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Six Months to Go Until The Largest Tax Hikes in History

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In just six months, the largest tax hikes in the history of America will take effect. They will hit families and small businesses in three great waves on January 1, 2011:

First Wave: Expiration of 2001 and 2003 Tax Relief

In 2001 and 2003, the GOP Congress enacted several tax cuts for investors, small business owners, and families. These will all expire on January 1, 2011:

Personal income tax rates will rise. The top income tax rate will rise from 35 to 39.6 percent (this is also the rate at which two-thirds of small business profits are taxed). The lowest rate will rise from 10 to 15 percent. All the rates in between will also rise. Itemized deductions and personal exemptions will again phase out, which has the same mathematical effect as higher marginal tax rates. The full list of marginal rate hikes is below:

- The 10% bracket rises to an expanded 15%
- The 25% bracket rises to 28%
- The 28% bracket rises to 31%
- The 33% bracket rises to 36%
- The 35% bracket rises to 39.6%

Higher taxes on marriage and family. The "marriage penalty" (narrower tax brackets for married couples) will return from the first dollar of income. The child tax credit will be cut in half from $1000 to $500 per child. The standard deduction will no longer be doubled for married couples relative to the single level. The dependent care and adoption tax credits will be cut.

The return of the Death Tax. This year, there is no death tax. For those dying on or after January 1 2011, there is a 55 percent top death tax rate on estates over $1 million. A person leaving behind two homes and a retirement account could easily pass along a death tax bill to their loved ones.

Higher tax rates on savers and investors. The capital gains tax will rise from 15 percent this year to 20 percent in 2011. The dividends tax will rise from 15 percent this year to 39.6 percent in 2011. These rates will rise another 3.8 percent in 2013.

Second Wave: Obamacare

There are over twenty new or higher taxes in Obamacare. Several will first go into effect on January 1, 2011. They include:

The "Medicine Cabinet Tax" Thanks to Obamacare, Americans will no longer be able to use health savings account (HSA), flexible spending account (FSA), or health reimbursement (HRA) pre-tax dollars to purchase non-prescription, over-the-counter medicines (except insulin).

The "Special Needs Kids Tax" This provision of Obamacare imposes a cap on flexible spending accounts (FSAs) of $2500 (Currently, there is no federal government limit). There is one group of FSA owners for whom this new cap will be particularly cruel and onerous: parents of special needs children. There are thousands of families with special needs children in the United States, and many of them use FSAs to pay for special needs education. Tuition rates at one leading school that teaches special needs children in Washington, D.C. (National Child Research Center) can easily exceed $14,000 per year. Under tax rules, FSA dollars can be used to pay for this type of special needs education.

The HSA Withdrawal Tax Hike. This provision of Obamacare increases the additional tax on non-medical early withdrawals from an HSA from 10 to 20 percent, disadvantaging them relative to IRAs and other tax-advantaged accounts, which remain at 10 percent.

Third Wave: The Alternative Minimum Tax and Employer Tax Hikes

When Americans prepare to file their tax returns in January of 2011, they'll be in for a nasty surprise—the AMT won't be held harmless, and many tax relief provisions will have expired. The major items include:

The AMT will ensnare over 28 million families, up from 4 million last year. According to the left-leaning Tax Policy Center, Congress' failure to index the AMT will lead to an explosion of AMT taxpaying families—rising from 4 million last year to 28.5 million. These families will have to calculate their tax burdens twice, and pay taxes at the higher level. The AMT was created in 1969 to ensnare a handful of taxpayers.

Small business expensing will be slashed and 50% expensing will disappear. Small businesses can normally expense (rather than slowly-deduct, or "depreciate") equipment purchases up to $250,000. This will be cut all the way down to $25,000. Larger businesses can expense half of their purchases of equipment. In January of 2011, all of it will have to be "depreciated."

Taxes will be raised on all types of businesses. There are literally scores of tax hikes on business that will take place. The biggest is the loss of the "research and experimentation tax credit," but there are many, many others. Combining high marginal tax rates with the loss of this tax relief will cost jobs.

Tax Benefits for Education and Teaching Reduced. The deduction for tuition and fees will not be available. Tax credits for education will be limited. Teachers will no longer be able to deduct classroom expenses. Coverdell Education Savings Accounts will be cut. Employer-provided educational assistance is curtailed. The student loan interest deduction will be disallowed for hundreds of thousands of families.

Charitable Contributions from IRAs no longer allowed. Under current law, a retired person with an IRA can contribute up to $100,000 per year directly to a charity from their IRA. This contribution also counts toward an annual "required minimum distribution." This ability will no longer be there.