

ARTHUR H. GEFFEN

A Professional Corporation

Attorney & Counselor at Law

1620 East Beltline Road

Carrollton, Texas 75006

972-242-8887

972-446-7976(fax)

www.dallasestateattorney.com

Email: ageffen@airmail.net

Tax Relief Act of 2010

President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“Tax Relief Act”) into law on December 17, 2010. The Tax Relief Act was designed to extend Bush-era tax cuts while providing other incentives to revive the economy. This is a summary of the most salient tax provisions of the Tax Relief Act:

Estate Tax Provisions

- **New *Exemption Amounts and Tax Rate*.** The Tax Relief Act reinstates the estate tax for 2011 and 2012. The new exclusion amount is \$5 million for 2011 and is adjusted for inflation in 2012. Absent further legislation, the exclusion will revert to \$1 million in 2013. The top estate and gift tax rate is 35 percent in 2010, 2011, and 2012. Again, absent further legislation, the top tax rate will revert to 55 percent in 2013.

- **Reunification of Estate, Gift and GST.** The Tax Relief Act reunifies the exemption amounts allowed for estate, gift, and generation-skipping transfer taxes at \$5 million. This is in contrast to the disparity that existed in 2009 of a \$3.5 million estate tax exemption and a \$1 million gift tax exemption. Unlike many provisions, the reunification is effective in 2011 and does not sunset.
- **Utilization of Exemptions Between Spouses.** Historically, every decedent had his or her own exemption amount. If proper planning was not done and the first-to-die spouse did not use his or her full exemption, then the remaining exemption was lost. The Tax Relief Act allows the estate of the second-to-die spouse to use any unused portion of his or her spouse's exemption. The unused portion must be determined on the first-to-die spouse's estate tax return. This election is first available in 2011.
- **Special Election for 2010.** The 2001 Act repealed the estate tax for estates of decedents dying during 2010. The estate tax repeal included a modified, carryover basis for property in the hands of beneficiaries. Prior to the repeal, estates were taxed on the value of assets in excess of the exemption amount and the basis of property received a step-up in basis. Under the Tax Relief Act, the executor of an estate of a decedent dying during 2010 may elect which set of rules to apply. The executor may elect (i) to calculate the estate tax based on a \$5 million exemption and a 35 percent top rate, with assets receiving a step-up in basis, or (ii) to pay no estate tax and use a modified, carryover basis for property in the hands of beneficiaries. The election has no effect on the applicability of the generation-skipping transfer tax.

Tax Breaks and Incentives for Individuals

- **Retention of Tax Brackets.** The Economic Growth and Tax Reconciliation Act of 2001 ("2001 Act") lowered the individual income tax rates from 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent to 10 percent, 15 percent, 25 percent, 28 percent, 33 percent and 35 percent, respectively. These lowered rates were set to expire at the end of 2010. The Tax Relief Act extends the 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent rates through December 31, 2012.
- **Extension of 15 Percent Long-Term Capital Gains Rate.** The Jobs and Growth Tax Reconciliation Act of 2003 ("2003 Act") cut the top capital gains rate from 20 percent to 15 percent. The reduced capital gains rate was set to expire at the end of 2010. The Tax Relief Act extends the long-term capital gains rate of 15 percent through December 31, 2012.
- **Extension of 15 Percent Rate on Qualified Dividends.** The 2003 Act cut the top individual rate on qualified dividends from 35 percent to 15 percent. The

reduced qualified dividends rate was set to expire at the end of 2010. The Tax Relief Act extends the qualified dividend rate of 15 percent through December 31, 2012.

- **Payroll Tax Reduction.** The Tax Relief Act provides all wage earners (including self-employed individuals) a one-year payroll tax reduction in the amount of Social Security taxes paid in 2011. The Social Security payroll tax will be reduced from 6.2 percent to 4.2 percent for individual wages earned in 2011 up to the taxable wage base of \$106,800. The employer's share of Social Security tax is not affected and will remain at 6.2 percent. Self-employed individuals will pay 10.4 percent on self-employment income up to the taxable wage base of \$106,800. The tax reduction will provide a maximum benefit of \$2,136 per wage earner.
- **AMT Patch.** The AMT provisions were originally enacted to make sure that wealthy Americans did not escape paying taxes. However, the AMT has started to apply to more middle-income taxpayers, due in part because the AMT parameters are not indexed for inflation. In recent years, Congress has provided a "patch" to prevent the AMT from encroaching on middle-income taxpayers by raising the AMT exemption amounts. The Tax Relief Act provides a "patch" for 2010 in the amounts of \$47,450 for individual taxpayers, \$72,450 for married taxpayers filing jointly and for surviving spouses, and \$36,225 for married individuals filing a separate return. The Tax Relief Act also provides an increased "patch" for 2011 in the amounts of \$48,450 for individual taxpayers, \$74,450 for married taxpayers filing jointly and for surviving spouses, and \$37,225 for married individuals filing a separate return.
- **Extension of Repeal of Itemized Deduction Limitation.** The 2001 Act repealed an overall limitation on itemized deductions applicable to higher income individuals for tax year 2010. The 2001 Act's repeal was set to expire at the end of 2010 and the overall limitation on itemized deduction for higher income individuals was to have returned for tax year 2011. The Tax Relief Act extends the full repeal of the overall limitation on itemized deductions through December 31, 2012.
- **Extension of Marriage Penalty Relief.** The 2001 Act, as amended by the 2003 Act and the Working Families Tax Relief Act of 2004, increased the basic standard deduction for married individuals filing jointly to twice the amount for single individuals. The increased standard deduction was set to expire at the end of 2010. The Tax Relief Act extends the marriage penalty relief through December 31, 2012.

- **Extension of *Child Tax Credit*.** The child tax credit is a credit equal to a maximum of \$1,000 for each qualifying child under the age of 17. The child tax credit begins to phase out at a modified adjusted gross income level of \$110,000 for married individuals filing jointly. The Tax Relief Act extends the \$1,000 child tax credit and income limitations through December 31, 2012.
- **Extension of *the American Opportunity Tax Credit*.** The American Opportunity Tax Credit temporarily replaced the Hope education credit under the 2009 Recovery Act. The American Opportunities Tax Credit benefits qualifying families with college students. The maximum amount of the credit is \$2,500. The credit begins to phase out at a modified adjusted gross income level of \$160,000 for married individuals filing jointly. The Tax Relief Act extends the American Opportunities Tax Credit and income limitations through December 31, 2012.

Incentives for Businesses

- **One Hundred Percent Exclusion of Gain from the Sale of Small Business Stock.** Under the Small Business Jobs Act of 2010, the gain from the sale of qualifying small business stock that is acquired after September 27, 2010 and prior to January 1, 2011 and held for more than five years is excluded from the income of a non-corporate taxpayer. The Tax Relief Act extends the exclusion for one more year, for stock acquired before January 1, 2012.
- **Research Tax Credit.** Under pre-Tax Relief Act law, a taxpayer was entitled to a research tax credit for qualifying amounts paid or incurred before January 1, 2010. The Tax Relief Act retroactively extends the research credit for two years by substituting a December 31, 2011 expiration date.
- **Extension of Bonus Depreciation and Section 179 Expense.** The Tax Relief Act makes 100 percent bonus depreciation available for the cost of qualified property placed in service after September 8, 2010, and before January 1, 2012 (through January 1, 2013 for certain longer-lived property and for transportation property). A 50 percent bonus depreciation is available for qualified property placed in service after December 31, 2011, and before January 1, 2013 (through January 1, 2014 for certain longer-lived property and for transportation property). Because the bonus depreciation percentage is increased to 100 percent, taxpayers avoid past limitations associated with Section 179, such as the \$125,000 annual dollar limitation and the \$500,000 taxable income limitation for tax years beginning in 2010 or 2011. The new limitations are \$500,000 and \$2 million, respectively.

Energy Incentives

- ***Extension of Section 1603 Treasury Grant.*** Section 1603 of the tax title of the 2009 Recovery Act appropriates funds for payments to persons who place in service specified energy property during 2009 or 2010, or after 2010 if construction commenced no later than December 31, 2010. The grant program provides a grant in lieu of a tax credit equal to 30 percent of the qualifying project property costs for solar, wind, biomass, geothermal, fuel cell, waste energy, hydropower, and marine power projects, and 10 percent of the project costs for microturbines, thermal heat pump systems, and combined heat and power systems. The Tax Relief Act extends the start of the construction commencement deadline for one year so that taxpayers can elect to receive the cash grant in lieu of a tax credit for specified energy properties that are placed in service or for which construction begins on or before December 31, 2011. The application deadline for the grant is also extended by one year and must be received prior to October 1, 2012.
- ***Non-business Energy Property Credit.*** The non-business energy property credit provided under Section 25C of the Internal Revenue Code provides an incentive to individuals to make energy efficient upgrades to their primary residences. Under the 2009 Recovery Act, this credit equaled 30 percent of the costs of qualified energy efficiency improvements and property, with a lifetime maximum credit of \$1,500. The Tax Relief Act extends the non-business energy property credit through December 31, 2011 at a reduced amount. The reduced credit amount applicable for 2011 is 10 percent of the costs of qualified energy property placed in service in 2011, with an aggregate lifetime maximum credit of \$500 for all tax years ending after December 31, 2005.

IRS Circular 230 Notice

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