

## The 2010 Tax Relief Act

On December 17, President Obama signed into law the \$857.8 billion Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The Act makes significant changes to estate, generation-skipping transfer and gift taxes, as well as to individual and business income taxes. This summary is intended to highlight some of its key provisions.

### INCOME TAX RELIEF

The 2010 Tax Relief Act provides an extension, through 2012, of all the Bush income tax cuts, including the 15% maximum rate for capital gains and qualified dividends. The provision extends the 10%, 15%, 25%, 28%, 33% and 35% individual income tax rates for the next two years, with the rate structure indexed for inflation. By extending the income tax rates into 2011 and 2012, the 2010 Tax Relief Act benefits individuals who complete Roth IRA conversions within the next two years.

At the end of 2012, the Act expires. Beginning in 2013, ordinary income, as well as short-term capital gains and qualified dividends, are scheduled to be taxed at a maximum 39.5% rate; the maximum long-term capital gains rate would be 20%. Net investment income would also be subject to a new 3.8% surtax.

### INDIVIDUAL ALTERNATIVE MINIMUM TAX RELIEF

The alternative minimum tax is a special tax system with a minimum 25% tax rate, originally designed to ensure that the ultra-affluent “paid their share.” The 2010 Tax Relief Act provides a two-year extension of alternative minimum tax (“AMT”) relief – indexing the AMT exemption for inflation for 2010 and 2011. It also allows individuals to offset regular tax liability and AMT by nonrefundable personal credits for 2010 and 2011.

<u>AMT Exemption</u>	<u>2010</u>	<u>2011</u>
Unmarried Individuals	\$47,450	\$48,450
Married/Surviving Spouses – Joint Filing	\$72,450	\$74,450
Married Spouses – Separate Filing	\$36,225	\$37,225

### WEALTH TRANSFER TAX RELIEF

The 2010 Tax Relief Act reunifies the estate and gift tax exemptions for 2011 and 2012, allowing taxpayers to transfer up to \$5 million tax-free during life. In addition, it imposes a maximum rate of 35% for both of these taxes, as well as the generation-skipping transfer (“GST”) tax. For decedents dying in 2011 and 2012, the Act allows for “portability” between spouses of any unused estate (but not GST) tax exemption. Portability does have limitations. As shown in the chart below, the Act sunsets at the end of 2012, providing a narrow window for use of the enhanced \$5 million exemptions and the low 35% rates.

Tax	2009		2010		2011 – 2012		2013	
	Exemption	Rate	Exemption	Rate	Exemption	Rate	Exemption	Rate
Gift	\$1M	45%	\$1M	35%	\$5M**	35%	\$1M (?)	55% (?)
Estate	\$3.5M	45%	\$5M*	35%*	\$5M**	35%	\$1M (?)	55% (?)
GST	\$3.5M	45%	\$5M	0%	\$5M**	35%	***\$1M(?)	55% (?)

\*Executors for 2010 decedents can also elect into the “no estate tax/modified carryover basis” regime.

\*\*Indexed for inflation, beginning 2012.

\*\*\*Indexed for inflation.

### ***Estate Tax***

While the 2010 Tax Relief Act imposes an estate tax on decedents dying in 2011 and 2012 at a rate of 35%, tax will not be due unless the taxable estate exceeds the decedent’s available estate tax exemption. In addition, all appreciated assets transferred at death in those years will receive a step-up in basis. The estates of 2010 decedents are also taxed at a 35% estate tax rate under the Act, with stepped-up basis and a \$5 million exemption. Importantly, the Act also provides a special election that allows 2010 decedents to be subject to no estate taxes, with a modified carry-over basis for estate assets.

### ***Gift Tax***

For individuals seeking to make gifts in excess of the annual gift tax exclusion (which for 2011 remains at \$13,000 per person), the 2010 Tax Relief Act affords the opportunity to make aggregate lifetime gifts up to \$5 million tax free. The Act reunifies the estate and gift tax systems, allowing full use of the \$5 million exemption amount during life without the imposition of gift tax. Thus, for the next two years, reunification gives an unprecedented opportunity for lifetime wealth transfer.

### ***Portability of Estate Tax Exemption***

Of key importance, the 2010 Tax Relief Act introduces the concept of “portability” of the estate tax exemption at the death of a spouse. Under certain circumstances, the second spouse to die will be allowed to share any unused estate tax exemption of the first spouse to die, providing spouses a combined \$10 million exemption from gift and estate taxes, regardless of how their assets are titled.

### ***Generation-Skipping Transfer Tax***

As for generation-skipping transfers, the 2010 Tax Relief Act allows individuals to make aggregate transfers of up to \$5 million to “skip persons” outright or in trust tax-free. (“Skip-persons” include family members two or more generations younger than the transferor as well as non-family members more than 37 ½ years younger than the transferor.) Any such transfers made in excess of this \$5 million exemption amount will be subject to the 35% GST tax. For generation-skipping transfers in 2010, the Act retroactively imposes a 0% percent tax and a \$5 million exemption amount. The \$5 million GST exemption amount available through 2012 may be used to exempt gifts to trusts that are expected to benefit multiple generations, so that generation-skipping transfers from the trusts in subsequent years are also exempt from GST.

## **INVESTMENT INCENTIVES**

The 2010 Tax Relief Act gives all businesses – not just small businesses – the ability to write off 100% of the cost of certain machinery and equipment placed into service from September 9, 2010 through December 31, 2011. In 2012, the write-off is reduced to 50% of the cost.

## **EMPLOYEE PAYROLL TAX CUT**

The 2010 Tax Relief Act grants a temporary reduction in the employee side of the payroll tax, from 6.2% to 4.2% for 2011 only. The employer tax rate for social security under the Act remains unchanged at 6.2%, with a wage base limit of \$106,800 for 2011. Also unaffected is the Medicare tax rate of 1.45%.

## **CERTAIN EXPIRING ENERGY, BUSINESS, DISASTER RELIEF AND INDIVIDUAL INCOME TAX PROVISIONS**

The 2010 Tax Relief Act grants a temporary extension – for 2010 and 2011 – of certain energy, business, disaster relief and individual tax provisions that expired at the end of 2009. Of particular relevance to our clients is the extension of two special charitable provisions. First, the 2010 Tax Relief Act allows individuals age 70 and ½ or older to transfer up to \$100,000 directly from an IRA to a qualified charity without including such distribution in income for the year. For 2010 only, distributions from IRAs made in January 2011 will be treated as if they were made in 2010. Second, the Act enhances charitable deductions for qualified conservation contributions.

Additional highlights pertaining to individual income tax relief for Texans include the extension through December 31, 2011 of provisions allowing taxpayers to elect to deduct state and local sales taxes in lieu of state and local income taxes, as well as an above-the-line deduction for qualified tuition and related expenses.

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