

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

After much fanfare, speculation and compromise, President Obama signed into law on December 17 the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). This summary will address many of the Individual, Estate and Business provisions that will impact your tax liability for 2011, 2012, and in some cases, 2010.

INDIVIDUAL:

INCOME TAX RATES

The Act extends the 10%, 25%, 28%, 33%, and 35% individual income tax brackets for an additional two years, through 2012.

CAPITAL GAINS RATES

The Act allows the capital gains rates to remain at 0% for taxpayers below the 25% bracket and 15% for all other taxpayers through 2012.

DIVIDENDS TAXED AT CAPITAL GAINS RATES

The current dividend rates of 0% for taxpayers below the 25% bracket and 15% for taxpayers in the 25% bracket and above are extended through 2012.

PHASE-OUT OF MARRIAGE PENALTY IN THE 15% BRACKET

The 15% regular income tax bracket for married couples filing joint returns set at twice the corresponding bracket for an unmarried individual filing a single return (marriage penalty relief for the 15% bracket) is extended through 2012.

EMPLOYEE PAYROLL TAX CUT

For 2011 only, the Act reduces the Social Security tax rate on employees to 4.2% (from 6.2%) and reduces the self-employment tax rate to 10.4% (from 12.4%). The Act does not reduce the Social Security contribution base, which is \$106,800 for 2011. Thus, the maximum Social Security tax in 2011 for employees is \$4,485.60. Employers will not see a corresponding drop in their share of the FICA tax. In addition, the rate reduction is not taken into account in determining the self-employment tax deduction allowed for determining net earnings from self-employment. As a result, the deduction for 2011 remains 7.65% of self-employment income (determined without regard to the deduction).

ALTERNATIVE MINIMUM TAX EXEMPTION AMOUNT AND CREDIT RELIEF

The Act patches the AMT exemption for 2010 and 2011 by increasing the exemption to \$72,450 in 2010 and to \$74,450 in 2011 for married taxpayers filing jointly. For an individual who is not married and is not a surviving spouse, the exemption amount is \$47,450 for tax years beginning in 2010, and \$48,450 for tax years beginning in 2011 and for married taxpayers filing separate returns, the exemption amount is 1/2 of the married filing jointly amount. In addition, both the personal credits and nonrefundable credits can offset AMT through 2011.

ELIMINATION OF MARRIAGE PENALTY IN STANDARD DEDUCTION

The Act extends, from 2010, the basic standard deduction for married couples filing joint

returns that is twice the basic standard deduction for an unmarried individual filing a single return, through 2012.

REPEAL OF PHASE-OUT FOR PERSONAL EXEMPTIONS

The Act extends the repeal of personal exemption for an additional two years, through 2012. Thus, the personal exemption amounts will continue to be allowed regardless of the taxpayer's income.

PHASE-OUT OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS

Similar to the personal exemption, the Act extends the repeal of the overall limitation on deductions for higher income taxpayers for an additional two years, through 2012.

DEPENDANT CARE CREDIT

This is a credit based on an applicable percentage of child and dependent care expenses for children under age 13 and disabled dependents. Eligible expenses of \$3,000 for one eligible child/disabled dependent and \$6,000 for two or more eligible children/disabled dependents, along with the increased applicable percentage of 35% are extended for an additional two years, through 2012.

DEDUCTION OF STATE AND LOCAL TAXES

The Act extends, from 2009, the election available to taxpayers who itemize their deductions to deduct state and local sales taxes in lieu of state and local income taxes.

CONTRIBUTIONS OF CAPITAL GAIN REAL PROPERTY MADE FOR CONSERVATION PURPOSES

The Act extends, from 2009, the increased contribution limitations and carryover period for charitable contributions of certain conservation property for contributions made through December 31, 2011.

TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR CHARITABLE PURPOSES

Through 2011, the Act allows taxpayer's at age 70 1/2 or older to make tax-free distributions to charities from their traditional individual retirement accounts up to \$100,000 per taxpayer, per taxable year.

A special provision is included permitting payments to charitable recipients made in January 2011 to be treated as if made on December 31, 2010.

DEDUCTION FOR MORTGAGE INSURANCE PREMIUMS

The Act extends for one year, through 2011, the itemized deduction for the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out so that the deduction is unavailable for a taxpayer with adjusted gross income in excess of \$110,000.

EXCLUSION OF 100% OF GAIN ON CERTAIN SMALL BUSINESS STOCK

The Act extends the 100% exclusion of the gain from the sale of qualifying small business stock that is acquired before January 1, 2012, and held for more than five years. This provision is effective with respect to stock acquired after December 31, 2010. Qualifying small business stock is stock from a C corporation whose gross assets do not exceed \$50 million (including the proceeds received from the issuance of the stock) and that meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of 10 times the taxpayer's basis in the stock or \$10 million of gain from stock in that corporation.

CREDIT FOR NON-BUSINESS ENERGY PROPERTY

The Act extends, from 2010, the non-business energy property credit (applicable to such items as furnaces, water heaters, insulation materials, exterior windows and doors), to property placed in service on or before December 31, 2011. For property installed after December 31, 2010, the credit is 10%, with a maximum of \$500, with \$200 of that for windows. Currently the credit is 30% with a lifetime maximum credit limit of \$1,500. The Act prohibits taxpayers from taking the credit for expenditures for qualified energy efficiency improvements made from subsidized energy financing.

ESTATE AND GIFT TAX:

Although the media primarily focused on the two-year extension of the Bush-era income tax cuts, the Act has an enormous impact on the estate, gift and generation skipping transfer tax. Moreover, many of the provisions were not expected. The following is a summary of the estate, gift and GST provisions of the new Act.

RETROACTIVE ESTATE TAX FOR 2010

The Act reenacts the estate tax for 2010 but gives estates of decedents dying after December 31, 2009 and before January 1, 2011, 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 a stepped-up basis or (2) no estate tax and modified carryover basis rules that were in effect for 2010. The estate tax return is normally due nine months after the date of death. In light of the special circumstances in 2010, the Act extends that filing date (as well as the payment date for the tax) for 2010 decedents to September 17, 2011.

ESTATE TAX FOR 2011 AND 2012

For decedents dying in 2011 and 2012, the Act greatly reduces the reach of the estate tax by granting estates a \$5.0 million exemption for property subject to the tax (adjusted for inflation in 2012) and a top estate tax rate of 35%. In addition, effective January 1, 2011, the Act introduces the concept of exemption "portability" between spouses - if one spouse does not use all of his or her \$5.0 million exemption, it may be used by the estate of the surviving spouse, effectively creating a \$10.0 million exemption for married couples.

GIFT TAX

For 2010, the gift tax rate remains at 35% with a \$1.0 million lifetime exemption for gift tax purposes. However, that exemption is increased to \$5.0 million for gifts made in 2011 and 2012, (adjusted for inflation in 2012), the top gift tax rate for 2011 and 2012 is 35% and the gift and estate tax is reunified.

GENERATION-SKIPPING TRANSFER (GST) TAX

The GST is an additional tax imposed on gifts and bequests to grandchildren and later descendants. Under the law prior to the Act, the GST tax was repealed for 2010 but there was a lack of clarity as to the effect of that repeal. The Act eliminates that uncertainty, providing that there is a GST tax for 2010, but it has a 0% tax rate and a \$5 million exemption. This means that any generation-skipping transfers that occur in 2010 are tax-free, and that taxpayers may take advantage of the various GST tax exemptions that could reduce or eliminate the tax in future years. In 2011 and 2012, the GST exemption is \$5.0 million (adjusted for inflation in 2012) and the tax rate is 35%.

A decedent's unused GST tax exemption is not "portable" to a surviving spouse.

There is a very narrow window until December 31 in which to make generation-skipping

gifts free of the GST tax. This would be especially beneficial with regard to trusts that are not protected from the GST tax. A distribution could be made outright to a grandchild or more remote descendant, such as a great grandchild, without having to pay any tax because of the 0% tax rate. Moreover, if the trust instrument or state law allows, the trust funds can be taken from an existing multigenerational trust, declared subject to the 2010 GST tax and deposited in a new trust for grandkids' benefit, with the GST tax now pre-paid at a 0% rate. Assets that aren't yet in a trust and are given to grandkids (either outright or in a trust) before year's end could also benefit from the 0% rate. However, to the extent the giver has used up his or her \$1 million lifetime gift tax exemption, the gift would be subject to a 35% gift tax.

SUNSET OF ESTATE, GIFT AND GST TAX IN 2013

Unfortunately, the Act is only a temporary measure - in 2013, the pre-2001 estate and gift tax provisions will return with the GST, estate and gift taxes, will revert to a \$1.0 million exemption and a 55% tax rate. The temporary nature of the estate, gift and GST tax changes means that they cannot be relied upon for long term planning purposes. Congress will revisit the estate, gift and GST taxes in late 2012, and we cannot predict what action it will take at that time. Nevertheless, now that there is certainty of the law for at least two years, the time is ripe to take advantage of these favorable provisions, including commencing in 2011 a \$5,000,000 gift tax exemption.

BUSINESS OWNERS:

BONUS DEPRECIATION

The Act extends the 50% bonus depreciation provision for qualified property acquired after December 31, 2007, and before January 1, 2013. In addition, it allows 100% bonus depreciation for property acquired and placed in service after September 8, 2010, and before January 1, 2012. Thus, taxpayers can claim a 100% depreciation deduction for property acquired and placed in service in the latter third of 2010, all of 2011 (and 2012, for certain long-lived property and transportation property). Property placed in service during 2012 (2013 for certain long-lived property and transportation property) would be eligible for 50% bonus depreciation. The Act also extends the provision allowing corporate taxpayers to elect to accelerate the AMT and research credits in lieu of bonus depreciation to the 2011 and 2012 taxable years. This provision is not limited to use by smaller businesses or capped at a certain dollar level.

SMALL BUSINESS EXPENSING

Under prior legislation, for taxable years beginning in 2010 and 2011, small businesses may elect to expense up to \$500,000 of capital investment, with the phase out beginning at \$2,000,000, known as Section 179 expensing. The limits were scheduled to be lowered to \$25,000 with a \$200,000 limitation for 2012. Under the new law, for 2012, such amount is raised to \$125,000, with a phase out threshold of \$500,000 (both figures to be adjusted for inflation). A \$25,000 maximum and \$200,000 phase out threshold will apply for tax years beginning after 2012 and will not be adjusted for inflation. The act also extends the treatment of off the shelf computer software as qualifying property if placed in service before 2013. Qualified real property does not share in the expensing benefits. However, under the 2010 Small Business Jobs Act, a taxpayer can elect up to \$250,000 of the \$500,000 Code Sec. 179 deduction limit (subject to the investment limit) for qualified real property (qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property) for any tax year beginning in 2010 or 2011.

TEMPORARY EMPLOYEE PAYROLL TAX CUT

For 2011 only, the 2010 TRA reduces the Social Security (OASDI) tax rate on employees to 4.2% (from 6.2%) and reduces the self-employment tax (SECA) rate to 10.4% (from 12.4%). The employer OASDI tax rate stays at 6.2%. Note that the 2010 TRA does not reduce the OASDI contribution base, which is \$106,800 for 2011. Thus, the maximum OASDI tax in 2011 for employees is \$4,485.60.

This rate reduction is not taken into account in determining the SECA tax deduction allowed for determining net earnings from self-employment. As a result, the deduction for 2011 remains 7.65% of self-employment income (determined without regard to the deduction).

RESEARCH CREDIT

Although the research credit expired on December 31, 2009, the Act extends for 2 years (2010 and 2011) the credit for amounts paid or incurred on or before December 31, 2011. The December 31, 2008 termination date for the alternative incremental credit election remains unchanged.

EMPLOYER WAGE CREDIT FOR EMPLOYEES WHO ARE ACTIVE DUTY MEMEBERS OF THE UNIFORMED SERVICES

The Act extends, from December 31, 2009, the activated military reservist wage payment credit of 20% of differential wage payments made to activated military reservists for payments made before January 1, 2012.

15-YEAR STAIGHT-LINE COST RECOVERY FOR QUALIFIED LEASHOLD IMPROVEMENTS, QUALIFIED RESTAURANT BUILDINGS AND IMPROVEMENTS, AND QUALIFIED RETAIL IMPROVEMENTS

The Act extends, from December 31, 2009, the special 15-year cost recovery period for certain leasehold improvements, restaurant buildings and improvements, and retail improvements to qualified property placed in service before 2012. Eligible improvements included:

- Any improvement to an interior portion of a building that is nonresidential real property, provided that the improvement is made under a lease of that portion of the property occupied exclusively by the lessee, and the improvement is placed in service more than three years after the date the building was first placed in service. Expenditures attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building are not qualified.
- Qualified restaurant property, which is any building if more than 50 percent of its square footage is devoted to the preparation of, and seating for on-premises consumption of prepared meals.
- Qualified retail improvement property, which is any improvement to an interior portion of nonresidential real property if such portion is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the building was first placed in service. Expenditures attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building are not qualified.

7-YEAR RECOVERY PERIOD FOR MOTORSPORTS ENTERTAINMENT COMPLEXES

The Act extends, from December 31, 2009, the 7-year recovery period for motorsports entertainment complexes to property placed in service before 2012.

EXPENSING OF ENVIRONMENTAL REMEDIAL COSTS

The Act extends, from December 31, 2009, the election to deduct environmental remediation costs in lieu of capitalization through December 31, 2011.

BASIS ADJUSTMENT TO STOCK OF S CORPORATIONS MAKING CHARITABLE CONTRIBUTIONS OF PROPERTY

Under current law an S corporation shareholder's basis reduction resulting from the corporation's charitable contribution of property equaled the shareholder's pro rata share of the adjusted basis of the contributed property. The Act extends this special rule from December 31, 2009, to contributions made on or before December 31, 2011.

WORK OPPORTUNITY CREDIT

Businesses are allowed to claim a work opportunity tax credit equal to 40% of the first \$6,000 of wages paid to new hires of one of nine targeted groups. While scheduled to expire August 31, 2011, the Act extends the credit through December 31, 2011, effective for individuals who begin work for an employer after December 17, 2010.

EXCLUSION OF 100 PERCENT OF GAIN ON CERTAIN SMALL BUSINESS STOCK

The Act extends the 100% exclusion of the gain from the sale of qualifying small business stock that is acquired before January 1, 2012, and held for more than five years. This provision is effective with respect to stock acquired after December 31, 2010. Qualifying small business stock is stock from a C corporation whose gross assets do not exceed \$50 million (including the proceeds received from the issuance of the stock) and that meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of 10 times the taxpayer's basis in the stock or 10 million dollars of gain from stock in that corporation.

INCREASE IN REHABILITATION CREDIT

The Act extends, from December 31, 2009, the increased rehabilitation credit for qualified rehabilitation buildings and certified historic structures located in the Gulf Opportunity Zone, for amounts paid or incurred on or before December 31, 2011.

NEW ENERGY EFFICIENT HOME CREDIT

The Act extends, from December 31, 2009, the new energy efficient home credit for qualified homes acquired from an eligible contractor on or before December 31, 2011.

Please feel free to contact our business and tax specialists to discuss the Act and to allow us to coordinate with your tax advisor so that you are able to maximize your tax benefits for 2010, as well as 2011 and 2012.

Sincerely,

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