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Election Year Tax Talk: Deciphering the Terminology

This year's election chatter is sure to include a healthy dose of tax talk. To keep up, here are five terms you should know.

The "Bush tax cuts"

A number of major tax changes were enacted in 2001 and 2003, including lower federal income tax rates, special maximum rates for long-term capital gains and qualifying dividends, and increased standard deduction amounts. While most of the provisions were extended by legislation passed in late 2010, these tax provisions are still commonly referred to as the "Bush tax cuts" or the "Bush-era tax cuts." With these provisions set to expire again at year-end, much of the tax debate will center around whether to extend the provisions again—particularly whether to extend the provisions for all taxpayers, or only to those who make less than a certain amount (e.g., individuals with incomes under $200,000, married couples with incomes under $250,000).

Alternative minimum tax (AMT)

The AMT is essentially a separate federal income tax system with its own rates and rules. If you're subject to the AMT, you have to calculate your taxes twice—once under the regular tax system and again under the AMT system. Bush tax cuts expanding AMT exemption amounts were extended only through the end of 2011. This increases the pressure to address AMT this year—failure to extend AMT relief would result in an estimated 30 million or more individuals being affected by the AMT in 2012. (Source: U.S. Congressional Research Service. The Alternative Minimum Tax for Individuals (RL30149; August 23, 2011), by Steven Maguire.)

The "Buffett rule"

On August 14, 2011, the New York Times published an opinion piece written by Warren Buffett, chairman and CEO of Berkshire Hathaway (Warren E. Buffett, "Stop Coddling the Super-Rich," New York Times, August 14, 2011). In the piece, Buffett essentially argued that he and his "mega-rich friends" weren't paying their fair share, noting that the rate at which he paid taxes (total tax as a percentage of taxable income) was lower than the other 20 people in his office. As Buffett points out, this is partially attributable to the fact that the ultra-wealthy typically receive a high proportion of their income from long-term capital gains and qualified dividends, which are currently taxed at rates that are generally lower than the rates that apply to wages and other ordinary income. President Obama has articulated the "Buffett rule" as the tenet that people making more than $1 million annually should not pay a smaller share of their income in taxes than middle-class families pay. (Source: www.whitehouse.gov.)

Value added tax (VAT)

A value added tax (VAT) is a consumption tax, like a sales tax. What distinguishes the VAT from a straight national sales tax is the fact that the VAT is assessed and collected at every point in the chain of production, on the "value added" at that step in the chain. Although a VAT can be implemented in different ways, here's one general approach: With a 10% VAT in effect, a supplier who sells $100 of materials to a manufacturer would pay $10 in VAT; the manufacturer who, in turn, sells a finished product to a retailer for $150 pays $5 in VAT ($150 sale price - $100 cost of materials, multiplied by the VAT rate); the retailer sells the product for $200, and pays an additional $5 in VAT ($200 sale price - $150 cost, multiplied by the VAT rate). Total VAT paid on the product is $20, or 10% of the final sale price.

Flat tax

Simple in concept, a flat tax would apply a single tax rate to individual income, or individual wages only (i.e., excluding investment income). A separate single rate might apply to businesses. Depending on the specific proposal, a base exemption may be allowed to exclude low-income families from the tax, and certain deductions may be allowed in determining the amount subject to tax.

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