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## **THE 2010 TAX RELIEF ACT IMPACT ON TAX PLANNING**

Last week Congress passed and the President signed into law a two-year extension of soon-to-have-expired Bush-era tax cuts, including extension of current individual ordinary income, capital gain and dividend tax rates. The most sweeping tax law in a decade, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (H.R. 4853), also known as the 2010 Tax Relief Act (the “Act”), was approved by the Senate on December 15, 2010, by the House on December 16, 2010 and signed by the President on December 17, 2010.

The new law is more than just an extension of existing tax rates. The new law also provides a temporary across-the-board payroll tax cut for wage earners, a retroactive AMT “patch,” estate tax relief, education and energy incentives and many valuable incentives for businesses, including 100 percent bonus depreciation and an extension of many temporary tax breaks.

The following summarizes some of the important aspects of the Act.

### **Individuals**

**Tax rates.** Among the most valuable tax breaks for individuals in the new law are a two-year extension of individual income tax rate reductions and a payroll tax cut. Both will deliver immediate tax savings starting in January 2011. The new law keeps in place the current 10, 15, 25, 28, 33, and 35 percent individual tax rates for two years, through December 31, 2012. If Congress had not passed this extension, the individual tax rates would have jumped significantly for all income levels. The new law also extends full repeal of the limitation on itemized deductions and the personal exemption phase-out for two years. Married couples filing jointly will also benefit from extended provisions designed to alleviate the so-called marriage penalty.

**Payroll tax cut.** The payroll tax cut is designed to get more money into workers’ paychecks and to encourage consumer spending. Effective for calendar year 2011, the employee share of the FICA portion of Social Security taxes is reduced from 6.2 percent to 4.2 percent (up to the taxable wage base of \$106,800). Self-employed individuals also benefit. Self-employed individuals will pay 10.4 percent on self-employment income up to the wage base (reduced from the normal 12.4 percent rate).

**Capital gains/dividends.** The new law also extends reduced capital gains and dividend tax rates. Like the individual rate cuts, the extended capital gains and dividend tax rates are temporary and will expire after 2012 unless Congress intervenes. In the meantime, however, for 2011 and 2012, individuals in the 10 and 15 percent rate brackets can take advantage of a zero percent capital gains and dividend tax rate. Individuals in higher rate brackets will enjoy a maximum tax rate of 15 percent on long-term capital gains and qualified dividends.

**AMT patch.** More and more individuals are falling under the alternative minimum tax (AMT) because of the way the AMT is structured. To prevent the AMT from affecting middle income taxpayers, Congress has routinely enacted so-called “AMT patches.” The new law continues this trend by providing higher exemption amounts and other targeted relief.

**Charitable Contributions.** Through 2011, the Act allows taxpayers age 70 1/2 or older to make tax-free distributions from IRAs up to \$100,000 per taxpayer directly to charitable organizations (not including private foundations). Such a charitable transfer can fulfill a taxpayer’s IRA required minimum distribution starting in 2010. The Act permits individuals to make a charitable transfer during January of 2011 as if they were made during 2010.

**More incentives.** Along with all these incentives, the new law extends many popular but temporary tax breaks. Extended for 2011 and 2012 are:

- \$1,000 child tax credit
- Dependent care credit
- Deduction for certain mortgage insurance premiums

The new law also extends retroactively some other valuable tax incentives for individuals that expired at the end of 2009. These incentives are extended for 2010 and 2011 and include:

- State and local sales tax deduction
- Teacher’s classroom expense deduction

**Individual Energy Credit.** The Act extends the credit for individuals who make energy efficiency improvements to their residences on or before December 31, 2011. For property installed after December 31, 2010, the credit is 10%, with a maximum of \$500, with \$200 of that for windows. The \$500 limit is a lifetime limit, so any credits claimed in prior years will reduce the amount that can be claimed as a credit for 2011.

## **Businesses**

**Bonus depreciation.** Bonus depreciation is intended to help businesses depreciate capital expenditures faster against their taxable income, thereby encouraging businesses to invest in more equipment. The new law creates 100 percent bonus depreciation available for new qualified property purchased after September 8, 2010 and before January 1, 2012. It also continues bonus depreciation, at 50 percent, on property placed in service after December 31, 2011 and before January 1, 2013.

In addition, the Act extends 15-year recovery period for qualified leasehold improvements, restaurant building and improvements, and retail improvements.

**Code Sec. 179 expensing.** Along with bonus depreciation, the new law also provides for enhanced Code Sec. 179 expensing for 2012. Under current law, the Code Sec. 179 dollar and investment limits are \$500,000 and \$2 million, respectively, for tax years beginning in 2010 and 2011. The new law provides for a \$125,000 dollar limit and a \$500,000 investment limit (both indexed for inflation) for tax years beginning in 2012. A \$25,000 maximum and \$200,000 phase out threshold will apply for tax years beginning after 2012 and will not be adjusted for inflation.

**Research credit.** Many businesses urged Congress to make the research credit permanent after the credit expired at the end of 2009. While this proposal enjoyed significant support in Congress, its cost was deemed prohibitive. Instead, Congress extended the research tax credit for 2010 and 2011.

## **Education**

The Tax Code includes a number of incentives to encourage individuals to save for education expenses. In 2009, Congress enhanced the Hope education credit and renamed it the American Opportunity Tax Credit (AOTC). Like many other incentives, the AOTC was temporary. The new law extends it for two years, through 2012. Along with the AOTC, the new law also extends:

- Higher education tuition deduction
- Student loan interest deduction
- Exclusion for employer-provided educational assistance

## **Estate and gift taxes**

The federal estate tax, along with federal gift and generation skipping transfer (GST) taxes, was significantly overhauled in 2001. At that time, Congress set in motion a gradual reduction of the estate tax until abolishing it for 2010. Under budget rules, however, those changes could extend for only 10 years; starting in 2011, the estate tax had been scheduled to revert to its pre-2001 levels of 55 percent and a \$1 million exclusion.

The Act revives the estate tax, but with a maximum estate tax rate of 35 percent with a \$5 million exemption and increases the gift tax exemption to \$5,000,000 as well. The revived estate tax is in place for decedents dying in 2011 and 2012. The new law gives estates for decedents who die in 2010 the option to elect to (1) apply the estate tax at the 35 percent/\$5 million levels for 2010 and obtain step-up in basis for income tax purposes for estate assets or (2) pay no estate tax but apply carryover basis for income tax purposes. The new law also allows “portability” between spouses of their unused \$5,000,000 estate exemption.

For more details on the estate and gift tax features of the Act, please refer to FGMK’s summary dated December 20, 2010 entitled *THE 2010 TAX RELIEF ACT IMPACT ON ESTATE AND GIFT TAX PLANNING*.

The Act was designed to provide some solidity to the tax law for the next two years. The Act provides many tax planning opportunities for 2010, 2011 and 2012. Our tax professionals can assist you with the most effective planning for you to gain the most value from the Act.

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