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Year end legislative changes

Congress was very busy as 2015 came to a close. First, with essentially no warning and no hearings, the rules governing Social Security benefit claims for married couples were overhauled. Strategies that allowed two-earner couples to maximize their retirement income are being phased out.

Then came the annual debate over the "tax extenders." These are tax breaks that are good tax policy but have, in the past, been thought to be "too expensive" to be a permanent part of the tax code. The big surprise here was the change in status, as many of the most significant extenders are now permanent. The debate over these provisions is over.

File and suspend

First, some background. The "Senior Citizens Freedom to Work Act" was signed by President Clinton in 2000. The most important change was the elimination of the earnings test for receiving Social Security benefits upon reaching full retirement age. Retirees who reach age 66 this year may collect benefits in full, no matter how high their income may be. Of course, with a higher income the amount of benefits subject to income tax goes up as well.

Another option created with that legislation was the opportunity to suspend benefits after they started, to allow for earning delayed retirement credits. However, sharp-eyed financial planners soon developed additional legal claiming strategies that may have gone beyond what Congress intended.

In November 2015, as part of the budget agreement, Congress enacted significant reforms curtailing some of these strategies. Anyone who already has implemented one of these strategies may continue it, but the ability for everyone else to use them is being phased out.

Married couples have been able to have their Social Security cake and eat it, too, in a sense. Husband files for benefits at age 66, and Wife immediately claims her 50% spousal benefit. Husband then suspends his benefit, waiting until age 70 to begin collecting. By doing so, his benefit will be boosted by 8% for each year of delay, up to a maximum of 32%. This approach maximizes Social Security income for the couple in their 70s and beyond.

File and suspend has not been eliminated, but during the suspension period the spousal benefit will no longer be available (nor will a child's benefit). The new rule goes into effect May 1, 2016. Only those who are age 66 or older before that date may file and suspend their benefits under the old rules until that date.

Spousal benefit only

Couples with two incomes have paid Social Security taxes to earn two primary benefits and two spousal benefits. A person may claim only one benefit at a time, so something will be going to waste. However, the deferred retirement credit could be used to reduce the loss, especially if the husband and wife are close in age.

When Wife claimed her benefit at age 66, Husband (also age 66) claimed his 50% spousal benefit based upon her work record. That allowed his own benefit to grow until he reached age 70. At that point he would claim a benefit based upon his own work record, now increased by 32%.

This option has now been limited to those who reached age 62 by December 31, 2015. In other words, no one born in 1954 or later will have this choice. This phase-in lasts much longer, as those born in 1953 will not turn 66 until 2019.

Permanent extensions

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As part of the final budget deal, Congress enacted the "Protecting Americans from Tax Hikes Act of 2015" (the PATH Act). Many temporary tax provisions were made permanent, and this was done without offsetting tax hikes.

For individual taxpayers perhaps the most important extender is the "Charitable IRA Rollover." Beginning in 2006, taxpayers who are age 70 ½ or older (in other words, those who must take required minimum distributions from their IRAs) have been permitted to direct transfers of up to $100,000 per year from their IRAs to a qualified charity. Such distributions satisfy the distribution requirement, *but they are not included in the taxpayer's income,* so they do not increase the taxpayer's adjusted gross income. That's much better than the usual charitable deduction.

This tax provision was temporary, and it repeatedly expired. Congress never failed to renew this provision, sometimes retroactively, but sometimes that renewal came very late in the year, giving taxpayers very little time to take advantage of it. Now it is permanent.

Other permanent provisions of the new law of interest to individuals include:

- deduction for state and local sales taxes;
- American Opportunity Tax Credit for college students;
- an enhanced child tax credit; and
- the above-the-line deduction for schoolteacher expenses.

The following provisions were extended only through 2016:

- exclusion from income of discharged mortgage debt on a qualified principal residence;
- deductibility of mortgage insurance premiums as residence interest; and
- above-the-line deduction for qualified tuition and fees.

Two changes were included that are not related to raising revenue. First, distributions from Section 529 education funding plans may be used to purchase computer equipment and related expenses on a tax-free basis. Second, the residency requirement for the new 529 ABLE accounts for special needs beneficiaries has been dropped.

With the passage of this law, the annual ritual of debating the "tax extenders" may finally be over. There is a good chance that the provisions that were temporarily extended will be allowed to expire.

Politics

The technical explanation of the PATH Act may was provided by the Joint Committee on Taxation in JCX 15-144. The Republicans managed to get their political licks in with several provisions in the "Tax Administration" section of the bill. For example:

- Section 402 of the legislation bars IRS employees from using their personal e-mail accounts for any official business (hat tip to Lois Lerner for the inspiration);
- Section 404 requires the IRS to publish procedures for appealing an adverse determination of tax-exempt status under IRC §501(c); and
- Section 407 requires the IRS to terminate any employee who undertakes official action, or fails to act, with respect to a taxpayer for political purposes. This provision might have applied to many of the IRS officials involved in the targeting of conservative organizations and the long delays in processing their §501(c) applications, but it is effective upon the date of enactment.

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