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2010 Tax Relief Act: What it Means for Taxpayers

The “Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010” (“2010 Tax Relief Act” or “Act”) was signed into law on December 17 by President Obama and provides guidance and temporary certainty after nearly a year of uncertainty for taxpayers. Unfortunately, the Act only provides an extension of the "Bush tax cuts" for a period of two years, ending on December 31, 2012. The Act has an impact on nearly every American taxpayer, both individuals and businesses. The highlights of the Act are summarized below.

Estate, Gift and Generation-Skipping Transfer Tax Provisions

The 2010 Tax Relief Act provides for the following:

- beginning in 2011, there will be an estate, gift and generation-skipping transfer tax exemption of $5 million per person and $10 million per couple, indexing these amounts for inflation beginning in 2012;
- the top tax rate of 35% for estate, gift, and generation-skipping transfer taxes will continue for an additional two years, through December 31, 2012;
- a special election is available for decedents dying in 2010, which allows an executor to choose between no estate taxes and a modified carryover basis or a 35% estate tax and a stepped-up basis; and
- for calendar year 2010, there is a $5 million generation-skipping transfer tax exemption and a zero percent rate.

Portability of Spouse's Unused Estate Tax Exemption Amounts

- The executor of a deceased spouse’s estate has the ability to transfer any unused estate tax exemption to the surviving spouse.
- The proposal would be effective for estates of decedents dying after December 31, 2010.
- Although portability may simplify planning for married couples, the portability does not apply to the generation-skipping transfer tax exemption. Additionally, a couple's estate planning documents should be reviewed to deal with the generation-skipping transfer tax planning, basis issues, and future appreciation, which may still make planning for a couple very complicated.
- The portability applies to the unused exemption of one’s last deceased spouse so remarriage complicates planning as well.
- An estate tax return must be filed on the first death, and an irrevocable election to allocate the unused exemption to the surviving spouse must be made on such return by the executor.

Reunification of Gift and Estate Tax Exemption Amounts

The 2010 Tax Relief Act reunifies the estate, gift and generation-skipping transfer tax exemptions for the first time since 2001. As stated above, beginning on January 1, 2011, each person will have one exemption for gift and estate taxes of $5 million, as well as a $5 million exemption from generation-skipping transfer taxes, and as described above, married couples would have a total of $10 million. The $5 million exemption will be effective for gifts made after December 31, 2010.

Income Tax Rates

The Act extends the Bush tax cuts, which are set to expire at the end of 2010, for all taxpayers, including individuals with incomes above $200,000 ($250,000 for married couples). The 2010 Tax Relief Act provides the following:

- income tax rates for individuals will stay at 10%, 15%, 25%, 28%, 33% and 35% through December 31, 2012;

- the 2010 repeal of the phase-outs of personal exemptions and itemized deductions is extended through 2012;

- the top capital gain and qualified dividends rate at 15% is extended through 2012;

- marriage penalty relief is maintained for two more years through 2012; and

- it continues the $1,000 child tax credit.

Employee Payroll Tax Cut

The Act provides for a reduction of the employee share of FICA taxes from 6.2% to 4.2% for 2011. It does not affect the employer share of FICA taxes. This provision is meant to replace the Making Work Pay Credit that was in effect for 2009 and 2010. Unlike the Making Work Pay Credit, however, there is no phase-out for high-income taxpayers. Thus, to a taxpayer with wages at or above the $106,800 cap, this reduction will be worth $2,136. To provide parity, a similar reduction in self-employment ("SECA") taxes will be provided for self-employed individuals.

Expensing

The 2010 Tax Relief Act provides for relief to business and provides benefits for certain expensing items as follows:

- there will be full expensing of investments that currently qualify for bonus depreciation and are placed in service through the end of 2011. This will allow businesses to expense the full cost of equipment and other qualifying property placed in service in 2011. Additionally, bonus depreciation at the current level (i.e., 50% expensing followed by regular depreciation) will be available for such investments in 2012;

- section 179 expensing limits are currently $500,000 and investment limits are $2 million, pursuant to the Small Business Jobs Act of 2010. The 2010 Tax Relief Act provides for the levels to remain constant for 2010 and 2011 and provides for $125,000 with a $500,000 investment limit in 2012; and

- section 181 election to deduct the cost of any qualifying film and television production in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances is extended for a two-year period to include 2010 and 2011. The Act provides this provision to be effective for film and television productions commencing after December 31, 2009 and prior to January 1, 2012.

AMT Patch

The Act includes a two-year AMT patch for tax years 2010 and 2011. The patch will prevent the AMT exemption from dropping in 2010, thus causing the AMT to apply to many taxpayers who would otherwise be exempt.

Other Provisions

The Act also extends numerous other expiring tax provisions that have benefited both individuals and businesses, such as the tax cuts enacted by the stimulus bill of 2009 and many of the tax provisions commonly referred to as "extenders." These provisions include things such as:

- American Opportunity Credit;

- earned income tax credit enhancements;

- child credit enhancements;

- research credit; and

- itemized deductions for state and local sales taxes.

In summary, the 2010 Tax Relief Act provides for the extension of many favorable tax cuts, which may provide individuals and businesses with unique planning opportunities for the next two years. Please be aware that there are nuances and differences regarding the effective dates for these various extensions; therefore, these provisions and the new law should be reviewed closely to determine the benefits to each taxpayer's specific situation. Additionally, the estate tax provisions provide a two year window of enhanced gifting and estate planning for clients. Please contact us to discuss the advantages of these estate planning opportunities before the window closes.
