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TAX RELIEF ACT OF 2010

By: William C. Hussey, II

On December 16, the House of Representative passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Tax Relief Act) that had previously passed the Senate following the compromise reached between the White House and Senate Republicans. The Tax Relief Act now goes to President Obama for his signature, which is expected without any further delay.

The Tax Relief Act contains a two-year extension of current income tax rates and other tax relief, a number of provisions designed to spur business investment, unexpected but significant estate tax reform, and a host of other tax relief measures. Nothing in the legislation, however, is permanent. The following brief overview of the Tax Relief Act explains how it might impact your personal or business tax planning.

CURRENT INDIVIDUAL INCOME TAX RATES EXTENDED FOR TWO YEARS

The personal income tax rates originally enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) were scheduled to expire on January 1, 2011. The Tax Relief Act extends those rates for all taxpayers for an additional two years. Accordingly, all of the following income provisions will continue to apply through 2012:

- The income tax rates for individuals will remain at 10%, 15%, 25%, 28%, 33% and 35% instead of reverting to 15%, 28%, 31%, 36% and 39.6%, respectively.
- The so-called "Marriage Penalty Relief" provisions are extended as well. Thus, the 15% tax bracket for married taxpayers filing a joint return (and surviving spouses) remains twice that of the 15% tax bracket for individual filers. The standard deduction for those taxpayers also remains twice that of the standard deduction for single taxpayers. If a married couple files separate returns, the standard deduction is one-half of that for joint filers. Without extension, both the 15% bracket and the standard deduction would revert to lower levels and result in higher taxes for those married taxpayers.
- Itemized deductions of higher-income taxpayers are not subject to reduction as a percentage of the taxpayer's Adjusted Gross Income (AGI). Likewise, such high-income taxpayer's personal exemptions are not subject to phase out when AGI exceeds certain levels.
- The lower dividend and capital gains tax rates originally enacted in 2003 are also extended through 2012. Accordingly, long-term capital gains will continue to be taxed at a maximum rate of 15% instead of increasing to 20% generally. The zero percent rate continues to apply to certain low-income taxpayers. Qualified dividends will also continue to be taxed at the long-term capital gains rates rather than increasing to the same rates applicable to ordinary income.

PAYROLL TAX RELIEF

Both employees and self-employed individuals will enjoy a one-year reduction in the Social Security tax equal to 2% of all wages and self-employment income up to $106,800. This payroll tax relief is intended to replace the "Making Work Pay" tax credit that had previously provided a refundable $400 tax credit to eligible taxpayers.

UNEMPLOYMENT BENEFITS EXTENDED

As a key component of the compromise legislation, federal unemployment benefits will be extended for an additional 13 months. For the unemployed residents of states hardest hit by the recent recession, unemployment benefits might be available to them for as long as 99 weeks.

TAX CREDITS AND OTHER EXCLUSIONS ALSO EXTENDED

The following tax benefit provisions, including many educational benefits, also remain in place for two more years: (i) the child tax credit; (ii) credit for household and dependent care; (iii) earned income tax credit, and (iv) above-the-line student loan interest deduction. The American Opportunity educational tax credit is also extended and worth up to $2,500 per year to offset higher education expenses. It can be claimed by qualifying individuals (*i.e.*, those single taxpayers with

modified AGI below $90,000 or $180,000 for married couples filing jointly) for up to four years of college expenses.

A number of other tax breaks for individuals that originally expired at the end of 2009 are retroactively reinstated and extended through 2011. Of particular interest, these provisions include: (i) extension of the rule permitting annual tax-free distributions to charity from IRAs of up to $100,000 per taxpayer (including the option to make charitable transfers during January 2011 as if made during 2010); (ii) the election to take an itemized deduction for state and local sales taxes rather than for state and local income taxes (generally beneficial for only those taxpayers who live in a state with no state income taxes); and, (iii) the above-the-line deduction for qualified tuition and related expenses.

ALTERNATIVE MINIMUM TAX (AMT) RELIEF

The AMT exemption amounts for 2010 will be $47,450 for individuals and $72,450 for married taxpayers filing jointly; for 2011, they will be $48,450 for individuals and $74,450 for married taxpayers filing jointly. Without the implementation of an AMT "patch," it is estimated that as many as 20 million additional taxpayers would be subject to the AMT this year.

BUSINESS TAX RELIEF AND INCENTIVES

The Tax Relief contains a number of familiar provisions that are extended in an effort to encourage business investment, including the following:

- For property acquired and placed in service after September 8, 2010 but by December 31, 2011, 100% bonus first-year depreciation is allowed;
- For property placed in service between January 1 and December 31, 2012, 50% bonus first-year depreciation is allowed.
- For 2012 and thereafter, the maximum amount that may be expensed under Code Section 1979 will be $125,000, and the investment-based phase-out amount will be set at $500,000.
- Like many individual tax credits, also reinstated retroactively to the 2010 tax year and made applicable through 2011 are a number of previously expired business tax credit provisions, including: (i) the research tax credit; (ii) the new markets tax credit; (iii) expensing of environmental remediation costs; and (iv) the work opportunity tax credit.
- A large number of 'green energy' tax provisions were extended through 2011 although not originally included in the compromise proposed by the White House.
- Numerous disaster relief zone provisions were also extended until the end of 2011.

(SURPRISE) ESTATE TAX RELIEF

The Tax Relief Act contained a surprising number of favorable estate tax provisions in addition to the income tax provisions discussed above. Without these provisions, the federal estate tax would have returned in 2011 to pre-2001 levels - which provided for only a $1 million exemption per individual and a top tax rate of 55%. It was previously widely expected that any compromise would have likely provided for only a $3.5 million exemption per person and a top tax rate of 45% as had been in effect in 2009. However, for decedents dying in 2011 and 2012 only, the estate tax provisions of the Tax Relief Act went well beyond those expectations:

- Surprise Number 1 – The Tax Relief Act includes a $5 million unified and indexed exemption amount per individual from the federal estate (and Generation Skipping Transfer) taxes. A completely new addition to the estate tax code will permit the executor of a deceased spouse's estate to transfer any unused exemption from his or her estate to the surviving spouse. Thus, for married couples, the provisions effectively permits them to shield up to $10 million in assets from the estate tax even if they have previously failed to properly title assets or otherwise make appropriate provisions for the use of both of their individual exemptions from the estate tax. The lifetime exemption from the federal gift tax will nevertheless remain at $1 million per person in 2010, but rises to $5 million in 2011 and 2012.
- Surprise Number 2 - The top marginal tax rate will be 35% and applies to all of the federal transfer taxes, including the estate, gift, and generation skipping transfer taxes.
- Surprise Number 3 - An election will now be permitted to allow the personal representative of a decedent who died in 2010 to choose whether to apply the 2010 or the 2011-2012 rules in determining their estate tax liability. Under EGTRRA, estates of decedents dying in 2010 were subject to no estate tax but were instead subject to modified carryover basis rules that permitted a limited amount of the estate's assets to be stepped up to their fair market value on the date of death. Under the Tax Relief Act, the personal representative may instead elect to apply the $5 million exemption and 35% top rate, but will receive a full step-up in basis of all the assets in the estate. The election to apply the new estate tax rules might be particularly beneficial to the estates of unmarried decedents that died in 2010 while holding a substantial amount of appreciated property.

If you would like to discuss how any of these changes may affect your business or personal income tax situation, or have any other tax or estate planning questions, please contact Bill Hussey (215.864.6257), Scott Borsack (215.864.7048), or Kevin Koscil (215.864.6827).

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