Akerman Practice Update

TAXATION

December 2010

2010 Tax Relief Act Will Preserve Lower Income Tax Rates and Provide Other Tax Incentives

L. Frank Cordero
frank.cordero@akerman.com

Richard T. Hurt
richard.hurt@akerman.com

William F. Sullivan Jr.
william.sullivan@akerman.com

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act). The 2010 Tax Relief Act extends Bush-era tax cuts for two years, and provides significant estate and gift tax changes and alternative minimum tax (AMT) relief. The bill also contains other tax incentives for businesses and individuals, including 100% first-year write-offs of qualifying property placed in service after Sept. 8, 2010 and before Jan. 1, 2012, a payroll/self-employment tax cut of two percentage points for 2011 for employees and self-employed individuals, and extensions of other tax incentives for businesses and individuals.

"The 2010 Tax Relief Act postpones the expiration of current income tax rates for two years."

Major Income Tax and Employment Provisions

Extension of Current Individual Income Tax Rates

Current individual income tax rates are due to expire on December 31, 2010. Upon expiration, the maximum federal income tax rate applicable to individuals would increase to 39.6%. The 2010 Tax Relief Act postpones the expiration of current tax rates for two years until the end of 2012. Hence, the maximum ordinary federal income tax rate applicable to individuals will remain at the current 35% level through 2012.

Extension of Current Rates on Long-Term Capital Gain and Qualified Dividends

Current individual tax rates applicable to long-term capital gains and qualifying dividends are due to expire on December 31, 2010. Upon expiration, the maximum federal income tax rate applicable to individuals on long-term capital gains would increase to 20%, and the maximum rate on dividends would increase to 39.6%. The 2010 Tax Relief Act postpones the expiration of current tax rates for two years until the end of 2012. Hence, the maximum federal income tax rate applicable to individuals with respect to long-term capital gains and qualifying dividends will remain at the current 15% level through 2012.

Temporary Social Security Tax Reduction

Under current law, employees pay a 6.2% Social Security tax on wages earned up to the applicable limit (which is currently $106,800), with employers also paying a matching 6.2%, and self-employed individuals pay a 12.4% Social Security tax on all their self-employment income up to the same limit. The 2010 Tax Relief Act provides for a one year, two percentage point reduction of the Social Security tax paid by employees and self-employed individuals on wages and self-employment income up to the applicable limit. Accordingly, in 2011, employees will pay only 4.2% Social Security tax on wages instead of 6.2% and self-employed individuals will pay 10.4% Social Security tax instead of 12.4%.

Other Individual Tax Relief

The 2010 Tax Relief Act also provides additional tax relief for individual taxpayers including: (1) increase of AMT exemption amounts for 2010 and 2011; (2) preservation of 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 through 2012; (3) preservation of the current repeal of the overall limitation on itemized deductions through 2012; (4) preservation of the current

> "2010 Tax Relief Act provides significant new business incentives including temporary 100% expensing of certain business assets."

repeal of the phase-out of personal exemptions through 2012. The $100,000 tax-free rollover for someone at least age 70 & ½ from an IRA to a charity is extended for 2010 and 2011. Plus, an IRA/charitable rollover made in January 2011 may be treated as made on December 31, 2010.

Incentives for Businesses to Invest in Machinery and Equipment

The 2010 Tax Relief Act provides major new incentives for businesses to invest in machinery and equipment, including the following: (1) A 100% write-off in the placed-in-service year of the cost of property eligible for bonus depreciation applicable to property acquired and placed in service after Sept. 8, 2010, and before Jan. 1, 2012; (2) A 50% bonus first-year depreciation allowance for property placed in service after Dec. 31, 2011, and before Jan. 1, 2013; (3) Extension through Dec. 31, 2012, of the election to accelerate the AMT credit instead of claiming additional first-year depreciation; (4) For tax years beginning after Dec. 31, 2011, setting the maximum expensing amount at $125,000 under Code Section 179 and the investment-based phase-out amount at $500,000 (without these changes, both of these amounts would have been reduced to much lower levels after 2011), and (5) qualification of off-the-shelf computer software for the Code Section 179 expensing election if placed in service in a tax year beginning before 2013.

Other Tax Incentives Retroactively Reinstated and Extended Through 2011

Multiple tax breaks that expired at the end of 2009 will be retroactively reinstated and extended through 2011. These include the research credit; the new markets tax credit; 15-year write-off for qualifying leasehold improvements, restaurant buildings and improvements, and retail improvements; 7-year write-off for motorsports entertainment facilities; accelerated depreciation for business property on an Indian reservation; expensing of environmental remediation costs; look-thru treatment of payments between related controlled foreign corporations under foreign tax rules; and basis adjustment to stock of S corporations making charitable contributions of property. Moreover, various energy-related provisions will be extended through 2011.

Estate, Gift and Generation-Skipping Tax Changes

The change in federal estate taxes under the 2010 Tax Relief Act includes an increase in the exemption to $5 million and a reduction in the tax rates applicable above the exempt amount to 35%. In 2009 the exemption was set at $3.5 million and the rate of tax was 45%. For 2010 the estate tax provisions

> "In light of the sunset of the new tax laws after 2012 long term planning is still elusive."

are not effective, but in 2011 without passage of a new law the exemption would have reverted to $1 million and the maximum rate increases to 55% with a 5% surcharge on estates from $10 million to $22 million.

With the changes the gift tax exemption will be reunified with the estate tax exemption in 2011. While the $1 million lifetime gift tax exemption remains in place through the end of 2010, beginning January 1, 2011 the gift tax exemption for lifetime gifts will increase to $5 million. Thus major gifting possibilities will arise for wealthy families who have previously utilized their gift tax exemption. The legislation sets a $5 million exemption for the generation-skipping transfer tax and a 0% tax rate for 2010. This GST tax exemption would continue for 2011 and 2012, but the GST tax rate will be 35%.

There are several nuances included. First, the new estate tax provisions are effective January 1, 2010, but they are optional just for 2010. Thus for a person dying in 2010 the estate may elect to be subject to the new law with a step up in the income tax basis for all included assets or the estate may be exempt from the estate tax, but be subject to carryover basis rules with a maximum basis step up of $1.3 million plus, for certain spousal transfers, an additional basis increase of $3 million.

Since the new law sunsets after 2012 without the adoption of another new law in the next two years we will again face the prospects in 2013 of a $1 million exemption and much higher estate tax rates. So true long term planning is still elusive.

The new law adopts "portability" which means that a surviving spouse may utilize the estate tax exemption of their "most recently deceased spouse" upon the surviving spouse's death. Thus a surviving spouse may be able to exempt up to $10 million in assets from the estate tax without the need to create a "bypass trust" upon the death of the first spouse to die. This provision, however, seems fraught with complex problems. If the first spouse creates a bypass trust at death, then appreciation on the assets in the bypass trust during the surviving spouse's lifetime will also be excluded from taxation at the surviving spouse's death. However, the assets in the bypass trust will not receive a step up in basis upon the surviving spouse's death which would occur if those assets were distributed to the surviving spouse and owned at the surviving spouse's subsequent death. In addition, if the surviving spouse remarries and the new spouse dies, then the estate tax exemption for the first spouse is lost. So portability coupled with the sunset possibilities will make this

an extremely difficult area of planning. It appears, however, that the $5 million GST tax exemption of a deceased spouse will not be portable so it may not be used by a surviving spouse.

Legislation has circulated for quite some time to eliminate discounts for gifts of certain partnership and other ownership interests in entities among family members. Proposals have also been made to mandate a minimum term of 10 years for grantor retained annuity trusts ("GRATs"). Neither of these proposals has been included in the proposed legislation so planning techniques utilizing these strategies remain viable at least for a while.

For more information, please contact a member of our Taxation practice.

Akerman is ranked among the top 100 law firms in the U.S. by *The National Law Journal NLJ 250* (2010) in number of lawyers and is the leading Florida firm. With 500 lawyers and government affairs professionals, Akerman serves clients throughout the U.S. and overseas from Florida, New York, Washington, D.C., California, Virginia, Colorado, Nevada, and Texas.

This Akerman Practice Update is intended to inform firm clients and friends about legal developments, including recent decisions of various courts and administrative bodies. Nothing in this Practice Update should be construed as legal advice or a legal opinion, and readers should not act upon the information contained in this Update without seeking the advice of legal counsel. ©2010 Akerman Senterfitt, Akerman Senterfitt LLP. All rights reserved.