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Taxmageddon: Massive Tax Increase Coming in 2013

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If President Obama and Congress fail to act this year, an enormous, unprecedented tax increase will fall on American taxpayers starting on January 1, 2013. *The Washington Post* called the looming tax increase "Taxmageddon,"[1] and Federal Reserve chairman Ben Bernanke called it a "massive fiscal cliff."[2]

This impending tax increase is mostly the result of the expiration of many long-standing policies that all expire at the end of 2012. President Obama and Congress should start working together now to prevent this massive tax increase rather than waiting until the end of the year. That would assure families, businesses, and investors that their taxes will not rise sharply as the economy is still staggering to its feet and show the voters that Washington really can get important things done—even in an election year.

This paper, in its entirety, can be found at
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Taxmageddon Is Huge

Taxmageddon is a $494 billion tax increase that strikes at the beginning of 2013. Under current law, tax policies in seven different categories will expire, and five of the 18 new tax hikes from Obamacare will begin.

These tax hikes will raise $494 billion in 2013 but will remain in place unless President Obama and Congress stop them. Taxpayers would see even bigger tax hikes in succeeding years as the tax increases raise more revenue as the economy grows.

Although these tax increases will not start raising new revenue until next year, they are having a negative impact on the economy today. Families, businesses, and investors need to know how much tax they will pay in the future before making important economic decisions. The uncertainty caused by Taxmageddon means they are stuck in neutral while they wait for President Obama and Congress to act. This is slowing job creation and stopping many of the millions of unemployed Americans from going back to work.

A tax increase the size of Taxmageddon for just one year is simply unprecedented. Usually tax and budget policies are evaluated on estimates over 10 years. A 10-year tax increase of Taxmageddon's magnitude would be off the charts. By comparison, all the tax increases in Obamacare—itself an enormous tax increase—raise $502 billion over 10 years, which is almost as much as Taxmageddon will increase taxes just in 2013.

Taxmageddon's Sources

Almost 34 percent of the tax increase from Taxmageddon comes from the expiration of the 2001 and 2003 Bush tax cuts. These cuts are best known for reducing marginal income tax rates, but they also reduced the marriage penalty, increased the Child Tax Credit and the adoption credit, and increased tax breaks for education costs and dependent care costs.

Another 25 percent of Taxmageddon comes from the expiration of the once-temporary payroll tax cut. The expiration of the patch on the Alternative Minimum Tax (AMT)—which would raise the income threshold over which families qualify for the AMT to prevent middle-income families from paying this tax that is only supposed to impact "the rich"—accounts for 24 percent of the total potential 2013 tax increase.

TABLE 1

Taxmageddon: $494 Billion Tax Increase Is Coming

These tax hikes will occur if President Obama and Congress do not act before the end of the year.

FIGURES ARE IN MILLIONS

TAX POLICIES SET TO EXPIRE ON JANUARY 1, 2013	TAX INCREASE IN 2013
Bush tax cuts	$165,750
Payroll tax cut	$124,636
Alternative Minimum Tax (AMT) patch	$118,750
Tax cuts from 2009 stimulus	$20,876
Tax extenders	$20,465
Death tax at 35 percent with $5 million exemption	$13,000
100 percent expensing for business investment	$7,695
TAX POLICIES SET TO BEGIN ON JANUARY 1, 2013	**TAX INCREASE IN 2013**
Tax hikes in Obamacare	$22,750
Total	**$493,922**

Sources: U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2013* (Washington, D.C.: U.S. Government Printing Office, 2011), at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf (accessed March 28, 2012); Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Jobcreation Act of 2010,'" December 10, 2012, at http://www.jct.gov/publications.html?func=startdown&id=3715 (accessed March 28, 2012).

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The remaining tax increases come in part from Obamacare, notably the start of the Hospital Insurance 3.8 percent surtax on wages and salaries over $250,000 and investment income over that amount. This is the most economically damaging tax in the law and the one that raises the most revenue.

Then there is the expiration of the tax cuts contained in the 2009 stimulus and the expiration of the "tax extenders," a group of about 50 tax policies that are regularly renewed for a year or two. The current policy on the death tax also expires in 2013. That means the rate will rise from 35 percent today to 55 percent and the exemption will fall from $5 million to $3.5 million.[3] The expiration of full expensing of new business capital investments (deducting the full cost at the time of purchase) rounds out Taxmageddon.

Table 1 lists the revenue each category of tax hikes would raise just in 2013. The appendix lists each separate tax policy that falls under each category that expires or begins in 2013.

Act Soon

Congress and President Obama have developed a penchant for waiting until the very last minute to act on pressing tax legislation. In 2010, they waited until late December to extend the expiring Bush tax cuts for two years. At the end of 2011, they waited again until late December to extend the expiring payroll tax holiday. They should break themselves of this bad habit.

Instead, Obama and Congress should remove the uncertainty clouding jobs and family finances by removing the threat of Taxmageddon now. Businesses, families, and investors need to know as soon as possible that this massive tax increase will not hit them as they awaken on New Year's Day 2013.

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1. Lori Montgomery, "'Taxmageddon' Looms at End of Payroll Tax Holiday," *The Washington Post*, February 18, 2012, at http://www.washingtonpost.com/business/economy/end-of-payroll-tax-holiday-sets-up-harder-hit-for-taxpayers/2012/02/16/gIQAnxqTMR_story.html (accessed March 14, 2012).
2. Peter Schroeder, "Bernanke Warns Lawmakers Country Headed for 'Massive Fiscal Cliff,'" *The Hill*, February 29, 2012, at http://thehill.com/blogs/on-the-money/801-economy/213351-fed-boss-warns-of-massive-fiscal-cliff (accessed March 14, 2012).
3. A repeal of the death tax starting in 2010 was part of the 2001 Bush tax cuts. The law that extended all the other Bush tax cuts for 2011 and 2012 undid the repeal of the death tax and set it at its current 35 percent rate with a $5 million exemption. Because the death tax policy was changed from the original Bush tax cuts, it is treated separately.

TABLE 2

Tax Relief Policies from Bush Tax Cuts Set to Expire

EXPIRING POLICIES	TAX INCREASE IN 2013
Marginal rate reductions: • 39.6 percent bracket reduced to 35 percent • 36 percent bracket reduced to 33 percent • 28 percent bracket reduced to 25 percent • 31 percent bracket reduced to 28 percent	$56 billion
10 percent bracket created	$37 billion
Capital gains rate reduced from 20 percent to 15 percent Dividends tax rate reduced from 39.6 percent to 15 percent	$29 billion
Eliminate exemptions and itemized deductions for high-income taxpayers (PEP and Pease)	$9 billion
Marriage penalty reductions	$17 billion
Child Tax Credit increased from $500 to $1,000	$6 billion
EITC expansion Coverdell Education Savings Accounts increase Employer-provided educational assistance increase Student loan interest deduction increase Eliminate taxation of scholarships Reduce tax on bonds for school construction Dependent care tax credit increase Adoption credit increase Employer-provided child care credit increase Alaska Native Settlement Trusts changes	$12 billion
Total	**$166 billion**

Sources: Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Jobcreation Act of 2010,'" December 10, 2012, at http://www.jct.gov/publications.html?func=startdown&id=3715 (accessed March 28, 2012).

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APPENDIX TABLE 1

Breakdown of Taxmageddon

CATEGORY	POLICY EXPIRING JANUARY 1, 2013
Bush Tax Cuts	
Marginal rate cuts	39.6 percent rate cut to 35 percent; 36 percent to 33 percent; 31 percent to 28 percent; 28 percent to 25 percent; 10 percent bracket created.
Capital gains and dividends rate increase	Capital gains cut from 20 percent to 15 percent; dividends from 39.6 percent to 15 percent.
Personal exemption phase-out and limitation of itemized deductions	PEP and Pease.
Child tax credit	Increased from $500/child to $1,000.
Marriage penalty	Brackets doubled for all married filers; standard deduction doubled for married filers.
ALL OTHER BUSH TAX CUTS	
EITC modification	Increase in joint returns beginning and ending income level for phase-out by $5,000 indexed after 2008.
Coverdell Education Savings Accounts	Increase annual contribution limit to $2,000 and other expansions.
Employer-provided educational assistance	Extend the exclusion for undergraduate courses and graduate level courses.
Student loan interest deduction	Eliminate the 60-month rule and the disallowance for voluntary payments; increase phase-out ranges to $50,000-$65,000 single/$100,000–$130,000 joint.
Taxation of scholarships	Eliminate the tax on awards under the National Health Service Corps Scholarship program and F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program.
Tax treatment of bonds for school construction	Increase arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million; issuance of tax-exempt private activity bonds for qualified education facilities with annual state volume caps, the greater of $10 per resident or $5 million.
Dependent care tax credit	Increase the credit rate to 35 percent, increase the eligible expenses to $3,000 for one child and $6,000 for two or more children and increase the start of the phase-out to $15,000 of adjusted gross income (AGI).
Adoption credit	Increase the expense limit and the exclusion to $10,000 for both non-special needs and special needs adoptions, make the credit independent of expenses for special needs adoptions, extend the credit and the exclusion, increase the phase-out start point to $150,000, and allow the credit to apply to the Alternative Minimum Tax (AMT).
Employer-provided child care credit	25 percent for child care expenditures and 10 percent for child care resource.
Alaska Native Settlement Trusts	Allow electing Alaska Native Settlement Trusts to tax income to the trust, not the beneficiaries.
Payroll Tax	Employees' portion of Social Security payroll tax reduced from 6.2 percent to 4.2 percent.
Alternative Minimum Tax (AMT)	Patch to raise income threshold over which taxpayers are subject to AMT so it does not impact middle-income taxpayers.
Stimulus Tax Cuts	
American Opportunity Credit	Refundable tax credit for higher education expenses.
Expand Child Tax Credit	Reduce the earnings threshold for the refundable portion of the child tax credit to $3,000.
Expand EITC	Increase the credit's percentage and increase in joint returns beginning and ending income level for phase-out by $5,000 indexed after 2008.
Tax Extenders	
ENERGY	
Incentives for biodiesel and renewable diesel	Income tax credits for producing biodiesel mixture, biodiesel, and agri-biodiesel.
Credit for refined coal facilities	$6.27/ton income tax credit for the production of refined coal.

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APPENDIX TABLE 1

Breakdown of Taxmageddon (continued)

CATEGORY	POLICY EXPIRING JANUARY 1, 2013
Tax Extenders (continued)	
ENERGY (continued)	
Credit for construction of energy-efficient new homes	Up to $2,000 credit for contractors constructing energy-efficient new homes.
Incentives for alternative fuel and alternative fuel mixtures	$0.50/gallon for selling alternative fuels and $0.50/gallon for producing an alternative fuel mixture.
Special rule to implement electric transmission restructuring	Delay of income recognition from sale of electric transmission transactions.
Suspension of limitation on percentage depletion for oil and gas marginal wells	Allows owners of wells to deduct more than 100 percent of their net income from a marginal well for depletion.
Grants for specified energy property in lieu of tax credits	Taxpayers can elect to receive a grant instead of a credit for property put in place to produce renewable electricity.
Provisions related to alcohol used as fuel	Income and excise tax credits for the production and purchase of ethanol.
Credit for energy-efficient appliances	Income tax credit for producers of energy-efficient dishwashers ($45–$75/unit), clothes washers ($75–$250/unit), and refrigerators ($50–$200/unit).
Credit for improving the energy efficiency of a home	30 percent credit for the purchase of energy-efficiency improvements to a home's envelope, including insulation, exterior windows, and roofing materials.
Alternative fuel vehicle refueling property	30 percent income tax credit for the cost of installing clean-fuel vehicle refueling property to be used in a business or at a home.
PROVISIONS FOR INDIVIDUALS	
$250 deduction for teacher classroom expenses	Educators can deduct up to $250 for books, supplies, computer equipment and other materials used in the classroom.
Deduction for state and local sales taxes	Taxpayers can choose to deduct their state and local sales taxes instead of their state income taxes—mostly used by taxpayers living in states without an income tax.
Contribution of capital gain real property made for conservation purposes	Removes the limitation on deductions for income, estate, and gift taxes for charitable contributions of appreciated property for the purpose of conservation.
Deduction for qualified tuition and related expenses	Deduction for higher education tuition and expenses.
Tax-free distributions from IRAs to charities	Withdrawals from traditional IRAs are usually taxable because the taxpayer did not pay tax on the income before contributing it to the IRA. This provision allows taxpayers to deduct charitable donations made with funds from their IRAs the same had they made the donation before putting their income in an IRA.
Look-thru for certain regulated investment company stock in determining gross estate for nonresidents	Allows estates of nonresidents who pass away to remove from their estates the portion of assets held outside the U.S. within regulated investment corporations.
Parity for exclusion from income for employer-provided mass transit and parking benefits	Employers can provide up to $120/month to employees tax free for mass transit and bicycling costs and $230/month for parking. As part of the stimulus, the exclusion from income for mass transit was raised to equal the parking exclusion ($230/month).
Refunds disregarded in the administration of federal programs and federally assisted programs	Refundable tax credits are not considered in a person's income when applying for welfare programs.
PROVISIONS FOR BUSINESSES	
Research and experimentation credit	A 20 percent credit for research expenses.
Indian employment tax credit	A credit for employers that hire an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe.
New markets tax credit	Credit for equity investment in a corporation whose mission is providing investment capital for low-income communities.

APPENDIX TABLE 1

Breakdown of Taxmageddon (continued)

CATEGORY	POLICY EXPIRING JANUARY 1, 2013
Tax Extenders (continued)	
PROVISIONS FOR BUSINESSES (continued)	
Railroad track maintenance credit	50 percent credit for railroad track maintenance costs.
Mine rescue team training credit	Credit for amount paid to mine rescue team employees.
Employer wage credit for activated military reservists	A credit of 20 percent for employers of the amount above their employees' military earnings they pay them while they are on active duty.
15-year straight-line cost recovery for qualified leasehold, restaurant, and retail improvements and new restaurants	Allows businesses to deduct from income investment in restaurant and retail properties over 15 years rather than the 39 years under standard depreciation rules.
Seven-year recovery period for certain motorsports racing track facilities	Allows motorsports entertainment complexes to deduct from income investment in property over seven years rather than the 39 years under standard depreciation rules.
Accelerated depreciation for business property on an Indian reservation	Allows businesses on Indian reservations to deduct from income investments in property (not related to gaming) faster than under standard depreciation schedules.
Enhanced charitable deduction for contributions of food inventory	Extends to all businesses that donate food from inventory to charitable organizations a deduction greater than the business's cost for the items donated.
Enhanced charitable deduction for contributions of book inventories to public schools	Extends charitable deduction of books from inventory to include public schools.
Enhanced charitable deduction for corporate contributions of computer inventory for educational purposes	Allows businesses that donate computers to charitable organizations a deduction greater than their cost for the computer items donated.
Election to expense mine safety equipment	Allows businesses to immediately expense 50 percent of the cost of mine safety equipment.
Special expensing rules for certain film and television productions	Allows taxpayers to deduct the cost of film and television production immediately rather than over a number of years.
Expensing of environmental remediation costs	Provides immediate expensing for environmental remediation expenditures.
Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico	Extends the domestic manufacturing production credit to income earned from sales in Puerto Rico.
Modify tax treatment of certain payments to controlling exempt organizations	Pertains to the tax treatment of non-taxable businesses. Income unrelated to an exempt organization's mission is generally taxable. Interest, rents, royalties, and annuities are usually excluded, however, unless they are paid by a controlled subsidiary (taxable or non-taxable). This provision alters that to make such payments taxable only to the extent the payment exceeds what the payment would have been had it been between two unrelated businesses.
Treatment of certain dividends of regulated investment companies	Foreigners holding investments in the U.S. through regulated investment companies (RIC) are exempt from tax on dividends earned through the RIC from interest and short-term capital gains.
Extend the treatment of RICs as "qualified investment entities"	Provision insures that foreigners holding investments in the U.S. through RICs are exempt from tax on real property interests held in RICs.
Exception under subpart F for active financing income	Exempts from current tax active foreign-source income earned from banking, financing, insurance, or other similar business that would otherwise qualify for immediate tax under subpart F income rules.
Look-thru treatment for payments between related controlled foreign corporations under foreign personal holding company rules	Exempts from current tax dividends, interest, rents, and royalties received by one controlled foreign corporation from another controlled foreign corporation.
Basis adjustment to stock of S corporations making charitable contributions of property	Allows shareholders of S corporations to reduce their share value by the adjusted basis of property donated to a charity rather than the property's fair market value.
Empowerment zone tax incentives	Employment tax credit, accelerated depreciation, tax-exempt bond financing, and deferral or exclusion of capital gains tax for businesses that operate in federally designated empowerment zones.
Tax incentives for investment in the District of Columbia	Employment tax credit, accelerated depreciation, tax-exempt bond financing, and deferral or exclusion of capital gains tax for businesses that operate in federally designated areas of the District of Columbia.