Opportunities, Anomalies and Pitfalls in the Federal Tax Law
Chit Chat Club
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INTRODUCTION

There is a significant incentive for understanding some of the principal provisions of federal tax law, which could influence, or in some instances, even dictate, the course of action to be taken with respect to financial or tax planning. During most of the years in which I taught taxation at law school, almost all of the students took one or two courses in the subject, because, among other things, it was on the California State Bar. That is no longer the case, and a lot of young lawyers have had no exposure to the subject. From the viewpoint of a tax professor, it is unthinkable that these men and women would advise their clients on such diverse subjects as real estate, estate planning, securities, real estate, corporations and partnerships and individuals' tax and estate planning without having had at least some exposure to the topic. So this evening I would like you to consider with me some of the taxation opportunities, pitfalls, and anomalies in the tax law which affect most of us sooner or later.

TAX SAVING OPPORTUNITIES

1. The New Estate Tax Exemption

The most important tax saving opportunity arose on January 1, 2013 with the New Year's Eve agreement by Congress to increase the federal estate and gift tax exemptions to $5.25 million per person, or $10.5 million for a married couple. This compromise was denominated as a "permanent" part of the Internal Revenue Code, and therefore, hopefully will be an integral part of the estate tax law for years to come. There is also an annual cost-of-living increase in this amount, so the exemption is expected to keep up with increases in the cost of living.

Let me illustrate the importance of this provision. Under prior law, when the estate tax exemption was only $1 million, tax planners often recommended to their clients that they use a QPERT to make a gift of the family home to their children. The requirements of such an arrangement are not important here, but if adhered to, the home would be excludable from the gross estate of a decedent. In a city like San Francisco, where the family home might well have cost $100,000 forty or fifty years ago, and which is now worth over $1 million, that was a sensible estate plan. However, now that the estate tax exemption is so large, very few married couples will find that they are even subject to any federal estate tax. Only if they have combined assets exceeding $10.5 million (this year) would they begin paying estate tax on the excess, albeit at an increased 40% rate. The advantage of *not* making a lifetime gift of highly appreciated property – a home, stocks or even tangible personal property – is that the beneficiary will receive a stepped-

up basis (discussed below). And, if the bequest or devise is to the decedent's spouse, there will also be no federal estate tax. Thus, the widow(er) can sell the family home and pay no income, capital gain or estate tax on the profit. This money can then be used to buy a residence more suitable for a single individual than a large house.

2. Section 1014 (b)(6)

Although the provisions of the so-called "stepped-up basis" are well known, I would like to explore the implications in your financial and tax planning of this important section. It provides, in essence, that with respect to community property, or property owned by any decedent alone, the amount that he or she paid for the asset ("basis") and possibly depreciated over the years is ignored. Instead the property receives a new basis (tax cost) based on the fair market value of the property on the date of death, or at the election of the executor six months later. Although the section also applies to property owned by a single decedent, it does not apply to the survivor's portion of joint tenancy property. So here are some suggestions which may save some taxes:

a. If one holds property in joint tenancy with another person, only the decedent's portion or interest in that property is "stepped-up", unless there is an agreement that, notwithstanding the way in which title is held, the asset is actually community property. Now most title companies, when they do the paperwork in the initial acquisition of the residence, tend to put title in "joint tenancy" because in the event of the death of one of the tenants, the survivor automatically, i.e., without probate, inherits the property. It's then very easy to insure the title for the survivor. The problem, however, is that the survivor's half of the property is not stepped up and she (usually) then has a "split-basis", meaning that half of the property is stepped-up and the survivor's half is not until she dies. But if the property is in the name of the community, both halves are stepped up.

A common situation illustrates this principle: Assume husband and wife purchased a home forty years ago for $100,000 and took title as community property. Then when one of them passes away. Assume the property is then worth $1 million. The survivor could sell the property and pay no income tax on the profit. i.e., the $900,000 appreciation would never be taxed to anyone. This would obviously facilitate the ability of the survivor – usually the wife – to sell the family home which is no longer needed, and to change his or her residence to a smaller house or an apartment. This is important, because the sale of one residence and the purchase of another [formerly IRC Section 1034], is no longer a tax-free transaction, although portions of the profit are exempted from tax for a sale of a principal residence.

This factor augers against making a lifetime gift of one's home to the children to avoid including the asset in the estate. The donor would have to pay rent to the children based on the fair rental value of the property for the years he or she lives in the house, which might be inconvenient after the parents owned the home outright for years. Perhaps more importantly, when the parent or the spouse dies, the children will not receive a stepped-up basis since the asset is no longer includable in a decedent's estate. The children will

continue to have the $100,000 basis that was paid for the home many years ago. So in the process of shifting an asset from the donor's estate to the children, one is also shifting the inherent tax liability, which will be realized when the donees dispose of the house. So unless the children intend to keep the house until they die, highly appreciated assets (like homes) are usually not suitable for lifetime gifts to reduce estate taxes. A better asset to give to one's children would be cash, real estate or securities which have not appreciated substantially, and where the stepped-up basis would not be important to the donees.

Perhaps a more dramatic example would be the founder of a major company, say Bill Gates of Microsoft, who owns at least $1 billion worth of his company's stock. The basis of that holding is probably close to zero, since it goes back to the initial funding of the company when it had virtually no value. Now if Mr. Gates were to pass away, his wife could sell the stock (which is assumed to be community property in the State of Washington) for $1 billion cash and pay no income tax on the immense appreciation that occurred during their joint lifetime. The theory is that the transaction should not be subject to tax twice – an income tax and an estate tax -- and that makes sense in the case of someone *other* than the decedent's spouse. But in the case of Mr. Gates, and anyone else leaving assets to his or her husband or wife, there is also no federal estate tax because of the marital deduction. So the sum total of these two transaction is that Mrs. Gates can sell the stock for $1 billion and keep all the proceeds free of both income and estate taxes. There will be an estate tax at a later date when *she* dies – unless she were to remarry and to bequeath a portion of those assets to her new husband, which would result in another marital deduction.

I should also note that there can be a "stepped-down" basis, so that a stock or other property bought at $100 which is worth $50 on the date of death will now have a $50 dollar cost based on its fair market value on the date of the death of decedent. So the loss inherent in the security is not available to anyone – it expires on the owner's death.

3. The Marital Deduction: §2056

An interesting related question which was at least partially resolved by the U.S. Supreme Court in its current term is "who is married"? There are several states in the U.S. in which same sex couples can marry and the Court has ruled that other states – like California – may not prohibit same sex marriages. The federal "Defense of Marriage Act" defined marriage as the union of one unmarried man with one unmarried woman, and did not recognize the "marriage" of two men or two woman to each other – even if permitted by state law. The U.S. Supreme Court has in essence decided is whether that the federal law is unconstitutional, at least when applied to tax privileges like the marital deduction.

There are also related questions, such as states which permit "common law marriage" for couples co-hebetating for a certain period of time, which is not the law of most other states, such as California. In this State, one is not married until one has a license, passes a blood test and the wedding is solomized by an authorized person.

So I leave you with this tax planning opportunity and suggestion: check with a title company to determine how your residence is entitled (you may also find this information on your property tax bill). If it is held in joint tenancy, either re-register it as community property or use a revocable trust which states that the nominal joint tenancy property is actually a community holding. That document should be signed by both parties, and should be notarized and recorded. I suggest you also check your securities holdings with your stock broker as to the title of the account, and change it to community property. This is easily effected by a letter signed by both husband and wife.

4. Section 1031

Almost from the inception of the federal tax law in 1913 there has been a provision allowing the exchange of one property held for a business use or for investment for a property "of a like kind" without the incurrence of federal or state income tax. The original intent was to permit a commercial corporation to rid itself of property which was no longer used in its trade or business, or for an individual to dispose of a property held for investment, and to acquire a more suitable property as a replacement without incurring a tax in the process.

It is important to note that Section 1031 does <u>not</u> permit the *sale* of one property for cash and the use of the funds to purchase another property, even if those funds are held in an escrow. What is required is formalized in the Tax Regulations and requires an independent trustee who sells the property to be disposed of and purchases the new property, but where the provisions of the exchange agreement do not permit the taxpayer to take the funds in cash at his or her discretion. If no substitute property can be found within the 45-and 180-day time limits permitted, then of course, the taxpayer can take the cash in the trustee's possession, but to do so will incur the full capital gains tax.

Let's explore now some of the planning opportunities that are provided by Section 1031, using the same illustration as above, i.e., a home that has a cost basis of $100,000 and a value of $1 million. I've already pointed out that if the asset is sold during the individual's or the couple's lifetime, a federal capital gains tax and California ordinary income tax will be realized on the sale except to the extent of the amount excluded (i.e. $500K for a married couple). But suppose that this couple decides that a four bedroom home worth millions of dollars is no longer suitable for them at this point in their life, and they do not want to wait until one of them dies for the property to receive a new basis. What can be done? The answer is the home – a personal asset which is not held for investment or in trade or business – can be converted to an investment asset by the couple's moving out and renting the property to one or more tenants who pay the fair rental value for the asset. After a period of time, the home will cease to be a personal

asset and become an investment asset, and at that point, the house could be exchanged for another property held for investment – say a triple net leased Walgreen's store, an apartment building, an office complex, a warehouse - or any other real estate to be held for investment. This is not cash, but it achieves the couple's objective in that they no longer own the house, and they are now receiving rent which they could use, if they like, to rent or buy a new residence.

5. Real Estate Financing

It may be possible to refinance the newly acquired property so as to remove a lot of the equity inherent in the building, and the owner can use that cash tax-free to purchase a smaller, more modest residence. If properly documented, the transaction completely achieves their objective of leaving their large home, acquiring a smaller home, and converting what was formerly an expensive-to-maintain asset into a productive income-producing one. Then when one of them dies, assuming the property is still community, the new property will receive a stepped-up basis, and the original difference between the $100,000 paid and the $1 million value – i.e., $900,000 will be forgiven, as well as any further appreciation in the new asset which occurred between the date of the exchange and the date of death. Incidentally, the refinancing proceeds which were not taxed at the time of the loan will also be stepped-up, so the beneficiary of the estate (the surviving spouse or the children) can now dispose of the investment property and pay no tax on the sale.

After a tax-free exchange of 2 investment properties, repeated refinancings may be possible. The proceeds of these loans are not income, because they are offset by the borrower's promissory notes. This is true even if the loans exceed – or far exceed – the owner's basis. To illustrate, assume one owns an investment property, say, the house we used previously as an illustration (cost/basis $100K, FMV $1M). It is exchanged for an apartment worth $1M and the exchanger takes out a mortgage of $500K. Although this is $400K more than his / her basis, the $400K is not income and is not taxed. If 10 years later the apartment is worth $2M, it can be refinanced again – say, for $1M – and no tax is yet paid on the "profit". And finally, when the owner dies, the profit is forgiven for tax purposes.

6. Section 103

I want briefly to mention the tax exemption of the interest paid by State and local governments, where the Internal Revenue Code has always permitted an exemption from income tax. This has to do with inter-governmental immunity, in that if the federal government were to impose a tax on the income from California bonds, California would have to pay a much higher rate of interest to compensate a bondholder. The federal tax would be an indirect but quite tangible burden on the State, so the federal government does not tax the interest on state or local obligations. [There may even be a Constitutional issue here, but it has not been necessary to resolve that question because the exemption has always been there.]

This becomes more important under the new tax legislation, because starting this year there is a 3.8% Medicare surtax on net investment income, and the top bracket in the federal income tax is now 39.6%. So the exemption from all these taxes on the interest on municipal bonds is a major tax planning opportunity. It makes it much preferable to buy exempt obligations than taxable ones such as those issued by corporations, unless the differential is sufficiently large to cover the additional state and federal taxes to be paid on the taxable bonds.

7. Section 170.

As you know, one can give appreciated property, such as stock or real estate, to a charitable organization and receive both a charitable deduction of the fair market value for income tax purposes and not be subject to tax on the inherent capital gain. This is substantially less expensive than writing a check, in that it has a double tax benefit. There are, however, exceptions for inventory, property held for sale to customers, works of art or literature where the donor's efforts created the property. These are ordinary assets – i.e., their sale would result in ordinary income – so the donor would receive a deduction only for his cost not the fair market value.

8. Section 453

If one wants to sell his / her home during one's lifetime and not convert it into an investment property, one Code section that may be helpful is to elect an installment sale. This in effect allows one to pay the capital gains tax over the period of time that the payments are received. So instead of realizing a large capital gain in one year, the seller can spread it over as many future years as there are payments. In the meantime, one receives interest with the installment payment of principal. The result is the conversion of a personal asset to an income-producing one. However, eventually one pays the tax on the capital gain less the $500,000 exempt amount, unless the asset is held to the date of death.

9. Section 167

I want briefly to mention depreciation, which is the deduction that is available to businesses and individuals who use property in business or hold it for investment. So if one uses a car partially for business, or a computer, or part of a home, one is allowed to depreciate the business or investment portion over the use of the life of the asset. *That deduction is permitted irrespective of whether the asset is actually depreciating*. So, for example, if one bought an apartment building forty years ago for investment purposes, the owner has been able to write off the building portion of the property over forty years, so that all of the basis that is remaining is the cost of the land (which is not depreciable). In point of fact, the building, rather than being worth zero, has appreciated substantially.

10. Retirement Plans

One of the best tax savings opportunities in the federal income tax are pension and profit sharing plans, IRAs, Keoghs and Individual Retirement Plans. The characteristics that all these plans have in common are: deductibility by the company or the individual making the contribution (subject to certain limits), and a tax exemption within the plan during the time it is in effect. So capital gains, dividends, interest, etc. are not taxed to the plan until the beneficiary begins withdrawals from the retirement plan. Those are required to begin by the time the taxpayer is age 70½, but by that time one is likely to be in a lower tax bracket. The one disadvantage of any of these plans is that when one does withdraw funds from the exempt trust, all of it, i.e., 100% is subject to ordinary income tax. This is because the taxpayer has no basis for contributions to, or earnings of the exempt plan. He or she has never previously paid tax on any of these amounts!

11. Partial Gifts

For estate and gift tax purposes, if one only owns a partial interest in property, the value for transfer tax purposes is not the proportionate share of the whole. Instead that share discounted for the restricted transferability of any asset which the taxpayer does not own 100%. For that reason family partnerships and trusts are popular. If you were to give a partial interest in your business or an investment asset, or even your home to your children, that would reduce the value for gift and estate tax purposes.

ANOMALIES

1. Section 1222: Capital Losses

I suggest that the most unfair provision in the Internal Revenue Code has to do with the timing of capital gains and losses. Let me illustrate: If in year one the taxpayer had, say, $100,000 of short term capital gain and in year two he / she had $100,000 of short-term capital losses, the tax effect would be that in the first year the investor would be paying ordinary income tax (federal and state) on the profits and in year two he /she could only write off $3,000 against ordinary income. The other $97,000 would carry forward to be used against future capital gains, if any. Although the arithmetical result between the two years is obviously zero, the tax result is far different: the TP has paid a lot of tax on $100,000 of gain in year one and he / she receives only a $3000 ordinary deduction in year two. The remaining $97,000 carryover to future years to be used against capital gains, or to be written off at the rate of $3,000 per year until it is used up or the taxpayer dies. If one does not have any gains, it will take her / him over 32 years to use up the capital loss carryforward in this example.

Now if one reverses the situation the result is radically different: if the individual has $100,000 capital loss in the first year, he / she writes off $3,000 against ordinary income and the other $97,000 is carried forward and would offset an equivalent amount of gain in the second year. So putting the two years together in that situation, which also totals zero, the tax is zero.

What is obviously missing is a capital loss carryback from year two to year one to receive a refund of the taxes paid in the first year. That *is* available to corporations, but not to individuals. This obviously is a very unfair and irrational provision, but Congress has not seen fit to change it.

III. Pitfalls

There are certain provisions in the Internal Revenue Code which experience has shown to be tax traps for the unwary. Some of the most prominent examples are the following:

A. Section 170(e)

The section relates to gifts of *tangible personal property* to charitable organizations where the asset in question would have resulted in ordinary income if it had been sold rather than donated. An example from a litigated case illustrates the principle: a corporation was in the business of demolishing buildings for a fee. One of the provisions of the demolition contract was that any of the demolished assets would become the property of the demolition company. In this case, the demolition company was retained to tear down an old church, which happened to contain a very valuable organ which the company thoughtfully removed and did not damage. It had the instrument appraised, and it was worth several hundred thousand dollars. Rather than sell it, they donated it to a charitable organization and took a deduction for the fair market value, which had been determined by appraisal. When the Internal Revenue Service audited the return, it found that the organ had been owned by the demolition company only for weeks, not for years and a day or more. As a result, if it had sold the organ, it would have resulted in short term capital gain. The effect of that is that under Section 170(e) the deduction is reduced by the amount that would have been taxed as ordinary income, which in this case would be 100%, since the demolition company had no basis (cost) for the organ – it was – "scrapped" and recovered in the process of demolition. The result was that the gift became 100% charitable and the taxpayer received no tax benefit whatever.

The same principle applies in other situations, such as a gift of a painting. The Code requires that "the use by the donee be related to the purpose or function of the charitable organization". So if you were fortunate enough to acquire stock in an initial public offering which immediately went to a big premium, and you donated that stock to a charitable organization, your deduction would be limited to your basis (cost), not the fair market value of the stock at the time of the gift. To achieve the latter result, one would have to hold the stock for at least a year and a day to make it a long-term capital gain asset. Then one could deduct the full amount of the market value.

Another example would be a valuable oil painting owned by a collector (not the artist). If it were donated to a museum, the fair market value of the painting would probably be deductible; but if given to the Red Cross it probably would not. The Code requires that tangible personal property be used in the exempt function of the charity – i.e., it may not auction or sell the donated property. For that reason, KQED - a charitable organization - discontinued its annual wine auction. The donors would have received a deduction only for their cost basis, perhaps a small fraction of the present value, since the wine was auctioned and not "*used*" by the charity.

B. Sections 673-678

Another pitfall relates to lifetime gifts made by individuals in an effort to avoid the inclusion of the gifted property in that person's gross estate. The Code requires in effect that the gift be outright to the donee with "no strings attached", or to a trust with an independent trustee. So if one wants to make a gift to one's grandchildren, but wants to retain the right to designate which of them will receive the income, that gift is not effective for estate tax purposes, with the result that the gift value *at the time of the donor's death* is includable in his / her gross estate. In effect, the gift is treated for tax purposes as if it had never been made during the donor's lifetime.

The same is true with respect to gifts taking effect of death, such as those where an individual retains the occupancy of gifted property without paying rent, or gifts that are effective only at the time of the individual's death, or gifts which are revocable. Here the element of control by the donor again appears. This, even though the gift is effective for state law purposes (i.e., the donor cannot change his mind when he finds out the tax consequences). In short, nothing has been accomplished by the gift from a tax standpoint, yet the donor loses control over the corpus of the gift since it is still effective for state law purposes. So gifts should be reviewed by a competent CPA or a tax attorney to make sure that the donor's tax objective will be realized by the transaction.

Addendum (Last page of Chit Chat Club speech)

As a result of the compromise reached on December 31, 2012 to avert at least part of the "fiscal cliff" Congress enacted the American Taxpayer Relief Act of 2012.

The principal portion of the law permanently extends most of Bush tax cuts for middle income taxpayers while extending and reinstating many previously expired provisions.

The following are the more pertinent changes that affect individuals and trusts.

A new marginal income tax top rate of 39.6% for incomes over $400,000 for single filers ($450,000 on joint returns). Taxable trusts are also subject to this top rate.

An additional 3.8% Medicare tax on earned income and investment income. There is also an additional 0.9% Medicare tax on wages and self-employment income in excess of the above levels. This applies to income such as interest, dividends, rents, royalties and capital gains. This will increase the effective tax rates for those earning more than the above income thresholds, taking the combined marginal tax rates to above 41.7%.

A new 20% rate applies to capital gains and dividends for individuals above the top income tax bracket. Alternative minimum tax at a 28% rate has been and is now indexed for inflation. The AMT exemption amounts are $78,750 for married taxpayers filing jointly and $50,600 for single filers.

There is a new limit on itemized deductions, which are reduced by 3% to the extent they exceed $300,000 for married couples ($250,000 for singles) of gross income.

Personal exemptions that are available to most taxpayers are phased out above the $300,000 level for married couples ($250,000 for singles). However charitable deductions, as well as other ordinary deductions, such as state income and local property taxes remain intact.

The estate tax rate was increased from 35 to 40%, but the exemption remains at a base of $5 million and is indexed for inflation starting this year. [It is now $5.25M].

Chit Chat Club / October 14, 2013

Opportunities, Anomalies and Pitfalls in the Federal Tax Law
Review of the 2013 Tax Payer Relief Act
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I. Tax Law Changes – 2013

Before discussing the principal topics of my presentation, I wanted briefly to review the changes made in the rates and exemption by the changes agreed upon by Congress on New Year's Eve 2012, which became effective the next day, January 1, 2013.

They were intended to fulfill President Obama's objective of imposing higher taxes on wealthy taxpayers, but at the same time they also made one change which affects the average working individual. That was that the payroll tax reduction which had been enacted during the 2008 – 2012 period expired on December 31. Lawmakers did not renew the 2 percentage point cut in the employees' share of the social security tax. They did not like the idea that government funding was required to make up the decrease in tax revenue for the social security trust fund. As a result employees will see smaller paychecks, but the same as the rates which were applicable prior to the temporary 2 percentage point cut.

The balance of the changes only effected upper income taxpayers, consistent with both Congressional and the President's objective to oppose higher taxes on that 1 – 2 percent of our population which are the highest earners. That included the following:

a. 0.9% medicare surtax on earned income which was passed in 2010 as part of health care reform but which became effective 1/1/13. The levee applies to wages as well as self-employed income to the extent that married couples earning over $250,000 or individuals who earn over $200,000. So for earnings over the threshold the effect of medicare tax rate will be 3.8% - formerly 2.9%.

b. A 3.8% medicare surtax on net investment income also part of the health care reform act of 2010. It applies to unearned income (AGI) over $250,000 ($125,000 for separate filers). Investment income includes interest, dividends, capital gains, annuities, royalties and passive rental income. It does however exempt tax-free interest from state and municipal obligations as well as payouts from retirement plans such as pension and profit sharing plans, 401K's, IRA's and the like.

c. The estate and gift tax exemption for 2013 is $5.25 million, i.e., $5 million last year adjusted for inflation. The rate will be adjusted hereafter every year. The tax rate jumps to 40%.

d. The annual gift tax exclusion, originally $10,000 is now $14,000 for 2013. That is the amount that an individual can gift to as many donees as he or she wishes without using any part of the gift tax exemption.

e. A little old $1 million of farm or business realty can receive a discount of estate tax valuation. The estate tax can now be paid in installments to the extent that a closely held business makes up more than 35% of the estate. The maximum amount is $572,000; interest is only 2%.

f. The tax rates on individuals have increased so that a 39.6% tax applies on the excess over $450,000 for married and $400,000 for singles.

g. The 2013 standard deduction for marries is $12,200 if one spouse is 65 or older and $13,400 if both are and $14,600.

h. A very important change is that high income earners loose some of their itemized deductions starting this year. Those are reduced by 3% to the extent that they exceed $300,000 for marries, $250,000 for singles but not more than total of the 80% of itemizations. This was a compromise designed to ___________ the concerns of charities, since during the negotiations there had been the discussion that might have eliminated the deduction for charitable contributions. However, charities, as well as other typically larger deductions (i.e., state income taxes) are very much affected by this limitation. To illustrate, a married couple earning $500,000 could retain their deductions to the extent of the first $300,000 but they would lose 3% of the next $200,000, i.e, $600,000. For a really high income taxpayer earning, say, $1.3 million, they would lose 3% of a million dollars, or $30,000 of otherwise deductible expenses.

i. The itemized reduction does not apply to medical expenses, investment interest or casual losses.

j. Personal exemptions increased to $3,900 for filers and their dependents but this is phased out for high-income earners. It is cut by 2% for each $2,500 of adjusted growth income above $300,000 ($250,000 for singles). The effect is that for very high earners there are no personal exemptions.

k. The top rate on capital gains and dividends increases to 20% for single with taxable income above $400,000 and couples over $450,000. The medicare surtax can boost the rate to 23.8%.

The alternative minimum tax exemption has been permanently fixed starting in 2013. $80,750 for couples and $51,900 for singles, a major increase from 2012 by $2050 and 1300 respectively. The exemptions will automatically increase in future years based on the rate of inflation.

l. The social security wage base arises this year to $113,700, an increase of $3,600, while social security benefits increase 1.7% this year, less than half of last year's increase.

m. The basic medicare part B premium increases to $104.90 per month this year but are much higher for upper income seniors. If AGI for 2011 exceeds $170,000 for couples, $85,000 for singles plus any tax exempt interest but increased the monthly premiums to $297.40 a month.

n. The threshold for deducting medical expenses jumps to 10% of AGI for singles under 65 or for married couples who file a joint return. One of the farthest is at least 65 or older in which case they get a 7.5% of AGI cap. Payins to health flexible spending accounts are now capped at $2,500.

II. Savings Plans

The maximum401K contribution is now $17,500 a year an increase of $500.00. But individuals born before 1964 can put in up to $23,000.

Employer contributions to qualified plan can be based on up to $255,000 of pay which means that a defined contribution plan can increase to $51,000.

The limits for IRA's and Roth IRA's to a maximum contribution (increases to $5,500 an increase of $500). Anyone born in 1963 or earlier can put in an extra $1,000.

III. Business Taxes

The 50% bonus depreciation stays in effect for assets placed in use this year and is applicable to new assets that have useful life of twenty years or less and up to $500,000 of business assets can be expenses.

IV. Revived Tax Breaks

a. The income tax exclusion of up to $2 million of forgiven home mortgage debt was revived for this year.

b. Tax payers age 70½ and older are allowed to directly transfer up to $100,000 tax free from their IRA's to charities. The effect of this provision is that the individual who owns the IRA does not have to pay tax on the funds transferred to charity, but he or she also does not get a child deduction. This has become more meaningful in light of the limitation on the itemized deductions imposed this year, discussed above.