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An Overview of The Tax Relief Act on 2010

On December 17, 2010, the President signed a multi-billion dollar tax cut package, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) (H.R. 4853). In general, the 2010 Tax Relief Act ex- tends the Bush-era individual and capital gains/dividend tax cuts for all taxpayers for two years. The bill also provides for an AMT "patch," a one-year payroll tax cut, 100 percent bonus depreciation through 2011 and 50 percent bonus depreciation for 2012, a top federal estate tax rate of 35 percent with a $5 million exclusion, and more.

The significance of the Act is that is gives taxpayers some assurance in tax planning for the next two years, especially concerning the individual income tax rates, capital gains/dividend tax rates and the estate tax. Though, the provisions are temporary and the new act delays the ultimate future of the Bush-era tax cuts to 2012, a presidential election year.

The following is a summary of a number of the most relevant provisions of the 1010 Tax Relief Act.

INDIVIDUALS

Individual Tax Rates

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the individual income tax rates had been scheduled to revert from their current levels of 10, 15, 25, 28, 33, and 35 percent to 15, 28, 31, 36, and 39.6 percent after December 31, 2010. The 2010 Tax Relief Act extends all individual rates at 10, 15, 25, 28, 33 and 35 percent for two years, through December 31, 2012.

The income tax rate schedule used by estates and nongrantor trusts (15, 25, 28, 33 and 35 percent) also has been extended for two years. The 10 percent bracket established under EGTRRA for individuals has never applied to estates and trusts.

Capital Gains/Dividends

Qualified capital gains and dividends currently are taxed at a maximum rate of 15 percent (zero percent for taxpayers in the 10 and 15 percent income tax brackets) for 2010. The

2010 Tax Relief Act continues this treatment for two years, through December 31, 2012.

Qualified dividends, which continue to be eligible for the reduced tax rates, are dividends received from a domestic corporation or a qualified foreign corporation, on which the underlying stock is held for at least 61 days within a specified 121 day period. A qualified foreign corporation is eligible for U.S. treaty benefits or has stock that is readily tradable on an established U.S. securities market. The reduced tax rates do not apply to dividends received from an organization that is exempt from taxation under Code Sec. 501.

Itemized Deduction Limitation

The "Pease" limitation reduces the total amount of a higher-income individual's otherwise allowable deductions. Under EGTRRA, the Pease limitation is repealed for 2010 but was scheduled to return in full after 2010 at a projected level of income starting at $169,550 ($84,775 for married couples filing separately). The 2010 Tax Relief Act extends full repeal of the Pease limitation for two years, through December 31, 2012.

Personal Exemption Phaseout

Before 2010, taxpayers with incomes over certain thresholds were subject to the personal exemption phaseout (PEP). The PEP reduced the total amount of exemptions that may be claimed by two percent for each $2,500 or portion thereof ($1,250 for married couples filing separate returns) by which the taxpayer's adjusted gross income (AGI) exceeded the applicable threshold (projected for 2011 to start at $169,550 for singles and $254,350 for joint filers). Under EGTRRA, the PEP is repealed for 2010. The 2010 Tax Relief Act extends repeal of the PEP for two years, through December 31, 2012.

The personal exemption amount for 2010 is $3,650. The IRS is expected to release the official personal exemption amount shortly.

Marriage Penalty Relief

EGTRRA provided relief from the so-called marriage penalty by increasing the basic standard deduction for a married couple filing a joint return to twice the amount for a single individual. EGTRRA also temporarily expanded the size of the 15 percent income tax rate bracket for married couples filing a joint return to twice that of single filers to help mitigate the marriage penalty.

Child Tax Credit

The 2010 Tax Relief Act extends the $1,000 child tax credit for two years, through December 31, 2012. The child credit continues to be phased out for taxpayers with adjusted gross income starting at $110,000 for joint filers ($75,000 for others). The qualifying child must be under age 17 at the close of the year and satisfy relation- ship, residency, support, citizenship, and dependent tests.

Earned Income Tax Credit

EGTRRA and subsequent legislation temporarily increased the beginning and end points of the earned income tax credit (EITC), increased the credit for three or more children and made other taxpayer friendly changes.

Dependent Care Credit

A taxpayer who incurs expenses to care for a child under age 13 or for an incapacitated dependent or spouse to enable him or her to work or look for work can claim a dependent care credit. EGTRRA temporarily increased the maximum amount of eligible expenses for the dependent care credit from $2,400 to $3,000 (from $4,800 to $6,000 for more than one qualifying individual).

Mortgage Insurance Premiums

Under current law, taxpayers may deduct certain premiums paid for qualified mortgage insurance during the tax year in connection with acquisition indebtedness on a qualified residence. The deduction is subject to phase- out based on a taxpayer's income. The 2010 Tax Relief Act extends the deduction for one year subject to some limitations.

American Opportunity Tax Credit

The 2009 Recovery Act enhanced and re- named the Hope education credit as the American Opportunity Tax Credit (AOTC) for 2009 and 2010. The 2010 Tax Relief Act extends the AOTC for two years, through December 31, 2012. Also extended are income limitations (the AOTC begins to phase out for single individuals with modified AGI of $80,000 ($160,000 for married couples filing jointly) and completely phases out for single individuals with modified AGI of $90,000 ($180,000 for married couples filing jointly).

Qualified taxpayers with higher education expenses will continue to benefit from an AOTC that is 40 percent refundable. However, the AOTC is not refundable if the taxpayer claiming the credit is a child who has at least one living parent, does not file a joint return, and meets other criteria.

Student Loan Interest Deduction

EGTRRA eliminated a 60-month rule for the $2,500 above-the-line student loan interest deduction and expanded the modified AGI range for phase-out. This treatment was scheduled to expire after December 31, 2010. The 2010 Tax Relief Act extends the enhancements for two years, through December 31, 2012.

Coverdell Education Savings Accounts

EGTRRA increased the maximum contribution amount to a Coverdell Education Savings Account (ESA) from $500 to $2,000 and, among other things, made elementary and secondary school expenses, in addition to post-secondary school expenses, qualified expenses. These enhancements were scheduled to sunset after 2010. The 2010 Tax Relief

Act extends them for two years, through December 31, 2012.

ALTERNATIVE MINIMUM TAX

The 2010 Tax Relief Act provides an AMT "patch" intended to prevent the AMT from encroaching on middle-income taxpayers by providing higher exemption amounts and other targeted relief for 2010 and 2011. Without this patch, which had expired at the end of 2009, an estimated 21 million additional households would be subject to the AMT.

The 2010 Tax Relief Act increases the exemption amounts for 2010 to $47,450 for individual taxpayers, $72,450 for married taxpayers filing jointly and surviving spouses, and $36,225 for married couples filing separately.

PAYROLL TAX CUT

The 2010 Tax Relief Act reduces the employee-share of the OASDI portion of Social Security taxes from 6.2 percent to 4.2 per- cent for wages earned in calendar year 2011 up to the taxable wage base of $106,800. Self-employed individuals would pay 10.4 percent on self-employment income up to the threshold.

EXAMPLE. Joe earns $50,000 a year and pays OASDI on his earnings. Under the 2010 Tax Relief Act, Joe's employee-share of OASDI tax is reduced from 6.2 percent to 4.2 percent for 2011. Instead of paying $3,100 in OASDI tax for 2011, Joe would pay $2,100 in OASDI tax, resulting in a tax savings of $1,000.

Note - The employer's share of OASDI remains at 6.2 percent. For 2010, certain employers may be eligible for payroll tax forgiveness under the Hiring Incentives to Restore Employment (HIRE) Act. How- ever, payroll tax forgiveness for employers under the HIRE Act ends after December 31, 2010 and is not extended under the 2010 Tax Relief Act. Also, the 2010 Tax Relief Act makes no changes to the Medicare (HI) portion of Social Security taxes, which is 2.9 percent.

BUSINESS INCENTIVES

100 Percent Bonus Depreciation

The 2010 Tax Relief Act boosts 50-percent bonus depreciation to 100-percent for qualified investments made after September 8, 2010 and before January 1, 2012. The 2010 Tax Relief Act also makes 50 percent bonus depreciation available for qualified property placed in service after December 31, 2011 and before January 1, 2013. Certain long-lived property and transportation property is eligible for 100- percent expensing if placed in service be- fore January 1, 2013.

This provision is one of the most expansive for businesses. Unlike Code Sec. 179 expensing, it is not limited to use by smaller businesses or capped at a certain dollar level.

Refundable Credits in Lieu of Bonus Depreciation

Under the 2009 Recovery Act, a corporation otherwise eligible for additional first year depreciation may elect to claim additional research or minimum tax credits in lieu of claiming depreciation for qualified property placed in service after March 31, 2008 and before December 31, 2008. The 2010 Tax Relief Act generally extends similar treatment for two years, through December 31, 2012.

Code Sec. 179 Expensing

Congress has repeatedly increased the dollar and investment limits under Code Sec. 179 to encourage business spending. The 2010 Small Business Jobs Act increased the Code Sec. 179 dollar and investment limits to $500,000 and $2 million, respectively, for tax years beginning in 2010 and 2011. The 2010 Tax Relief Act provides for a $125,000 dollar limit (indexed for inflation) and a $500,000 investment limit (indexed for inflation) for tax years beginning in 2012 (and sun-setting after December 31, 2012). The 2010 Tax Relief Act also extends the treatment of off-the-shelf computer software as qualifying property if placed in service be- fore 2013.

Note: Qualified real property does not share in the expensing benefits allowed under the 2010 Tax Relief Act.

Research Tax Credit

The Code Sec. 41 research tax credit expired at the end of 2009. The 2010 Tax Relief Act renews the credit for two years, through December 31, 2011 and is effective for amounts paid or incurred after December 31, 2009.

Small Business Stock

The 2010 Small Business Jobs Act enhanced the exclusion of gain from qualified small business stock to non-corporate taxpayers. For stock acquired after September 27, 2010 and before January 1,
2011, and held for at least five years, the 2010 Small Business Jobs Act provided an exclusion of 100 percent. The 2010 Tax Relief Act extends the 100 percent exclusion for one more year, for stock acquired before January 1, 2012.

Work Opportunity Tax Credit

The Work Opportunity Tax Credit (WOTC) is intended to encourage employers to hire individuals from targeted groups. The WOTC is equal to 40 percent of up to $6,000 of the targeted employee's qualified first-year wages, subject to certain requirements and limitations. The 2010 Tax Relief Act extends the WOTC for individuals who begin employment after August 31, 2011 and before January 1, 2012, but with some modifications.

ENERGY INCENTIVES

The 2010 Tax Relief Act temporarily extends for one or two years a number of energy tax incentives, primarily targeted to businesses. One popular energy incentive for individuals, the Code Sec. 25C residential energy property credit, is extended but with some limitations.

Business Energy Incentives

Business energy incentives extended by the 2010 Tax Relief Act are:

- Credits for biodiesel and renewable diesel fuel (two years) Credit for refined coal facilities (two years with modifications);
- New energy efficient home credit for qualified builders and manufacturers (homes purchased before January 1, 2012) Excise tax credits and outlay payments for alternative fuel and alternative fuel mixtures (two years);
- Sales of electric transmission property (sales before January 1, 2012) Percentage depletion for oil and gas from marginal wells (two years);
- Grants for certain energy property in lieu of tax credits (variable) Tax credits and outlay payments for ethanol and duties on imported ethanol (one year with modifications);
- Energy efficient appliance credit (one year with modifications)

Individuals

The Code Sec. 25C credit is designed to reward individuals who make energy efficiency improvements to their residences with a tax benefit. Under current law, the credit amount is 30 percent of the sum of expenditures for qualified energy efficiency improvements and property, such as furnaces, water heaters, insulation materials, exterior windows and doors, and other items, for 2009 and 2010 property. The credit under current law is limited to a lifetime maxi- mum credit of $1,500 for 2009 and 2010 property. The 2010 Tax Relief Act extends the Code Sec. 25C credit through 2011. However, the new law returns the credit to its pre-2009 Recovery Act parameters.

CHARITABLE INCENTIVES

In addition to extending tax-free distributions from IRAs for charitable purposes and special rules for contributions of capital gain real property for conservation purposes, the 2010 Tax Relief Act also extends through 2011:

- Charitable deduction for contributions of food inventory Charitable deduction for contributions by C corporations of books to public schools;
- Charitable deduction for corporate contributions of computer equipment for educational purposes.

FEDERAL ESTATE TAX

EGTRRA gradually reduced over a period of years and then abolished the federal estate tax for decedents dying in 2010. The pre-EGTRRA estate tax (with a maximum tax rate of 55 percent and a $1 million applicable exclusion amount) was scheduled to be revived after 2010. Additional EGTRRA changes affected the gift and generation- skipping transfer (GST) tax.

Estate Tax Compromise

The 2010 Tax Relief Act revives the estate tax for decedents dying after December 31, 2009, but at a significantly higher applicable exclusion amount and lower tax rate than had been scheduled under EGTRRA. The maximum estate tax rate is 35 percent with an applicable exclusion amount of $5 million. This new estate tax regime, however, is itself temporary and is scheduled to sunset on December 31, 2012.

Together with the revival of the estate tax, the 2010 Tax Relief Act eliminates the modified carryover basis rules and replaces them with the stepped up basis rules that had applied until 2010. Property with a stepped-up basis receives a basis equal to the property's fair market value on the date of the decedent's death (or on an alternate valuation date).

Option for 2010

The 2010 Tax Relief Act gives estates of decedents dying after December 31, 2009 and before January 1, 2011, the option to elect not to come under the revived estate tax. The new law gives those estates the option to elect to apply (1) the estate tax based on the new 35 percent top rate and $5 million applicable exclusion amount, with stepped- up basis or (2) no estate tax and modified carryover basis rules under EGTRRA. Any election would be revocable only with the consent of the IRS.

In general, for individuals, the most immediate impact of the new law will be the payroll tax cut and the extension of the reduced individual income tax rates. Whereas, for businesses, the 2010 Tax Relief Act, boosts 50-percent bonus depreciation to 100-percent for qualified investments made after September 8, 2010 and before January 1, 2012.

For more information on the 2010 Tax Relief Act and it's impact on IRAs please contact one of our IRA Experts at 800-472-0646.