

# Highlights of the 2010 Tax Relief Act

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On December 17, 2010, President Barack Obama signed into law H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act). This massive bill affects almost every American taxpayer and has an estimated cost to the U.S. Treasury of \$858 billion.<sup>1</sup>

Many of the bill's provisions are designed to provide relief to the unemployed, stimulate job growth, and protect what many observers see as a still-fragile economic recovery.<sup>2</sup> Significant provisions in the legislation include:

- **Unemployment benefits:** Extends federal unemployment benefits at their current levels for an additional 13 months, through the end of 2011.
- **Extend expiring tax provisions:** Many provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and subsequent legislation, were slated to expire at the end of 2010. If this prior law had ended as scheduled, most taxpayers would have faced a significant increase in their tax burden, beginning in 2011. The 2010 Tax Relief Act has extended many of these provisions for an additional two years.
- **Payroll tax cut:** For one year, 2011, the legislation reduces the OASDI part of the Social Security payroll tax for both employees and the self-employed by 2.0%.
- **Estate tax modification:** EGTRRA included a phased-in reduction in the federal estate tax, which, like EGTRRA's individual income tax provisions, was also scheduled to end after 2010. The 2010 Tax Relief Act sets a 35% tax rate on taxable estates in excess of \$5,000,000, with this new estate tax law expiring after 2012.
- **Business tax incentives:** A large number of the provisions are targeted at business with the intention of spurring business investment and economic growth.

The following is a brief, summary description of a few of the provisions in this act.

## Provisions Affecting Individual Taxpayers Generally

Item	Prior Law	2010 Legislation
<b>Individual marginal income tax rates</b>	EGTRRA created a 10% income tax bracket for a portion of taxable income that previously was taxed at 15%. All other income tax brackets (except the 15% bracket) were gradually reduced over a period of years. The former brackets were scheduled to reappear after December 31, 2010.	Extends the 10%, 15%, 25%, 28%, 33%, and 35% brackets for an additional two years, 2011 and 2012.

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<sup>1</sup> See JCX-54-10, prepared by the Joint Committee on Taxation, for the estimated budget effects of this legislation.

<sup>2</sup> The discussion here concerns federal income tax law; state or local income tax law may be different.

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## Individual Marginal Tax Rate Comparison

Year	%	%	%	%	%	%
Before EGTRRA	N/A	15.0	28.0	31.0	36.0	39.6
2010 under EGTRRA	10.0	15.0	25.0	28.0	33.0	35.0
2011-2012	10.0	15.0	25.0	28.0	33.0	35.0

Item	Prior Law	2010 Legislation
<p><b>Marriage penalty relief</b> (A "marriage penalty" exists when the combined tax bill of a married couple is <u>greater</u> than the tax bill that would be due if each files a separate, unmarried return. A "marriage bonus" exists when the combined tax liability is <u>less</u> than the separate unmarried tax liabilities would be.)</p>	<p>EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice that for an unmarried person filing a single return. It also increased the top of the 15% marginal bracket to twice the size of the corresponding bracket for an unmarried person filing a single return. Both provisions were due to expire after 2010.</p>	<p>Extends both provisions for two years, 2011 and 2012.</p>
<p><b>Employee payroll tax cut</b></p>	<p>An employee is required to pay 6.2% of covered wages, up to a wage base (\$106,800 in 2010 and 2011) for the OASDI portion of Social Security payroll taxes.<sup>1</sup> Medicare hospital insurance (HI) tax is levied at a rate of 1.45% on all of an employee's covered wages. Similarly, a self-employed individual pays 12.4% of self-employment (SE) income, for OASDI payroll taxes, up to the wage base, and 2.9% of SE income for HI tax. A self-employed individual is allowed to deduct 7.65% of SE income in calculating the amount of income subject to payroll taxes. A self-employed taxpayer is also allowed to deduct 50% of the amount of OASDI and HI paid, in determining taxable income.</p>	<p>For 2011 <u>only</u>, the employee portion<sup>2</sup> of the OASDI payroll taxes is reduced to 4.2% of covered wages, up to the wage base.<sup>1</sup> For self-employed individuals, the OASDI rate is reduced to 10.4% of SE income, up to the wage base. For self-employed individuals, the 2.0% rate reduction is ignored in determining the amount of SE income subject to OASDI and HI tax and also in calculating the deduction for payroll taxes paid in determining taxable income.<sup>3</sup></p>

<sup>1</sup> The provision is equally applicable to Tier 1 payroll taxes under the Railroad Retirement System.

<sup>2</sup> The employer portion of the OASDI tax, also 6.2%, is not reduced.

<sup>3</sup> In 2011, the deduction used to determine the amount of SE income subject to OASDI and HI taxes remains at 7.65%. A self-employed individual will be allowed to deduct the sum of 59.6% of the OASDI portion of payroll taxes and 50% of HI taxes paid, in determining taxable income.

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Item	Prior Law	2010 Legislation
<b>Phase out of itemized deductions for high-income taxpayers</b>	Prior to EGTRRA, certain itemized deductions of taxpayers with adjusted gross income (AGI) in excess of specified limits were reduced by 3% of AGI in excess of those limits. EGTRRA gradually phased out this limitation for high-income taxpayers, completely repealing it in 2010.	Extends the repeal of the limitation on the amount of allowable itemized deductions for higher-income taxpayers for two years, 2011 and 2012.
<b>Phase out of personal exemption for high-income taxpayers</b>	Prior to EGTRRA, the deduction from taxable income for personal exemptions was ratably reduced for taxpayers with an AGI in excess of certain limits. EGTRRA gradually phased out this exemption reduction for high-income taxpayers, completely repealing it in 2010.	Extends the repeal of the reduction in personal exemptions for high-income taxpayers for two years, 2011 and 2012.
<b>Long-Term Capital gains<sup>1</sup></b>	Under EGTRRA and subsequent legislation, in 2010, generally, individual capital gain was taxed at a maximum rate of 15% (0% for those in the 10% or 15% marginal brackets); gain on collectibles was taxed at 28%; real estate depreciation treated as capital gain was taxed at 25%.	Extends this capital gain tax treatment for an additional two years, 2011 and 2012.
<b>Dividends<sup>2</sup></b>	Under EGTRRA and subsequent legislation, in 2010, "qualified" dividends (generally, dividends received from domestic corporations and certain, qualified foreign corporations) were taxed at preferential rates. These rates were either 0% (for those in the 10% or 15% marginal brackets) or 15% for those in a marginal tax bracket above 15%.	Extends this preferential treatment of qualified dividends for an additional two years, 2011 and 2012.

<sup>1</sup> "Long-term" capital gains are gains on certain property held more than one year. "Short-term" capital gains are gains on certain property held one year or less. Short-term capital gains under both old and new law are treated as ordinary income, taxable at the taxpayer's regular marginal rate.

<sup>2</sup> The discussion here concerns the federal tax treatment of dividends received by individuals and estates and trusts.

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Item	Prior Law	2010 Legislation
<b>Alternative Minimum Tax (AMT) exemption amount</b>	Under prior law, for 2010, the exemption amounts for the AMT were as follows: Married filing joint - \$45,000 Married filing separate - \$22,500 Single - \$33,750	For 2010, the exemption amounts for the AMT are increased to: Married filling joint - \$72,450 Married filing separate - \$36,225 Single - \$47,450 For 2011, the exemption amounts for the AMT will be: Married filling joint - \$74,450 Married filing separate - \$37,225 Single - \$48,450

## Incentives for Families and Children

- Child tax credit:** An individual is allowed a tax credit for each qualifying child under the age of 17. This credit is phased out for individuals with income in excess of certain limits. For some taxpayers, a portion of the credit is refundable. Under prior law, the credit was \$1,000 per child through 2010, and \$500 per child thereafter. The new law extends the maximum \$1,000 tax credit amount for two years, 2011 and 2012.
- Earned income tax credit:** Low- and moderate-income taxpayers may be eligible for a refundable "Earned Income Tax Credit" (EITC), based on earned income and a number of other factors. In general, the credit is calculated by multiplying a specified percentage times a taxpayer's earned income, up to a certain limit (the "cut-off amount"), with the credit completely phased out for higher-income taxpayers. A temporary provision enacted in 2009<sup>1</sup> increased the percentage for taxpayers with three or more children to 45% and expanded the phase-out threshold for couples using the married filing jointly status to \$500 above that for other filers. The 2010 Tax Relief Act extends these provisions for two additional years, 2011 and 2012.
- Child and dependent care tax credit:** Under federal income tax law, a credit is available for expenses paid to care for a dependent (a qualifying child or adult) in order to allow the taxpayer to work. Under EGTRRA, a taxpayer could claim a credit of up to \$1,050 (35% x \$3,000) for one qualifying dependent or \$2,100 (35% x \$6,000) for two qualifying dependents. The credit percentage is gradually reduced, but not below 20%, for taxpayers with an AGI more than \$15,000. The 2010 Tax Relief Act extends this expanded credit for two additional years, 2011 and 2012.
- Adoption credit and employer-provided adoption assistance:** Present law (effective through 2011) provides in 2010 for (1) a maximum adoption credit of \$13,170 per eligible child, and (2) a maximum exclusion from income for employer-provided adoption assistance of \$13,170 per eligible child. The dollar amounts are adjusted annually for inflation, and the credits are phased out for taxpayers with income in excess of certain levels. The 2010 act extends these two benefits for one year, 2012.

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<sup>1</sup> See the American Recovery and Reinvestment Act of 2009.

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## Provisions Affecting Educational Incentives

Item	Prior Law	2010 Legislation
<b>Coverdell Education Savings Account (ESA)</b>	Under EGTRRA, Coverdell ESAs received an increased annual contribution limit of \$2,000 (up from \$500). EGTRRA also extended the contribution and use periods for special needs beneficiaries, allowed the use of funds for qualified elementary and secondary education expenses, and provided for an increased contribution phase-out range for high-income taxpayers.	The 2010 legislation extends the provisions of EGTRRA affecting Coverdell ESAs for two years, 2011 and 2012.
<b>American Opportunity Tax Credit</b>	ARRA 2009 <sup>1</sup> renamed the Hope Credit as the American Opportunity Tax Credit, raised the maximum credit from \$1,800 to \$2,500 per eligible student per year for qualified tuition and related expenses for each of the student's first four (up from two) years of post-secondary education, increased the credit phase-out range for high-income taxpayers, allowed the credit to be used against the AMT, and made a portion of the credit refundable.	Extends the provisions of ARRA 2009 with regard to the American Opportunity Tax Credit for two years, 2011 and 2012.
<b>Deduction for student loan interest</b>	Allows for an above-the-line deduction for qualified student loan interest of up to \$2,500 per year. EGTRRA raised the deduction phase-out ranges for high-income tax payers and extended deductibility of interest beyond the first 60 months that payments are required.	Extends the EGTRRA provisions for two years, 2011 and 2012.
<b>Deduction for tuition and related expenses</b>	Allows for an above-the-line deduction for qualified tuition and related expenses for higher education. The deduction is either \$4,000 or \$2,000 depending on AGI, and a number of restrictions and limitations apply.	This deduction previously expired at the end of 2009. The 2010 legislation extends it for two tax years, 2010 and 2011.

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<sup>1</sup> The American Recovery and Reinvestment Act of 2009 modified the Hope Credit for two tax years, 2009 and 2010.

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## Other Provisions Affecting Individual Taxpayers

- **Deduction for certain expenses of elementary and secondary school teachers:** An above-the-line deduction is allowed for up to \$250 of unreimbursed classroom expenses (certain books, equipment, and supplies) for qualifying elementary and secondary school teachers. Under prior law the deduction expired at the end of 2009. The 2010 legislation extends this deduction for an additional two years, to 2010 and 2011.
- **Deduction of state and local sales taxes:** For tax years 2004 – 2009, a taxpayer could choose to deduct as an itemized deduction state and local general sales taxes in lieu of the deduction for state and local income taxes. This provision expired at the end of 2009. The 2010 Tax Relief Act extends this option for two years, to 2010 and 2011.
- **Tax-free distributions from IRAs for charitable purposes:** Through December 31, 2009, federal income tax law provided for an exclusion from gross income for up to \$100,000 for distributions made from a Roth or traditional IRA directly to a qualified charitable organization. The IRA owner (or beneficiary of an inherited IRA) must have been at least age 70½ when the distribution was made and no charitable deduction was allowed for such qualified charitable distribution. The 2010 legislation extends this provision for two additional tax years, 2010 and 2011. Further, a taxpayer may elect to have a qualified charitable distribution made in January 2011 treated as having been made on December 31, 2010.
- **Contributions of capital gain real property made for conservation purposes:** In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. For 2006 – 2009, federal income tax law allowed an expanded deduction for the charitable contribution of a qualified conservation easement. For individual taxpayers, the deduction was limited to 50% of the donor's AGI, with any unused deduction carried forward for up to 15 years. For "qualified farmers and ranchers," the deduction was generally 100% of AGI, with a 15-year carry-forward of any unused deduction. The 2010 Tax Relief Act extends this expanded deduction of charitable contributions of qualified conservation easements for two years, 2010 and 2011.

## Provisions Affecting the Federal Estate, Gift, and Generation-Skipping Taxes

Under EGTRRA, beginning in 2002, the federal estate tax was gradually reduced until it was completely repealed for one year, 2010. If Congress had not acted, the EGTRRA legislation would have "sunset" after 2010, with pre-EGTRRA law returning in 2011.

The 2010 Tax Relief Act reversed the one year repeal of the federal estate tax, raised the applicable exclusion amount to \$5,000,000, lowered the top marginal rate to 35%, and pushed the "sunset" of most of the remaining EGTRRA estate tax provisions two years into the future, to December 31, 2012. Estates of decedents dying in 2010 may choose to be taxed under the "repealed" law (no estate tax, but a modified carryover basis adjustment) or under the new legislation, (\$5,000,000 applicable exclusion amount, 35% top bracket, full step-up in basis).

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<b>Gift tax</b>	<p>Before 2004, the estate and gift taxes were fully unified, with a single, graduated rate schedule and a single, effective exemption amount of \$1,000,000. Between 2004 - 2009, the applicable exclusion amount for <u>estate tax</u> purposes increased to \$3,500,000, while the <u>gift tax</u> applicable exclusion amount remained at \$1,000,000. Under EGTRRA, the applicable exclusion amount for both estate and gift taxes was scheduled to be \$1,000,000 in 2011.</p>	<p>For gifts made in 2010, the applicable exclusion amount is \$1,000,000 and the top gift tax rate is 35%. For gifts made in 2011 and 2012, the gift tax is re-unified with the estate tax with an applicable exclusion amount of \$5,000,000 and a top estate and gift tax rate of 35%.</p>
<b>Basis of property</b>	<p>Before 2010, property passing from a decedent generally received a “stepped-up” (or “stepped-down”) basis to its fair market value on the date of death (or alternate valuation date). Under EGTRRA, for decedents dying in 2010, a “modified carryover” basis applied. An executor could “step-up” to fair market value the basis of up to \$1.3 million in property, or up to \$4.3 million for property passing to a surviving spouse.</p>	<p>For decedents dying in 2010, the new law generally repeals the modified carryover basis rules that had applied under EGTRRA and replaces them with a “stepped-up” basis regime, unless an executor chooses to have the estate taxed under the EGTRRA rules. The stepped-up basis rules will apply to decedents dying in 2011 and 2012.</p>
<b>State death tax credit</b>	<p>Before 2005, a credit was allowed against the federal estate tax for death taxes paid to a state or the District of Columbia. Under EGTRRA, the allowable amount of the state death tax credit was gradually reduced from 2002 – 2004. For decedents dying after 2004, the credit was repealed and was replaced with a deduction for state death taxes paid.</p>	<p>For 2010, 2011, and 2012, amounts paid for state death taxes will be allowed as a deduction rather than a credit.</p>

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Item	Prior Law	2010 Legislation
<b>Generation-skipping transfer tax (GSTT)</b>	<p>Under EGTRRA, for 2001-2003, the GSTT exemption was \$1,000,000, adjusted for inflation. For 2004-2009, the GSTT exemption amount was tied to the estate tax applicable exclusion amount, reaching \$3,500,000 in 2009, with no GSTT in 2010. Assets subject to the GSTT were taxed at a rate linked to the maximum estate tax rate. In addition, EGTRAA also made certain mechanical rules regarding the allocation of the GSTT.</p>	<p>For 2010, the new law exempts up to \$5,000,000 (the applicable exclusion amount) in assets from the GSTT.<sup>1</sup> Any amount in excess of \$5,000,000 is taxed at a 0% rate, effectively eliminating the GSTT for decedents dying in 2010. For 2011 and 2012, the amount of assets exempt from the GSTT is the same as the estate tax applicable exclusion amount, taxed at the highest estate and gift tax rate in effect in each year, 35%. The 2010 legislation also extends through 2012 the mechanical rules regarding the allocation of the GSTT.</p>

## Other Provisions Affecting Estate Planning

- **Portability of unused exemption between spouses:** Beginning with 2011, any applicable exclusion amount that remains unused at the death of a spouse (the “deceased spouse unused exclusion amount”) is generally available for use by the surviving spouse, as an addition to the surviving spouse’s own applicable exclusion amount.
- **Extension of filing deadlines:** The 2010 Tax Relief Act provides an extension of nine months for filing certain transfer tax returns, such as estate or GSTT returns. This filing deadline extension applies to decedents dying after December 31, 2009 and before the date of enactment, December 17, 2010.
- **Conservation easements:** Under EGTRRA, an executor could elect to exclude from the taxable estate 40% of the value of any land subject to a qualified conservation easement, up to a maximum of \$500,000. The exclusion percentage was reduced by formula if the value of the easement was less than 30% of the land. The new legislation extends this section of the code for two additional years, 2011 and 2012.

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<sup>1</sup> The \$5,000,000 GSTT exemption is available regardless of whether the executor of an estate of a decedent who dies in 2010 decides to apply the EGTRRA 2010 estate tax and basis rules.

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- **Installment payment of estate tax for closely-held businesses:** Estate tax is generally due within nine months of a decedent's death. However, an executor may elect to pay estate tax attributable to an interest in a closely-held business in two or more installments, up to a maximum of 10. EGTRRA made certain changes to the installment payment provisions of the law, including increasing from 15 to 45 the maximum number of partners in a partnership or shareholders in a corporation that may be treated as a closely-held business interest, and expanding the availability of the installment payment provisions to include an interest in a qualifying lending and financing business. The new legislation extends the EGTRRA modifications of the installment payment provisions for two additional years, 2011 and 2012.
- **Qualified family-owned business interests (QFOBI):** Prior to 2004, a deduction from the gross estate was permitted for the adjusted value of a qualified family-owned business of a decedent, up to \$675,000. Under EGTRRA, the QFOBI deduction was repealed for decedents dying in 2004 – 2010. The Tax Relief Act of 2010 extends the repeal of the QFOBI deduction for an additional two years, 2011 and 2012.

## Provisions of Interest to Business

A number of the provisions in the 2010 Tax Relief Act were targeted at business, with the intention of spurring business investment and economic and job growth:

- **100-Percent Bonus depreciation:** The new law boosts 50-percent bonus depreciation to 100-percent for qualified investments made after September 8, 2010 and before January 1, 2012. 50-percent bonus depreciation is available for qualified property placed in service after December 31, 2011 and before January 1, 2013.
- **Code Sec. 179 expensing:** The new legislation increased the Code Sec. 179 dollar and investment limits to \$500,000 and \$2 million, respectively, for tax years 2010 and 2011. It also provides for a \$125,000 dollar limit (indexed for inflation) and a \$500,000 investment limit (indexed for inflation) for tax year 2012. It also extends the treatment of off-the-shelf computer software as qualifying property if placed in service before 2013.
- **Research Tax Credit:** The research tax credit, which expired at the end of 2009, is renewed for two years through December 31, 2011 and is effective for amounts paid or incurred after December 31, 2009.
- **Sale of Small Business Stock:** The act enhanced the exclusion of gain from qualified small business stock to non-corporate taxpayers. For stock acquired after September 27, 2010 and before January 1, 2011, and held for at least 5 years, the 100-percent exclusion is extended for one more year, for stock acquired after January 1, 2012. The excluded gain is not subject to AMT.
- **Energy Tax Incentives:** The act extends for one or two years a number of energy tax incentives, primarily targeted to businesses.
- **Work Opportunity Credit:** The credit is extended for individuals who begin employment after August 31, 2011 (when it was set to expire) and before January 1, 2012, but with some modifications.

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## Seek Professional Guidance

Because federal tax law can be complex, the advice and guidance of experienced financial and tax professionals is strongly recommended.