

JANSEN WALK THOMPSON REAHM PC

Certified Public Accountants and Consultants

December 2010

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010—Individual Income Tax Provisions

To our Clients and Friends:

On December 17, 2010 President Obama signed *The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (H.R. 4853—the 2010 Tax Relief Act). The 2010 Tax Relief Act extends for two years the so called Bush-era tax rate cuts, provides significant estate tax relief, and includes a two-year AMT “patch.” However, it also contains a trove of other tax breaks for businesses and individuals, including a 100% first-year bonus depreciation for qualifying property placed in service after September 8, 2010 and before January 1, 2012, a payroll / self-employment tax cut of two percentage points for 2011 only for employees and self-employed individuals, and a host of “extenders” for businesses and individuals. Here is an overview of the individual tax provisions of the 2010 Tax Relief Act.

EGTRRA Tax Rate Cuts Extended for Two Years

Under current law, the provisions of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA), other than those made permanent or extended by subsequent legislation, would have sunset and would not have applied to tax or limitation years beginning after 2010. The sunset was designed to keep the costs of EGTRRA small enough to ensure widespread support in Congress at that time. The 2010 Tax Relief Act would amend EGTRRA to postpone that sunset until after 2012. That is, under the 2010 Tax Relief Act, the income tax provisions of EGTRRA, other than those made permanent or extended by subsequent legislation, will sunset and will not apply to tax or limitation years beginning after 2012 (instead of 2010).

Tax rates. The income tax rates for individuals will stay at 10%, 15%, 25%, 28%, 33% and 35%, instead of moving to 15%, 28%, 31%, 36% and 39.6%. Additionally, the size of the 15% income tax bracket for joint filers and qualified surviving spouses will remain at 200% (instead of dropping to 167%) of the 15% income tax bracket for individual filers.

Under the 2010 Tax Relief Act, the tax rate schedules for 2011, adjusted for inflation, will be:

FOR MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES, THE 2011 RATE BRACKETS WILL BE:	
If taxable income is:	The tax will be:
-----	-----
Not over \$17,000	10% of taxable income
Over \$17,000 but not over \$69,000	\$1,700.00 plus 15% of the excess over \$17,000
Over \$69,000 but not over \$139,350	\$9,500.00 plus 25% of the excess over \$69,000
Over \$139,350 but not over \$212,300	\$27,087.50 plus 28% of the excess over \$139,350
Over \$212,300 but not over \$379,150	\$47,513.50 plus 33% of the excess over \$212,300
Over \$379,150	\$102,574.00 plus 35% of the excess over \$379,150

FOR SINGLE INDIVIDUALS (OTHER THAN HEADS OF HOUSEHOLDS AND SURVIVING SPOUSES), THE 2011 RATE BRACKETS WILL BE:

If taxable income is:	The tax will be:
-----	-----
Not over \$8,500	10% of taxable income
Over \$8,500 but not over \$34,500	\$850.00 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$83,600	\$4,750.00 plus 25% of the excess over \$34,500
Over \$83,600 but not over \$174,400	\$17,025.00 plus 28% of the excess over \$83,600
Over \$174,400 but not over \$379,150	\$42,449.00 plus 33% of the excess over \$174,400
Over \$379,150	\$110,016.50 plus 35% of the excess over \$379,150

FOR HEADS OF HOUSEHOLDS, THE 2011 RATE BRACKETS WILL BE:

If taxable income is:	The tax will be:
-----	-----
Not over \$12,150	10% of taxable income
Over \$12,150 but not over \$46,250	\$1,215.00 plus 15% of the excess over \$12,150
Over \$46,250 but not over \$119,400	\$6,330.00 plus 25% of the excess over \$46,250
Over \$119,400 but not over \$193,350	\$24,617.50 plus 28% of the excess over \$119,400
Over \$193,350 but not over \$379,150	\$45,323.50 plus 33% of the excess over \$193,350
Over \$379,150	\$106,637.50 plus 35% of the excess over \$379,150

FOR MARRIEDS FILING SEPARATE RETURNS, THE 2011 RATE BRACKETS WILL BE:

If taxable income is:	The tax will be:
-----	-----
Not over \$8,500	10% of taxable income
Over \$8,500 but not over \$34,500	\$850.50 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$69,675	\$4,750.00 plus 25% of the excess over \$34,500
Over \$69,675 but not over \$106,150	\$13,543.75 plus 28% of the excess over \$69,675
Over \$106,150 but not over \$189,575	\$23,756.75 plus 33% of the excess over \$106,150
Over \$189,575	\$51,287.00 plus 35% of the excess over \$189,575

Standard deduction for marrieds. EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. If the EGTRRA sunset had kicked in, the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) would have dropped to 167% of the standard deduction for single taxpayers. The standard deduction for married taxpayers filing separately would have been one-half of the standard deduction for joint filers.

Under the 2010 Tax Reform Act, the 2011 and 2012 basic standard deduction for married taxpayers filing jointly (and qualified surviving spouses) remains at 200% (rather than 167%) of the basic standard deduction for single taxpayers. (The standard deduction for marrieds filing separately continues to be one-half of the joint filer amount.)

Based on CPI figures, we calculate that under the 2010 Tax Reform Act, for marrieds filing a joint return (or surviving spouses), the 2011 basic standard deduction will be \$11,600 (up from \$11,400 for 2010). By comparison, under EGTRRA's sunset rule the 2011 basic standard deduction would have been only about \$9,650 for marrieds filing jointly. For marrieds filing separately, the basic standard deduction will be \$5,800 for 2011 (up from \$5,700 for 2010).

Pease and PEP limitations will not apply. For 2011 and 2012.

Pease. Prior to EGTRRA, certain itemized deductions of higher-income taxpayers were limited under the so-called "Pease" limitation. The Pease limitation was phased out under EGTRRA over the years 2006-2010, but was scheduled to come back in 2011. That is, after 2010 the total of those itemized deductions would have been reduced by 3% of AGI above an inflation-adjusted figure, but the reduction would not have exceeded 80% of the total itemized deductions subject to the phase-out. The 2010 Tax Reform Act extends full repeal of the Pease limitation for 2011 and 2012.

PEP. Prior to EGTRRA, a higher-income taxpayer's personal exemption deduction was also limited. The limitation was phased out under EGTRRA over the years 2006-2010, but was scheduled to come back in 2011. That is, after 2010 the total of the personal exemption deduction could have been reduced based on AGI above an inflation-adjusted figure, and the reduction could have taken the deduction for personal exemptions to zero. The 2010 Tax Reform Act extends full repeal of the PEP limitation on the deduction for personal exemptions for 2011 and 2012.

Based on CPI figures, we calculate that for 2011 the personal exemption amount will be \$3,700 (up from \$3,650 for 2010). Current law rules for the following tax provisions will also remain in place through 2012 (many subject to limitations based on AGI):

- The \$2,000 Coverdell Education Saving Accounts (CESAs), formerly called education IRAs;
- The \$5,250 exclusion for employer-provided educational assistance;
- Exemption from the payments-for-services rule for amounts received under certain Government health professions scholarship programs;
- The \$2,500 above-the-line student loan interest deduction;
- Credit for employer-provided child care facilities;
- Enhanced earned income tax credit (EITC);

- Higher credit for household and dependent care;
- The \$1,000 child tax credit;
- The adoption credit enhancements made under the health care reform bill; and
- The American Opportunity Tax Credit (formerly the Hope credit), which was enhanced under a 2009 tax act.

JGTRRA Rules for Capital Gains and Qualified Dividends Extended for Two Years

The bill defers for two years the sunset of the *Jobs and Growth Tax Relief Reconciliation Act of 2003* (JGTRRA). Thus, through December 31, 2012, long-term capital gain (with the exception of the 28% rate on collectibles and the 25% rate for recaptured Section 1250 gain) will continue to be taxed at a maximum rate of 15%. If the JGTRRA sunset rule went into effect, long-term capital gain would have been taxed at 20% (18% for assets held more than five years).

And through 2012, qualified dividends paid to individuals will be taxed at the same rates as long-term capital gains (generally 15%), instead of being taxed under the JGTRRA sunset rule at the same rates that would have applied to ordinary income—a maximum of 39.6% under JGTRRA.

Alternative Minimum Tax (AMT) “Patched” for Two Years

The higher AMT exemption amounts expired at the end of 2009. Under the 2010 Tax Reform Act, the AMT exemption amounts (like a “standard deduction” in the AMT calculation) for 2010 will be as follows:

- Married individuals filing jointly and surviving spouses: \$72,450, less 25% of AMTI exceeding \$150,000 (zero exemption when AMTI is \$439,800);
- Unmarried individuals: \$47,450, less 25% of AMTI exceeding \$112,500 (zero exemption when AMTI is \$302,300) (different amount applies for a child subject to the kiddie tax); and
- Married individuals filing separately: \$36,225, less 25% of AMTI exceeding \$75,000 (zero exemption when AMTI is \$219,900). But AMTI is increased by the lesser of \$36,225 or 25% of the excess of AMTI (without the exemption reduction) over \$219,900.

Under the 2010 Tax Reform Act, the AMT exemption amounts for 2011 will be as follows:

- Married individuals filing jointly and surviving spouses: \$74,450, less 25% of AMTI exceeding \$150,000 (zero exemption when AMTI is \$447,800);
- Unmarried individuals: \$48,450, less 25% of AMTI exceeding \$112,500 (zero exemption when AMTI is \$306,300) (different amount applies for a child subject to the kiddie tax); and
- Married individuals filing separately: \$37,225, less 25% of AMTI exceeding \$75,000 (zero exemption when AMTI is \$223,900). But AMTI is increased by the lesser of \$37,225 or 25% of the excess of AMTI (without the exemption reduction) over \$223,900.

Without the “patch” in the 2010 Tax Reform Act, post-2009 AMT exemption amounts would have plummeted to their pre-EGTRRA levels. For 2010, they would have been \$45,000 for

married individuals filing jointly and surviving spouses, \$33,750 for unmarried individuals; and \$22,500 for married individuals filing separately.

Also for 2010 and 2011, many nonrefundable personal credits will be allowed against the AMT. Without the “patch,” they could not offset the Tentative Minimum Tax (TMT) in deriving AMT.

Estate Tax Relief

EGTRRA phased-out the estate and generation-skipping transfer taxes so that they were fully repealed in 2010, gradually lowered the gift tax rate to 35% and increased the gift tax exemption to \$1 million for the years 2002 through 2010. Under the EGTRRA sunset rule, the estate tax was set to return in 2011, with the top estate and gift tax rate reverting to 55% with an estate tax exemption of \$1 million in 2011. For 2010, under EGTRRA, the basis rules for inherited property were to be similar to the gift tax rules with a limited opportunity for heirs to get an increase in tax basis for transferred assets. Under the EGTRRA sunset rule, the pre-EGTRRA basis step-up rules were to return for 2011.

Among other changes, the 2010 Tax Relief Act:

- Lowers estate and GST taxes for 2011 and 2012 by increasing the exemption amount (technically, the applicable exclusion amount) from \$1 million to \$5 million (as indexed after 2011) and by reducing the top estate tax rate from 45% in 2009 and 55% previously planned for 2011 to 35% for 2010, 2011 and 2012.
- Allows estates of decedents dying in 2010 to choose between: (1) an estate tax based on a \$5 million exemption and a 35% top rate with a step-up in basis, or (2) no estate tax and modified carryover basis. In technical terms, the Act achieves this choice by making the estate tax and basis changes effective retroactively for estates of decedents dying after 2009 by allowing the opt-out choice for estates of decedents dying in 2010.
- For gifts made after December 31, 2010, reunifies the gift tax with the estate tax, with an applicable lifetime gift exclusion of \$5 million with a top gift tax rate of 35%.
- Provides that the GST tax exemption for decedents dying or gifts made after December 31, 2009 is equal to the applicable exclusion amount for estate tax purposes (e.g., \$5 million for 2010). Therefore, up to \$5 million in GST tax exemption may be allocated to a trust created or funded during 2010. Although the GST tax is applicable in 2010, the GST tax rate for transfers made during 2010 is 0%. The GST tax rate for transfers made in 2011 and 2012 will be 35%.
- For a decedent dying after December 31, 2009, and before the enactment date, provides that the due date for actions (e.g., filing an estate tax return) is not to be earlier than the date that is nine months after the enactment date.
- Effective for estates of decedents dying after December 31, 2010, allows the executor of a deceased spouse’s estate to elect to transfer any unused exemption to the surviving spouse.

With the above election and careful estate planning, married couples can effectively shield up to \$10 million from estate tax by providing that each spouse maximize his or her \$5 million exemption under the 2010 Tax reform Act.

Temporary Employee / Self-Employed Payroll Tax Cut for 2011

Under current law, employees pay a 6.2% Social Security tax on all wages earned up to \$106,800 (in 2011) and self-employed individuals pay 12.4% Social Security self-employment taxes on all their self-employment income up to the same threshold. For 2011, the 2010 Tax Reform Act gives a two-percentage-point payroll / self-employment tax holiday for employees and self-employed, in lieu of the Making Work Pay credit that expires at the end of 2010. As a result, employees will pay only 4.2% (6.0%-2.0%) Social Security tax on wages and self-employment individuals will pay only 10.4% (12.4%-2.0%) Social Security self-employment tax on self-employment income up to the threshold.

The maximum employee and self-employed savings for 2011 will be \$2,136 (2% * \$106,800).

Long List of Tax Breaks for Individuals Retroactively Reinstated and Extended Through 2011

Many tax breaks for individuals that expired at the end of 2009 will be retroactively reinstated and extended through 2011, including:

- The \$250 above-the-line deduction for certain expenses of elementary and secondary school teachers;
- The election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes;
- Increased contribution limits and carryforward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes;
- The above-the-line deduction for qualified tuition and related expenses;
- The provision that permits taxpayers age 70½ or older to make tax-free distributions of up to \$100,000 per taxpayer to charity from an Individual Retirement Account (IRA) per tax year. Additionally, individuals will be allowed to treat IRA transfers to charities during January of 2011 as if made during 2010;
- The increase in the monthly exclusion for employer-provided transit and vanpool benefits to that of the exclusion for employer-provided parking benefits; and
- The 2010 Tax Reform Act will extend for an additional year (i.e., through 2011 only), the rule allowing premiums for mortgage insurance to be deductible as interest that is qualified residence interest.

The 2010 Tax Reform Act did not extend to 2010 through 2012 the additional standard deduction for real property taxes, which expired at the end of 2009.

In addition to the above, there were a number of business and energy tax provisions that were extended through 2011 or 2012. See our separate letter on those.

Circular 230 disclosure:

This written advice and its contents are not intended or written to be used, and cannot be used, by you or any other person or entity for the purpose of avoiding penalties that may be imposed on you by IRS under the Internal Revenue Code or by any applicable state or local law.