Some of those provisions are scheduled to expire soon, so now may be a good time to consider if your circumstances warrant taking advantage of those benefits. The remaining portion of this Newsletter lists seven of them.

Some Tax Benefits Scheduled to Expire in 2011 or 2012

√ Most new business assets qualify for "bonus depreciation." The bonus depreciation rules are: (1) 100% of the cost of qualified property placed in service after Sept. 8, 2010 and before Jan. 1, 2012 can be written off in the first year; and (2) 50% of the cost of qualified property placed in service during 2012 can be written off in year #1. There are exceptions for what assets qualify. For example, among other restrictions, many *used* assets do not qualify.

√ Similar to bonus depreciation is Sec. 179 asset expensing. Sec. 179 can be more beneficial than bonus depreciation in some cases. For example, most *used* assets qualify for Sec. 179 and Sec. 179 has a tendency to save depreciation deductions for profitable years. For tax years 2010 and 2011 the dollar limitation on the Sec. 179 asset expense deduction is $500,000 as long as your total qualified assets placed in service do not exceed $2,000,000; when a business spends over $2,000,000 on qualified assets, Sec. 179 expensing starts phasing out; **f**or 2012 the maximum Sec. 179 expensing amount is $125,000 with a phase-out starting at $500,000.

√ In 2011 and 2012 passenger automobiles will enjoy first year depreciation deductions of up to $11,060 compared to $3,060 beginning in 2013 if the tax laws do not change. Light trucks and vans are subject to similar rules.

√ Currently, the favorable "Indian" depreciation that most Oklahoma businesses have enjoyed for many years will expire at the end of 2011. The Indian depreciation has not been as advantageous lately due to bonus depreciation and the high thresholds for Sec. 179. But, most real estate will not qualifying for Sec. 179 or bonus depreciation. However, some real estate does qualify for Indian deprecation. Thus, purchasing commercial real estate in 2011 vs. 2012 may be beneficial.

√ Although this is complex, the rules against collapsible corporations have been repealed through 2012. These rules denied capital gain treatment for shareholders' gains from the liquidation (or sale of stock) of their corporation where the profit was attributable to ordinary income assets of the corporation.

√ Taxpayers who are age 70½ or older can make tax-free distributions to a charity from an Individual Retirement Account (IRA) of up to $100,000. These distributions aren't subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer's return. This rule is scheduled to expire 12-31-11.

√ For 2011 taxpayers may elect to deduct state and local sales and use taxes instead of state and local income taxes. This can be beneficial for taxpayers living in states without an income tax and/or for taxpayers thinking about large consumer purchases (boats, planes, cars, etc.) in either 2011 or 2012. It may be beneficial to make the purchase in 2011 instead of 2012.