



## Manufacturers' Association of South Central Pennsylvania

September 20, 2010

Dear MASCPA Members and Friends,

Our federal tax laws are entering a period of significant change. Many tax cuts originally signed into law by President Bush are scheduled to expire at the end of 2010, and President Obama's economic stimulus bill, health care reform bill, and proposed budgets are also likely to impact the federal income taxes you will pay, now and in the future. We understand that these changes can be confusing, and we want to assist you to be able to prepare for them in advance.

With the assistance of Stambaugh Ness, PC, Certified Public Accountants, an Associate Member of the MASCPA, we have compiled the attached charts to outline some of the most significant Federal tax changes that are anticipated. The objectives of these charts are to describe the current law, describe how the law may change in the future, and analyze the potential impact of the change.

Many of these tax issues have yet to be finalized and will ultimately be decided by Congressional action over the next year. If Congress fails to act, many Americans could see significant tax increases next year and in the years to come. Be sure to make your vote count in the November elections, and contact your Congressmen to let them know how you feel about these tax issues and other issues facing our manufacturing industry.

While this economy struggles to regain any sustained momentum, increasing taxes on investors and working Americans could drive the economy into a tailspin for years to come. The time for Congress and President Obama to act is now! Extend the current tax rates for an additional ten years.

Sincerely,

Michael Smeltzer  
Executive Director, MASCPA

## TAX LAW CHANGES ARE COMING – ARE YOU READY?

TAX LAW CHANGES FOR BUSINESSES			
Issue	2010 Tax Year	Status for 2011	Outlook
Section 179 Deduction	Businesses that purchase \$800k or less in qualifying equipment can treat \$250k of the value as an expense (deduction) for tax purposes rather than deducting it through depreciation over time.	Without action from Congress, the Section 179 limits will be reduced to \$25,000, with the dollar for dollar phase-out starting at \$200,000 in qualifying purchases.	President Obama's 2011 budget proposes a limit of \$125k for businesses who purchase \$500k or less in qualifying equipment. Congress waited until March 18, 2010, to establish the limits for 2010, so the actual limits for 2011 may not be determined until sometime in 2011.
Bonus Depreciation	For qualifying equipment purchases in 2009, businesses could immediately deduct 50% of the purchase price as depreciation.	Bonus depreciation has not been extended to 2010 or 2011.	The National Association of Manufacturers (NAM) has urged Congress to extend bonus depreciation, describing it as "a proven incentive for manufacturers of all sizes to invest in new, more efficient equipment, stimulating much-needed economic growth and job creation."
LIFO	Businesses can elect to use the Last-In First-Out method of accounting for inventory. When inventory costs are rising, it helps to defer income taxes by expensing the newer, more expensive items rather than the older, less expensive items.	Congress is considering a LIFO repeal that would disallow the use of LIFO and require businesses currently using LIFO to write up their beginning LIFO inventory to its FIFO value in the first taxable year beginning after December 31, 2011.	This could significantly impact manufacturers. In a recent survey by NAM of small and medium-sized manufacturers, approximately 80 percent of respondents indicated they use LIFO. President Obama's proposal would allow the one-time increase in gross income resulting from the FIFO conversion to be pro-rated over the ten years beginning after January 1, 2012.
Research & Experimentation Tax Credit	Firms can elect to use one of several allowable methods to receive a tax credit for having qualified research expenses.	The R&E credit will expire if Congress does not take action to extend the credit or make it permanent.	Since its enactment as a temporary provision in 1981, the research and experimentation (R&E) tax credit has been extended, with modifications, fourteen times. Obama's current 2011 budget proposal would make the credit permanent.
HIRE Act	Employers who hire unemployed workers after 2/3/10 and before 1/1/11 may qualify for a 6.2% payroll tax credit. If those employees are retained for at least a year, the business may qualify for an additional credit of \$1,000 per employee.	The provisions of the HIRE Act only apply to 2010. Congress would need to act in order to extend the benefits.	The HIRE Act is aimed at providing hiring incentives to restore some of the jobs lost in the latest economic recession. The goal is to help put Americans back to work as soon as possible. Business owners that hire qualifying workers sooner rather than later will get the most out of the tax credits, as the tax credits diminish over time, disappearing completely by January 1, 2011.



## TAX LAW CHANGES FOR INDIVIDUALS

Issue	2010 Tax Year	Status for 2011	Outlook
Personal Income Tax Rates	<p>The tax cuts enacted in 2001 are still in effect:</p> <p>Top bracket – 35% Fifth bracket – 33% Fourth bracket – 28% Third bracket – 25% Second bracket – 15% First bracket – 10%</p>	<p>If Congress takes no action, the 2001 tax cuts will expire and the tax rates will be:</p> <p>Top bracket – 39.6% Fifth bracket – 36% Fourth bracket – 31% Third bracket – 28% Second bracket – 15% First bracket – N/A</p>	<p>In his 2011 budget proposal, President Obama has proposed allowing the tax cuts to expire only for higher-income taxpayers (\$200k+ single, \$250k+ joint filers). Under this plan, the current 33% and 35% tax brackets would increase to 36% and 39.6%, and all other brackets would remain unchanged from 2010.</p>
Capital Gains and Qualified Dividends	<p>Taxpayers in the 10% or 15% brackets pay 0%. All other taxpayers pay 15%.</p>	<p>If the 2001 and 2003 tax cuts are allowed to expire, capital gains will be taxed at 10% and 20% instead of 0% and 15%, and qualified dividends will be taxed as ordinary income (see rates above).</p>	<p>President Obama's 2011 budget proposal contains a rate of 20% for higher-income taxpayers and 15% for everyone else. If rates are increased, some businesses may consider accelerating dividend payments into 2010 while the lower rates are still in effect.</p>
Marriage Penalty	<p>The standard deduction for joint filers is twice the deduction for single filers. Some tax brackets for joint filers are twice as wide as for single filers, while others are narrower.</p>	<p>If the marriage penalty relief enacted in 2003 is not extended, the standard deduction for joint filers will only be 1.67 times as large as the deduction for single filers and all tax brackets would be narrower for joint filers.</p>	<p>Many married couples, particularly those with only one wage earner, actually receive a marriage "bonus" and pay less tax jointly than they would separately. The marriage penalty is generally largest when both spouses have equal incomes.</p>
Estate Tax	<p>There is no federal estate tax during 2010.</p>	<p>Without Congressional action, the estate tax reverts to its 2001 status in 2011, with estates greater than \$1 million subject to tax rates up to 60 percent.</p>	<p>President Obama is considering making the 2009 law permanent, which would tax 45% of the estate value over \$3.5MM. George Steinbrenner's estate is estimated to have saved as much as \$500 million in estate tax due to his death during this year of estate tax hiatus, which has drawn attention to the subject.</p>
Gift Tax	<p>Gift tax is currently assessed at the highest individual income tax rate (35%), and the first \$1,000,000 is exempt.</p>	<p>In 2011 and beyond, the gift tax rate will increase to 55%, unless changed by Congress.</p>	<p>President Obama's 2011 budget proposal would cap the gift tax rate at 45%.</p>



## TAX LAW CHANGES FOR INDIVIDUALS - continued

Issue	2010 Tax Year	Status for 2011	Outlook
Tax Credits	<p>Child Tax Credit - \$1,000 per child</p> <p>American Opportunity Tax Credit (replaced the Hope Credit for education) - \$2,500 per year</p>	<p>Unless a new law is passed, the child tax credit will automatically decrease to \$500 per child and the American Opportunity Tax Credit will revert to the Hope Credit.</p>	<p>President Obama's 2011 budget proposal would keep the Child Tax Credit at \$1,000 per child and permanently extend the American Opportunity Tax Credit.</p>
Alternative Minimum Tax	<p>Congress has not yet passed a one-year "patch" to raise the AMT exemption amount for 2010 like it has in previous years.</p>	<p>The AMT exemption amounts are not indexed for inflation, so without action, the amounts would revert to the original 1993 levels.</p>	<p>The Congressional Budget Office estimates that 27 million taxpayers will be subject to AMT this year if it is not patched, up from 4 million in 2009. However, Congress has passed 7 temporary AMT patches since 2001 to keep the exemptions in line with inflation, and Obama's 2011 budget proposal would make the 2009 AMT parameters permanent and index them for inflation.</p>
Elimination of Phase Outs	<p>The personal exemption and the amount of itemized deductions are not subject to phase-out as taxpayers reach income thresholds.</p>	<p>Unless a new law is passed, the phase-outs will return and higher-income taxpayers may receive reduced personal exemptions and reductions in itemized deductions.</p>	<p>Under President Obama's proposal, higher-income taxpayers would see their itemized deductions reduced in 2011 by 3 percent of their income over \$203,850 (for single filers; the threshold would be \$254,850 for couples filing jointly) but not by more than 80 percent. Personal exemptions, which are now worth \$3,650, could be reduced by up to 1/3 for the highest earners.</p>



## TAX LAW CHANGES UNDER HEALTH CARE REFORM

Issue	2010 Tax Year	Under Health Care Reform	Impact
Over-the-counter Medications	Pre-tax dollars can be used to purchase certain over-the-counter medications via qualified savings and spending accounts.	Effective January 1, 2011, qualified medical expenses will only include medications that are prescribed.	Because these plans are not subject to federal, state or FICA taxes, a family that spends \$500 per year on non-prescription, over-the-counter drugs and has a 28% marginal Federal tax rate will pay an approximately \$200 more in taxes next year.
Flexible Spending Accounts	Flexible spending account limits are established at the discretion of each plan, not by the government.	Effective January 1, 2013, the maximum amount available for reimbursement under a flexible spending account will be \$2,500.	Because these plans are not subject to federal, state or FICA taxes, a family that had been contributing \$5,000 to a flexible spending account with a 28% marginal Federal tax rate will pay an approximately \$1,000 more in taxes next year.
Medicare Tax	Employers and employees must pay 1.45% of covered wages in Medicare taxes.	Effective January 1, 2013, taxpayers will pay an additional 0.9% on the wages that exceed the threshold (\$200k+ single, \$250k+ joint).	A couple filing jointly with \$300,000 wages subject to Medicare tax would pay an additional \$450 in Medicare taxes under the new rules.
Medicare Tax on Net Investment Income	There is no such tax.	Effective January 1, 2013, taxpayers will be assessed a 3.8% surtax on the lesser of their net investment income or the excess of their modified adjusted gross income over a threshold.	The threshold will be \$200,000 for single filers and \$250,000 for joint filers. Taxpayers under these thresholds will not be affected. For example, if a couple filing jointly had \$300,000 in MAGI with \$100,000 in business income, they would pay 3.8% x \$50,000 (\$300k income - \$250k threshold), or \$1,900 in the surtax.
Itemized Deductions – Medical Care	Taxpayers can only claim itemized deductions for unreimbursed health care expenses over 7.5% of their Adjusted Gross Income.	Effective January 1, 2013, taxpayers will only be able to claim itemized deductions for unreimbursed health care expenses over 10% of their Adjusted Gross Income.	If a taxpayer is 65 or older, the threshold remains 7.5% through 2016.
Uninsured Individuals	There is no excise tax on individuals who fail to maintain health insurance.	Beginning in 2014, an excise tax will be imposed on individuals who fail to maintain a minimum level of health insurance.	The amount of the penalty is the greater of \$95 or 1.0% of the taxpayer's income above the filing threshold (currently \$18,700 for joint filers) in 2014, and rises to the greater of \$695 or 2.5% of the income over the filing threshold in 2016.
Tax Credits for Small Businesses	Small employers who cover at least 50% of the cost of health care for its workers may qualify for a credit worth up to 35% of the business's premium costs in 2010.	The 35% credit is available from 2010 through 2013. In 2014, the maximum credit increases to 50%.	To be eligible, an employer must have fewer than 25 full-time equivalent (FTE) employees and the average annual wages of its employees for the year must be less than \$50,000 per FTE.



## **SOURCES**

Tax Policy Center, 2011 Budget Proposal – Available at <http://bit.ly/9RtQ5n>

“Top 5 Tax Changes in Your Future” by Carla Fried, CBS Moneywatch – Available at <http://bit.ly/ckhoYJ>

“Obama’s budget: Impact on your taxes” by Jeanna Sahadi, CNN Money – Available at <http://bit.ly/aKeRBF>

“Affordable Care Act Tax Provisions” by the IRS – Available at <http://bit.ly/bHnLh8>

“ManuFACTS: Last-In, First-Out (LIFO) Accounting” by the National Association of Manufacturers – Available at <http://bit.ly/aoBL8t>

“What is LIFO and Why Do Businesses Use It?” – Available at <http://www.savelifo.org>

“Health Care Reform Reshapes Tax Code”, by Alistair M. Nevius, Journal of Accountancy – Available at <http://bit.ly/bAbb8P>

“2010 HIRE Act: Tax Breaks for Small Business” – Available at <http://hireact.org>

## **DISCLAIMERS**

\*\* Please note that the items described in these documents are subject to change at any time. These documents are meant for your informational purposes only, and are not intended to be legal, accounting, tax, investment or other professional advice. Please consult with a Certified Public Accountant or other financial professional to discuss your unique circumstances before making any tax planning, legal, or investment decisions. The MASCPA and Stambaugh Ness are not responsible for any errors, omissions or misrepresentations in these documents. Any analysis is intended to be as objective as possible based on publicly available tax discussion and information, and does not necessarily represent the views or opinions of the MASCPA or Stambaugh Ness. This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state, or local tax penalties.

