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TAX UPDATE

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# TAX RELIEF 2010

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On December 17, President Obama signed into law the compromise legislation dealing with the expiring Bush Tax Cuts designated the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010 (Tax Relief 2010).

The primary purpose of Tax Relief 2010 is to temporarily extend the sunset date, the date the legislation would terminate, of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (“JGTRRA”), commonly referred to as the Bush Tax Cuts legislation.

By extending the sunset date for EGTRRA provisions and JGTRRA provisions from December 31, 2010, to December 31, 2012, the scheduled increase in all tax rates, and other related tax increase items, for all taxpayers will not take place on January 1, 2011. Individual tax rates, which in 2010 ranged from 15% to 35%, and other related tax items, such as the personal exemption phaseout, the itemized deduction limitation and the marriage penalty relief, will remain at 2010 levels for two additional years. And, the 2010 15% maximum tax rate for long-term capital gains transactions and qualified dividends will remain through December 31, 2012.

Tax Relief 2010 carries with it many more features and temporary extension items than just the extension of the Bush Tax Cuts. For example, the following items will remain in place through tax year 2012.

- American Opportunity Tax Credit and related income limitations
- Child Tax Credit as enhanced by EGTRRA and other more recent legislation
- Earned Income Credit
- Adoption Credit
- Dependent Care Credit
- Employer Provided Child Care

Also included is a “patch” for the Alternative Minimum Tax (AMT). The AMT exclusion amounts are increased in 2010 to \$72,450 (Married Filing Jointly) and \$47,450 (Single); and in 2011 to \$74,450 (Married Filing Jointly) and \$48,450 (Single).

Changes to depreciation include extending the 50% first year bonus method by two (2) years from the extended dates provided in the Small Business Jobs Act, but would also introduce a new 100% expensing (rather than the 50% level) for qualifying property acquired by the taxpayer after September 8, 2010, and before January 1, 2012, which is also placed in service by the taxpayer before January 1, 2012, or January 1, 2013, for certain long-lived or transportation property. Qualified property for the 100% expensing would be the same as currently defined for 50% expensing.

Another depreciation change is to increase the Section 179 limitation in 2012 to \$125,000. Section 179 was scheduled to return to a \$25,000 limitation in 2012. Also, the investment limitation amount is increased to \$500,000 in 2012, as it was scheduled to return to the \$200,000 level. And, for the first time, an inflation adjustment provision is included that would provide a means to automatically increase the limitation levels of Section 179 in the future.

Believing that extra dollars in the hands of employees would be spent and would, therefore, translate into expanded job opportunities being created, Tax Relief 2010 provides for an employee payroll tax holiday.

For 2011, employees will pay 2 percentage points less (4.2% rather than 6.2%) on Social Security wages. Self-employed individuals will get a similar tax reduction (10.4% rather than 12.4%) on self employment income.

That means if wages or taxable self-employed income is equal to \$106,800, the savings will be \$2,136. The Social Security system will apparently not be damaged by the payroll tax holiday tax reduction. A provision is provided in Tax Relief 2010 to transfer an amount equal to the tax reduction from the payroll tax holiday from the General Fund to the Social Security Trust, or Equivalent Benefit, Fund.

One of the more contentious parts of Tax Relief 2010 is the reinstatement of estate and gift tax provisions.

In 2011, without modification, estate and gift rules were to return in 2011 to \$1 million exclusion and maximum 55% tax rate. Tax Relief 2010 introduces a \$5 million exclusion level and maximum 35% tax rate. And, a married couple would have the benefit of passing any unused exclusion from the passing of the first spouse to the surviving spouse, giving the couple, in reality, a \$10 million exclusion. In addition, the change is effective January 1, 2010. Thus, an executor of an estate can make an election to be excluded from the change for an estate arising on or after January 1, 2010, and before January 1, 2011. Also, estate and gift tax will once again be unified for gifts made after December 31, 2010, as the gift exclusion is increased by \$4 million to \$5 million.

One of the compromise positions required to get this legislation drafted, debated, passed and signed, was the agreement to extend unemployment benefits for an addition 13 months. Tax Relief 2010 contains various provisions related to extensions for unemployment benefits through January 3, 2012.

Tax Relief 2010 also contains numerous extensions for credits and deduction items. A few individual provisions that have general interest, extended through December 31, 2011, are:

- \$250 expensing for elementary and secondary school teachers
- Deduction of state and local sales taxes
- Contributions of capital gain real property for conservation purposes
- Deduction for qualified tuition and related expenses
- Tax –free distribution from individual retirement plans for charitable purposes (limited to \$100,000). Note that these types of distributions can be made through January 2011 for 2010 treatment.

A few business provisions, with general interest, extended through December 31, 2011, are:

- Research credit
- Indian employment tax credit
- New markets credit
- Wage credit for active duty uniformed services
- 15 year straight line cost recovery period for qualified improvements
- 7 year recovery period for motor sports entertainment complexes
- Accelerate depreciation for property on an Indian reservation
- Enhance charitable deduction for food or book inventory
- Basis adjustment stock in S Corp making charitable contribution of property

Energy provisions, with general interest, extended through December 31, 2011, are:

- Incentives for biodiesel and renewable diesel
- New energy efficient home credit
- Excise tax credits and outlay payments for alternative fuels
- Suspension of limitation on percentage depletion for oil and gas
- Grants for specified energy property in lieu of tax credits
- Alcohol used as fuel
- Energy efficient appliance (dishwasher, clothes washer, refrigerators, and other)
- Credit for nonbusiness energy property
- Alternative fuel vehicle refueling property

Watch for additional articles that will deal with various sections of Tax Relief 2010 in more detail.

If you would like additional information, contact your Eide Bailly service representative.