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<u>2010 Tax Relief Act: What it Means for Taxpayers</u>

The "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" ("2010 Tax Relief Act" or "Act") was signed into law on December 17, 2010, by President Obama, and provides at least some temporary guidance to taxpayers, after nearly a year of uncertainty created by the inaction of Congress. ***Unfortunately, the Act only provides for a two year extension of the "Bush tax cuts", ending on December 31, 2012. Thus, we will have to wait for some additional, hopefully more permanent, tax relief, in the coming months.***

The 2010 Tax Relief Act has an impact on nearly every American taxpayer, both individuals and businesses. The highlights of the Act are summarized below.

<u>Individual Income Tax Rates Remain the Same</u>

The Act extends the Bush tax cuts, which were set to expire at the end of 2010, for all taxpayers, including individuals with incomes above $200,000 ($250,000 for married couples). The 2010 Tax Relief Act provides the following:

- Income tax rates for individuals will stay at 10%, 15%, 25%, 28%, 33% and 35% through December 31, 2012.
- The phase-out of personal exemptions and itemized deductions has been blocked through 2012.
- The top capital gain, and qualified dividend, tax rate of 15% is extended through 2012.
- Relief from the "marriage tax penalty" is maintained for two more years (through 2012).
- The $1,000 child tax credit is extended through 2012, as are the expanded dependent care credit, and other child care and educational expense deductions.

<u>Employee Payroll Tax Cut (for 2011 Only)</u>

The Act provides for a reduction of the employee share of FICA taxes by 2% − from 6.2% to 4.2% − but for 2011 only. It does not affect the employer share of FICA taxes. This provision is meant to replace the Making Work Pay Credit that was in effect for 2009 and 2010. Unlike the Making Work Pay Credit, however, there is no phase-out for high-income taxpayers. Thus, to a taxpayer with wages at or above the $106,800 cap, this reduction will be worth $2,136. To provide parity, a similar reduction in self-employment ("SECA") taxes will be provided for self-employed individuals.

<u>Alternative Minimum Tax "Patch"</u>

The Act includes a two-year Alternative Minimum Tax "patch" for tax years 2010 and 2011. The patch will prevent the AMT exemption from being dropped in 2010. Without this "fix", the AMT would have become applicable to millions of Americans, who would otherwise be exempt.

Estate, Gift and Generation-Skipping Transfer Tax Provisions

The 2010 Tax Relief Act provides for the following changes to federal gift and estate tax laws:

- The Act reinstates the federal estate tax retroactively to Jan. 1, 2010, with a $5 million exemption and a top rate of 35%.
- A special election is available for decedents dying in 2010. An executor is given a choice either: (i) to use the $5 million exemption and a 35% estate tax with a stepped-up basis; or (ii) to elect no estate tax, with the modified carryover basis rules in effect for 2010.
- For calendar year 2010, there is a $5 million generation-skipping transfer tax exemption and a zero percent rate.
- Beginning in 2011, there will be an estate, gift and generation-skipping transfer tax exemption of $5 million per person and $10 million per couple, indexing these amounts for inflation beginning in 2012.
- The top tax rate of 35% for estate, gift, and generation-skipping transfer taxes will continue for an additional two years, through December 31, 2012.

The concept of "portability" of a spouse's unused estate tax exemption amount is introduced into the law:

- The executor of a deceased spouse's estate will have the ability to transfer any unused estate tax exemption to the surviving spouse.
- This transfer option will be effective for estates of decedents dying after December 31, 2010.
- Although portability may simplify planning for married couples, the portability does not apply to the generation-skipping transfer tax exemption. Additionally, a couple's estate planning documents should be reviewed to deal with the generation-skipping transfer tax planning, basis issues, and future appreciation, which may still make planning for a couple very complicated.
- The portability applies to the unused exemption of one's last deceased spouse so remarriage complicates planning as well.
- An estate tax return must be filed on the first death, and an irrevocable election to allocate the unused exemption to the surviving spouse must be made on such return by the executor.

The Act reunifies gift and estate tax exemption amounts:

- The 2010 Tax Relief Act reunifies the estate, gift and generation-skipping transfer tax exemptions for the first time since 2001.
- Beginning on January 1, 2011, each person will have one exemption for gift and estate taxes of $5 million, as well as a $5 million exemption from generation-skipping transfer taxes, and, as described above, married couples would have a total exemption of $10 million.
- The $5 million exemption will be effective for gifts made after December 31, 2010. This is significant, because individuals will no longer be limited to the $1 million dollar lifetime gift tax exemption.

Relief for Businesses: Expense Deductions and Investment Incentives

The 2010 Tax Relief Act provides relief in the area of cost recovery (ie. depreciation) for equipment and property placed in service in 2011, as well as a variety of benefits and incentives for certain business investments, as follows:

- In one of the most expansive benefits for businesses, there will be full expensing of investments that currently qualify for bonus depreciation and are placed in service after September 8, 2010, through the end of 2011. This will allow businesses to expense the full cost of equipment and other qualifying property placed in service in 2011.
- Additionally, bonus depreciation at the current level (i.e., 50% expensing followed by regular depreciation) will be available for such investments in 2012.
- Section 179 expensing limits are currently $500,000, and investment limits are $2 million, pursuant to the Small Business Jobs Act of 2010. The 2010 Tax Relief Act provides for the levels to remain constant for 2010 and 2011 and provides for $125,000 with a $500,000 investment limit in 2012.
- The legislation also extends the 15-year cost recovery period for qualified leasehold improvements, qualified restaurant property and qualified retail improvements, to cover property placed in service through December 31, 2011.

Other Provisions in the Act

The 2010 Tax Relief Act also extends numerous other provisions that would otherwise have expired, and which have benefited both individuals and businesses. Examples include the tax cuts enacted by the stimulus bill of 2009, and many of the tax provisions commonly referred to as "extenders." These provisions include things such as:

- American Opportunity Credit;
- Earned Income Tax Credit enhancements;
- Child Credit enhancements;
- Research Credit; and
- Itemized deductions for state and local sales taxes.

Conclusions

While the 2010 Tax Relief Act provides for the extension of tax rates, and many favorable tax cuts, it is important to realize that it is not permanent. Individuals and businesses are presented with unique planning opportunities for the next two years, including various enhanced gift and estate planning options to be considered. Taxpayers and their advisors should keep up their lobbying efforts in regards to making permanent the two-year temporary "fix", while at the same time taking advantage of the opportunities presented by the new law. This is but a short summary of the highlights of the Act, and does not purport to serve as an exhaustive list of all changes. We welcome your questions, comments and inquiries, and stand by ready to help you with your personal and business planning needs.

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