Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act

Extension of tax cuts, estate changes highlight final bill of 2010

After a year of speculation as to how Congress would address the looming expiration of the 2001 and 2003 tax cuts, the answer finally came during the last week of the 2010 legislative session. The Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act of 2010 contains changes impacting both the 2010 tax year (extension of several previously expired provisions) and the next two years (extension of the tax cuts expiring after 2010), as well as several unanticipated items (estate tax relief, reduction in employment taxes). Below is a summary of the key provisions of this important tax act.

Extension of the Tax Cuts of 2001 and 2003

The tax bills passed in 2001 and 2003 that reduced ordinary and capital gain tax rates for all taxpayers, among other changes, both contained provisions saying all the changes expired at the end of 2010. The future of these tax cuts has dominated the political landscape for the last year, but this act has ended those discussions, at least for now.

Under this act, all provisions of the 2001 and 2003 tax cuts have been extended two years, through 2012. This means that all of the following items that were scheduled to expire after 2010 will be available for the next two tax years:

- ***Lower ordinary tax rates*** – The lowest tax bracket will remain at 10%, rather than increasing to 15%, and all other tax brackets will remain at their current level.
- ***Lower capital gain, dividend tax rates*** – Long-term capital gains and qualified dividends will continue to be taxed at a top tax rate of 15%. Those items will remain tax-free for taxpayers in the two lowest tax brackets.
- ***Phaseouts remain expired*** – The phaseouts of itemized deductions and personal exemptions had been gradually reduced over the last few years, to where there are no phaseouts at all for 2010. That elimination of the phaseouts will continue through 2012.
- ***Larger child tax credit*** – The tax credit for dependent children will remain at $1,000, rather than being reduced to $500. This credit amount is still subject to a phaseout for married couples with AGI above $110,000 and singles above $75,000.
- ***Larger dependent care credit*** – Single taxpayers, or couples where both spouses are employed, will continue to be eligible for the same level of dependent care credit. Eligible expenses remain $3,000 per child (maximum of 2 children) with a maximum credit rate of 35%.
- ***Marriage penalty relief*** – The provisions helping couples minimize the marriage penalty – a larger standard deduction and 15% tax bracket – were extended through 2012.

- ***Adoption programs maintained*** – The tax credit for adopting a child, as well as the amount of tax-free employer-provided adoption benefits, will both remain at $10,000 for 2012. These had previously been extended through 2011.
- ***Education incentives continue*** – The following incentives to save and pay for education have all been extended through 2012:
  - The maximum contribution to Coverdell accounts will remain $2,000 (rather than falling to $500), and K-12 costs will continue to be qualified expenses.
  - Employer-provided educational assistance of up to $5,250 will remain tax-free to the employee.
  - The expanded above-the-line deduction for student loan interest will remain.
  - The American Opportunity Tax Credit, an expanded version of the Hope Scholarship credit, will still be fully available to married couples with AGI below $160,000 and singles below $80,000 (subject to phaseout above those amounts).

Alternative Minimum Tax Relief

The highly anticipated patch to the Alternative Minimum Tax, which will help millions of taxpayers avoid the AMT, was included in this bill. Enacting this patch has been an annual occurrence since 2006, but this act extended the patch for both 2010 and 2011. For 2010, married couples will now have an AMT exemption amount of $72,450 and singles will have a $47,450 exemption. For 2011, those amounts will increase to $74,450 and $48,450, respectively.

Because this AMT exemption is phased out for taxpayers with Alternative Minimum Taxable Income (AMTI) above certain thresholds, many taxpayers did not benefit from the exemption. While the phaseout is still in place, an increase in the exemption means it will take higher levels of income before it is fully phased out, allowing more taxpayers to benefit from the exemption.

2010 AMT Personal Exemption	Married Taxpayers Filing Jointly		Single Taxpayer	
	Before Patch	After Patch	Before Patch	After Patch
Maximum exemption	$45,000	$72,450	$33,750	$47,450
AMTI when exemption begins phasing out	$150,000		$112,500	
AMTI when exemption is fully phased out	$330,000	$439,800	$247,500	$302,300

Reduction in Payroll Tax

For 2011, the 6.2% FICA tax that all employees pay on their wages will be reduced to 4.2% of income. For self-employed taxpayers, their employment tax amount will drop from 12.4% to 10.4%. The maximum income subject to the tax will remain $106,800 for 2011, and there was no change to the 1.45% Medicare tax that applies to all wages. Individuals whose wages or self-employment income meet or exceed this threshold will realize a total tax savings of $2,136 in 2011. This change does not affect the employer portion of the employment tax.

Estate Tax Relief

The fluctuation in the estate tax system over the last few years had created a difficult environment for estate planners and taxpayers alike. And while the changes included in this act provide some unexpected relief from the estate tax for 2011 and 2012, longer-term questions on the future of the estate tax remain.

Under this act, the federal estate tax exemption will increase to $5 million, the largest amount ever, before reverting to $1 million in 2013. In addition, the top tax rate for estates over this amount will be reduced from 55% to 35%. Both of these changes apply to 2011 and 2012 only. However, the act provides that the exemption amount is subject to inflation adjustments after 2012, leaving the impression that lawmakers may plan on eventually extending these changes past 2012.

In a surprise addition to the estate tax rules, this exemption amount has been made portable, meaning any exemption amount not used at the death of one spouse may be added to the exemption amount for the surviving spouse.

Another unexpected change is that the estate and gift tax systems will be re-unified under the new rules. Since 2001, the lifetime exemption had been limited to $1 million, while the estate tax exemption gradually increased to as high as $3.5 million in 2009. Under the new rules, individuals will be able to use the full $5 million exemption to make lifetime gifts without incurring gift tax. Married couples will be able to make combined lifetime gifts of up to $10 million. The new 35% tax rate will apply to gifts above the exemption amount.

Finally, there is a special election available for estates of individuals dying in 2010. Administrators of the estate of someone dying in 2010 may either: (1) elect the new $5 million estate tax exemption, with an unlimited adjustment to the basis of assets included in the decedent's estate, or (2) elect the temporary full repeal of the estate tax, with the adjustment to the basis of the decedent's property limited to $1.3 million (more for spousal transfers). Executors or personal representatives faced with this election should consult with their tax advisor before making a decision.

Extension of Expired Provisions

A variety of tax deductions and other incentives that had expired as of the end of 2009 were re-enacted for 2010 and extended through 2011, after which they are scheduled to expire again.

- Distributions from an IRA directly to a charity will continue to be tax-free. In addition, taxpayers can elect to treat distributions made in January 2011 as if they were made in 2010. The effect of this aspect is that taxpayers have a one month extension for taking their 2010 Required Minimum Distribution, as long as that RMD goes directly to a charity. This provision continues to be limited to taxpayers over age 70½, and the maximum distribution remains $100,000 per taxpayer.

- Teachers can continue to deduct up to $250 for unreimbursed classroom expenses.
- Taxpayers who itemize their deductions will be able to deduct the greater of state and local income taxes or general sales taxes paid during the year.
- Qualified tuition and related education expenses can be deducted from gross income to arrive at Adjusted Gross Income (AGI).
- Mortgage insurance paid on a qualified personal residence may still be deducted through 2011, although the benefit is phased out for married taxpayers with AGI between $100,000 and $110,000.

Exclusion of Gain on Small Business Stock

The Small Business Job Act (SBJA) passed in September increased the exemption on the sale of small business stock to 100% of the gain, subject to limitation, but only for stock acquired between September 27 and December 31, 2010. The new act extends that benefit to stock acquired through 2011.

To qualify for the exclusion, the stock must be held for at least 5 years and the company must be a C Corporation with gross assets of no more than $50 million. The excluded gain can't exceed the greater of 10 times the taxpayer's basis in the stock or $10 million.

Business Incentives

The SBJA also extended the bonus depreciation rules to allow businesses to deduct up to 50% of the cost of assets placed in service during 2010. This new act now allows businesses to deduct 100% of the cost of assets placed in service from September 8, 2010 through December 31, 2011. For assets placed in service during 2012, the bonus depreciation is equal to 50% of the cost. The section 179 deduction for business was also expanded for purchases of assets during tax year 2012.