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2010 Tax Relief Act extends Bush-era tax cuts & other tax breaks, includes stimulus measures.

On Friday, December 17, 2010, President Obama signed the 2010 Tax Relief Act into law. It basically preserves the tax changes placed into law during the Administration of George W. Bush (these changes were originally set to expire after 2010), changes the Estate Tax Law Provisions and includes new stimulus provisions. Note that most (but not all) of the provisions of this law extend the Bush tax cuts for TWO YEARS ONLY.

Summary

1. Tax rate brackets will not increase beginning 01/01/11.
2. Standard deduction amounts will not be reduced beginning 01/01/11.
3. Reductions for itemized deductions and personal exemptions will not be reduced for higher income taxpayers beginning 01/01/11.
4. Long Term Capital Gain tax rates will not increase beginning 01/01/11.
5. The Alternative Minimum Tax is patched through 12/31/12.
6. Estate tax law is changed beginning 01/01/11. There will be a 5 million estate exclusion amount with a tax rate of 35 percent.
7. Extended incentives to purchase business equipment and machinery.
8. Payroll taxes reduced for all employees for Year 2011 only. The employee portion of Social Security Tax is reduced from 6.2% of wages to 4.2% of wages.
9. Various business tax credits extended through 2011, such as the research credit, etc.
10. Extension of rules regarding educational accounts and expenses.
11. Various individual tax breaks extended through 2011, such as certain qualified tuition expense deductions, educator expense deductions, etc.

This is, probably, the largest single tax bill we've had in over 10 years. More detail are below.

EGTRRA Tax Cuts Extended for Two Years

Under current law, the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16), other than those made permanent or extended by subsequent legislation, sunset and won't apply to tax or limitation years beginning after 2010. (Sec. 901 of EGTRRA)

The 2010 Tax Relief Act postpones the Sec. 901 EGTRRA sunset rule for two years. That is, under the 2010 Tax Relief Act, the income tax provisions of EGTRRA, other than those made permanent or extended by subsequent legislation, will sunset and will not apply to tax or limitation years beginning after 2012 (instead of 2010). Thus, all of the following favorable tax rules (among others) will remain in place through 2012.

Tax rates. The income tax rates for individuals will stay at 10%, 15%, 25%, 28%, 33% and 35% (instead of moving to 15%, 28%, 31%, 36% and 39.6%). Additionally, the size of the 15% tax bracket for joint filers and qualified surviving spouses will remain at 200% (instead of dropping to 167%) of the 15% tax bracket for individual filers.

Standard deduction for married taxpayers. EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. If the EGTRRA sunset kicked in, the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) would drop to 167% of the standard deduction for single taxpayers, and the standard deduction for married taxpayers filing separately would continue to be one-half of the standard deduction for joint filers.

Under the 2010 Tax Reform Act, the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) remains at 200% (rather than 167%) of the standard deduction for single taxpayers for 2011. (The standard deduction for married taxpayers filing separately is half of the joint filer amount.)

Pease and PEP limitations won't apply. For 2011 and 2012:

- Itemized deductions of higher-income taxpayers will not be reduced (under the EGTRRA sunset rule for the “Pease limitation,” after 2010 they would have been reduced by 3% of AGI above an inflation-adjusted figure, but the reduction couldn't exceed 80%).
- A higher-income taxpayer's personal exemptions will not be phased out when AGI exceeds an inflation-adjusted threshold (under the EGTRRA sunset rule for the “Pease limitation,” after 2010 they would have been phased out).

Current law's rules for the following tax provisions also will remain in place through 2012: Coverdell Education Saving Accounts (CESAs), formerly called education IRAs; exclusion for employer-provided educational assistance under Code Sec. 127 ; exemption from the payments-for-services rule for amounts received under certain Government health professions scholarship programs; above-the-line student loan interest deduction; credit for employer-provided child care facilities; adoption credit and adoption assistance programs exclusion, arbitrage rebate for school construction bonds, tax-exempt private activity bonds for qualified education facilities, American opportunity tax credit, extended earned income tax credit (EITC); tax relief for Alaska native settlement funds; credit for household and dependent care; and child tax credit.

JGTRRA Rules for Capital Gains and Qualified Dividends Extended for Two Years

The 2010 Tax Reform Act defers for two years the sunset rule of Sec. 303 of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA, PL 108-27). Thus, through Dec. 31, 2012, long-term capital gain (with the exception of 28% rate gain and unrecaptured section 1250 gain) will continue to be taxed at a maximum rate of 15%. If the JGTRRA sunset rule went into effect, long-term capital gain would face a tax of 20% (18% for assets held more than five years)). And before 2013, qualified dividends paid to individuals will be taxed at the same rates as long-term capital gains (instead of being taxed under the JGTRRA sunset rule at the same rates that apply to ordinary income).

Alternative Minimum Tax (AMT) "Patched" for Two Years

Under the 2010 Tax Reform Act, the AMT exemption amounts for 2010 will be as follows:

> ... Married individuals filing jointly and surviving spouses: $72,450, less 25% of AMTI exceeding $150,000 (zero exemption when AMTI is $439,800);
> ... Unmarried individuals: $47,450, less 25% of AMTI exceeding $112,500 (zero exemption when AMTI is $302,300) (different amount applies for a child subject to the kiddie tax); and
> ... Married individuals filing separately: $36,225, less 25% of AMTI exceeding $75,000 (zero exemption when AMTI is $219,900). But AMTI is increased by the lesser of $36,225 or 25% of the excess of AMTI (without the exemption reduction) over $219,900.

Under the 2010 Tax Reform Act, the AMT exemption amounts for 2011 will be as follows:

> ... Married individuals filing jointly and surviving spouses: $74,450, less 25% of AMTI exceeding $150,000 (zero exemption when AMTI is $447,800);
> ... Unmarried individuals: $48,450, less 25% of AMTI exceeding $112,500 (zero exemption when AMTI is $306,300) (different amount applies for a child subject to the kiddie tax); and
> ... Married individuals filing separately: $37,225, less 25% of AMTI exceeding $75,000 (zero exemption when AMTI is $223,900). But AMTI is increased by the lesser of $37,225 or 25% of the excess of AMTI (without the exemption reduction) over $223,900.

Without the "patch" in the 2010 Tax Reform Act, post-2009 AMT exemption amounts would have plummeted to their pre-EGTRRA levels. For 2010, they would have been $45,000 for married individuals filing jointly and surviving spouses, $33,750 for unmarried individuals; and $22,500 for married individuals filing separately.

Also for 2010 and 2011, many nonrefundable personal credits will be allowed against the AMT (without the "patch," they couldn't offset AMT).

Estate Tax Relief

EGTRRA phased out the estate and generation-skipping transfer taxes so that they were fully repealed in 2010, lowered the gift tax rate to 35% and increased the gift tax exemption to $1 million for 2010. Under the EGTRRA sunset rule, the estate tax was set to return in 2011, with the top estate and gift tax rate reverting to 55%. For 2010, under EGTRRRA, the basis rules for inherited property were to be similar to the gift tax rules but with many opportunities for heirs to get increases in basis. Under the EGTRRA sunset rule, the pre-EGTRRA step-up in basis rules were to return for 2011.

The 2010 Tax Relief Act:

> ... Lowers estate and GST taxes for 2011 and 2012 by increasing the exemption amount (technically, the applicable exclusion amount) from $1 million to $5 million (as indexed and rounded to the nearest multiple of $10,000 after 2011) and reducing the top rate from 55% to 35%.
> ... Allows estates of decedents dying in 2010 to choose between (1) estate tax (based on a $5 million exemption and 35% top rate) and a step-up in basis or (2) no estate tax and modified carryover basis. In technical terms, the Act achieves this choice by making the estate tax and basis changes effective retroactively for estates of decedents dying after 2009 but allowing the opt-out choice for estates of decedents dying in 2010.
> ... For gifts made after Dec. 31, 2010, reunifies the gift tax with the estate tax, with an applicable exclusion amount of $5 million and a top estate and gift tax rate of 35%.
> ... Provides that the GST tax exemption for decedents dying or gifts made after Dec. 31, 2009, is equal to the applicable exclusion amount for estate tax purposes (e.g., $5 million for 2010). Therefore, up to $5 million in GST tax exemption may be allocated to a trust created or funded during 2010. Although the GST tax is applicable in 2010, the GST tax rate for transfers made during 2010 is 0%. The GST tax rate for transfers made in 2011 and 2012 will be 35%.
> ... For a decedent dying after Dec. 31, 2009, and before the enactment date, provides that the due date for filing an estate tax return, making any payment of estate tax, and disclaiming an interest in property passing by reason of death is not to be earlier than the date that's nine months after the enactment date.
> ... Effective for estates of decedents dying after Dec. 31, 2010, allows the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse.

Incentives for Businesses to Invest in Machinery and Equipment

The 2010 Tax Relief Act OKs the following major new incentives for businesses to invest in machinery and equipment:

> (1) A 100% writeoff in the placed-in-service year of the cost of property eligible for bonus depreciation under Code Sec. 168(k) . This will apply for property acquired and placed in service after Sept. 8, 2010, and before Jan. 1, 2012;
> (2) A 50% bonus first-year depreciation allowance under Code Sec. 168(k) for property placed in service after Dec. 31, 2011, and before Jan. 1, 2013;
> (3) Extension through Dec. 31, 2012, of the election to accelerate the AMT credit instead of claiming additional first-year depreciation; and

(4) For tax years beginning after Dec. 31, 2011, setting the maximum expensing amount under Code Sec. 179 at $125,000 and the investment-based phaseout amount at $500,000 (under current law, the expensing figures drop from $500,000/$2 million for 2010 and 2011 to $25,000/$200,000 after 2011). Also, off-the-shelf computer software will qualify for the Code Sec. 179 expensing election if placed in service in a tax year beginning before 2013.

Temporary Employee/Self-Employed Payroll Tax Cut for 2011

Under current law, employees pay a 6.2% Social Security tax on all wages earned up to $106,800 (in 2011) and self-employed individuals pay 12.4% Social Security self-employment taxes on all their self-employment income up to the same threshold. For 2011, the 2010 Tax Reform Act gives a two-percentage-point payroll/self-employment tax holiday for employees and self-employed taxpayers. As a result, employees will pay only 4.2% Social Security tax on wages and self-employment individuals will pay only 10.4% Social Security self-employment taxes on self-employment income up to the threshold.

Host of Expired Business Tax Breaks Retroactively Reinstated and Extended Through 2011

The following business tax breaks that expired at the end of 2009 will be retroactively reinstated and extended through 2011:

... the research credit;
... the Indian employment tax credit;
... the new markets tax credit;
... railroad track maintenance credit;
... mine rescue team training credit;
... employer wage credit for activated reservists;
... 15-year writeoff for qualifying leasehold improvements, restaurant buildings and improvements, and retail improvements;
... 7-year writeoff for motorsports entertainment facilities;
... accelerated depreciation for business property on an Indian reservation;
... enhanced charitable deductions for contributions of food inventory, for contributions of book inventories to public schools and for corporate contributions of computer equipment for educational purposes;
... election to expense mine safety equipment;
... special expensing rules for certain film and television products;
... expensing of environmental remediation costs;
... allowance of the Code Sec. 199 domestic production activities deduction for activities in Puerto Rico; and
... modification of tax treatment of certain payments to controlling exempt organizations;
... treatment of certain dividends of regulated investment companies (RICs);
... RIC qualified investment entity treatment under FIRPTA;
... exceptions for active financing income;
... look-thru treatment of payments between related controlled foreign corporations under foreign personal holding company rules;

... basis adjustment to stock of S corporations making charitable contributions of property;
... empowerment zone tax incentives;
... tax incentives for investment in the District of Columbia;
... temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands; and
... American Samoa economic development credit.

Other Business Tax Breaks Extended Through 2011

The following business tax breaks are extended through 2011:

... the work opportunity tax credit; and
... qualified zone academy bonds.

Long List of Tax Breaks for Individuals Retroactively Reinstated and Extended Through 2011

All of the following tax breaks for individuals that expired at the end of 2009 will be retroactively reinstated and extended through 2011:

- the $250 above-the-line deduction for certain expenses of elementary and secondary school teachers;
- the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes;
- increased contribution limits and carryforward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes;
- the above-the-line deduction for qualified tuition and related expenses;
- the provision that permits taxpayers age 70 1/2 or older to make tax-free distributions to charity from an Individual Retirement Account (IRA) of up to $100,000 per taxpayer, per tax year (additionally, individuals will be allowed to treat IRA transfers to charities during January of 2011 and as if made during 2010);
- look-thru of certain RIC stock in determining gross estate of nonresidents; and
- disregard of refunds in the administration of federal or federally assisted benefit programs.

Other Individual Tax Breaks Extended Through 2011

The following tax breaks for individuals that were set to expire at the end of 2010 will be extended through 2011:

- the increase in the monthly exclusion for employer-provided transit and vanpool benefits equal to that of the exclusion for employer-provided parking benefits (i.e., $230 per month);
- treatment of mortgage insurance premiums as deductible qualified residence interest; and
- exclusion of 100% of gain on certain small business stock.

Other Provisions Extended Through 2011

The list of energy-related provisions that will be extended through 2011 are:

- the $1.00 per gallon production tax credit for biodiesel, as well as the small agri-biodiesel producer credit of 10 cents per gallon;
- the $1.00 per gallon production tax credit for diesel fuel created from biomass;
- the placed-in-service deadline for qualifying refined coal facilities;
- the credit for manufacturers of energy-efficient residential homes;
- the $0.50 per gallon alternative fuel tax credit (but the credit will not be extended for any liquid fuel derived from a pulp or paper manufacturing process);
- deferral of gain on qualified electric utilities' sales or dispositions of electric transmission property;
- the suspension on the taxable income limit for purposes of depleting a marginal oil or gas well;
- grants for specified energy property in lieu of tax credits;
- the income tax credit for alcohol used as fuel;
- the reduced credit for ethanol blenders;
- the excise tax credit for alcohol used as fuel;
- the payment for alcohol fuel mixture;
- additional duties on imported ethanol;
- the energy efficient appliance credits (in new amounts and with new requirements);
- the Code Sec. 25C credit for energy-efficient improvements to existing homes, but reinstating the credit as it existed before passage of the American Recovery and Reinvestment Act (standards for property eligible under Code Sec. 25C are updated to reflect improvements in energy efficiency));
- the 30% investment tax credit for alternative vehicle refueling property.

The following disaster relief provisions will also be extended through 2011:

- the time for issuing New York Liberty Zone bonds, effective for bonds issued after Dec. 31, 2009;
- the increased rehabilitation credit for qualified expenditures in the Gulf Opportunity Zone (GO Zone);
- the placed-in-service deadline to claim additional low-income housing credits for buildings in GO Zones;
- tax-exempt bond financing; and
- the additional depreciation deduction claimed by businesses equal to 50% of the cost of new property investments made in the GO Zone (expenditures in 2011 will be eligible if the property is placed in service by Dec. 31, 2011).

Planning Alert! We highlight only *selected* provisions of the new tax legislation. If you have heard or read about any tax development not discussed in this letter, feel free to call our office. You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax) with and without the strategy. You should also consider any state income tax consequences of a particular planning strategy. We recommend you call our firm before implementing any tax planning technique discussed in this letter, or if you need more information.

Please feel free to call our office at 828-398-0257 if you need to discuss any of the provisions in this letter.