Tax Relief Act of 2010 extends Bush-era tax cuts and carries a host of other tax breaks

Late on December 9, Senate Majority Leader Harry Reid (D-NV) introduced H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 **(the 2010 Tax Relief Act)**. The 2010 Tax Relief Act contains a two-year extension of the Bush-era tax cuts that was negotiated by the President and Republicans, and significant estate tax relief. However, it also contains a trove of other tax breaks for businesses and individuals, including enhanced first-year depreciation deductions for businesses, a payroll/self-employment tax cut of two percentage points for 2011 for employees and self-employed individuals, and a two-year alternative minimum tax (AMT) “patch.”

The House voted 277-148 late Dec. 16 on a $859 billion bill to extend the 2001 and 2003 tax cuts for two years and set the estate tax at 35 percent through 2012.

The legislation (H.R. 4853), which passed the Senate by a vote of 81-19 on Dec. 15, will now head to President Obama for his signature.

Here's an overview of what's in the 2010 Tax Relief Act, based on the latest information available.

EGTRRA Tax Cuts Extended for Two Years

Under current law, the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 other than those made permanent or extended by subsequent legislation, sunset and won't apply to tax or limitation years beginning after 2010. (Sec. 901 of EGTRRA)

The 2010 Tax Relief Act postpones the Sec. 901 EGTRRA sunset rule for two years. That is, under the 2010 Tax Relief Act, the income tax provisions of EGTRRA, other than those made permanent or extended by subsequent legislation, will sunset and will not apply to tax or limitation years beginning after 2012 (instead of 2010). Thus, all of the following favorable tax rules (among others) will remain in place through 2012:

(1) The income tax rates for individuals stay at 10%, 15%, 25%, 28%, 33% and 35% (instead of moving to 15%, 28%, 31%, 36% and 39.6%).
(2) The size of the 15% tax bracket for joint filers and qualified surviving spouses remains at 200% (instead of dropping to 167%) of the 15% tax bracket for individual filers.
(3) The standard deduction for married taxpayers filing jointly (and qualified surviving spouses) remains at 200% (rather than 167%) of the standard deduction for single taxpayers. (The standard deduction for marrieds filing separately is half of the joint filer amount.)
(4) Itemized deductions of higher-income taxpayers are not reduced (after 2010 they would have been reduced by 3% of AGI above an inflation-adjusted figure, but the reduction couldn't exceed 80%).
(5) A higher-income taxpayer's personal exemptions are not phased out when AGI exceeds an inflation-adjusted threshold (they would have been after 2010).

(6) Based on CPI figures, it is projected that under the 2010 Tax Reform Act, for married filing a joint return (or surviving spouses), the standard deduction will be $11,600 (up from $11,400 for 2010); for married filing separately, it will be $5,800 (up from $5,700 for 2010).
(7) It also projected, based on CPI figures, the 2011 the personal exemption amount will be $3,700 (up from $3,650 for 2010).

Current law's rules for the following tax provisions also will remain in place through 2012: Coverdell Education Saving Accounts (CESAs), formerly called education IRAs; exclusion for employer-provided educational assistance under Code Sec. 127; exemption from the payments-for-services rule for amounts received under certain Government health professions scholarship programs; above-the-line student loan interest deduction; credit for employer-provided child care facilities; earned income tax credit (EITC); credit for household and dependent care; and child tax credit.

JGTRRA Rules for Capital Gains and Qualified Dividends Extended for Two Years

The bill defers for two years the sunset rule of Sec. 303 of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA, PL 108-27). Thus, through Dec. 31, 2012, long-term capital gain will continue to be taxed at a maximum rate of 15% (instead of 20% (18% for assets held more than five years)). And qualified dividends paid to individuals will be taxed at the same rates as long-term capital gains (instead of being taxed at the same rates that apply to ordinary income).

Alternative Minimum Tax (AMT) “Patched” for Two Years

Under the 2010 Tax Reform Act, the AMT exemption amounts for 2010 will be as follows:

- Married individuals filing jointly and surviving spouses: $72,450, less 25% of AMTI exceeding $150,000 (zero exemption when AMTI is $439,800)
- Unmarried individuals: $47,450, less 25% of AMTI exceeding $112,500 (zero exemption when AMTI is $302,300) (different amount applies for a child subject to the kiddie tax)
- Married individuals filing separately: $36,225, less 25% of AMTI exceeding $75,000 (zero exemption when AMTI is $219,900). But AMTI is increased by the lesser of $36,225 or 25% of the excess of AMTI (without the exemption reduction) over $219,900

Under the 2010 Tax Reform Act, the AMT exemption amounts for 2011 will be as follows:

... Married individuals filing jointly and surviving spouses: $74,450, less 25% of AMTI exceeding $150,000 (zero exemption when AMTI is $447,800);
... Unmarried individuals: $48,450, less 25% of AMTI exceeding $112,500 (zero exemption when AMTI is $306,300) (different amount applies for a child subject to the kiddie tax); and
... Married individuals filing separately: $37,225, less 25% of AMTI exceeding $75,000 (zero exemption when AMTI is $223,900). But AMTI is increased by

the lesser of $37,225 or 25% of the excess of AMTI (without the exemption reduction) over $223,900.

Without the "patch" in the 2010 Tax Reform Act, post-2009 AMT exemption amounts would have plummeted to their pre-EGTRRA levels. For 2010, they would have been $45,000 for married individuals filing jointly and surviving spouses, $33,750 for unmarried individuals; and $22,500 for married individuals filing separately.

Also for 2010 and 2011, many nonrefundable personal credits will be allowed against the AMT (without the "patch," they couldn't offset AMT).

Estate Tax Relief

EGTRRA phased-out the estate and generation-skipping transfer taxes so that they were fully repealed in 2010, lowered the gift tax rate to 35% and increased the gift tax exemption to $1 million for 2010. The 2010 Tax Reform Act sets the exemption at $5 million per person and $10 million per couple and provides for a top tax rate of 35% for estate, gift, and generation skipping transfer taxes through 2012. The exemption amount will be indexed beginning in 2012. The changes will be effective Jan. 1, 2010, but executors will be allowed to make an election to choose no estate tax and modified carryover basis for estates arising on or after Jan. 1, 2010 and before Jan. 1, 2011. Also, a $5 million generation-skipping transfer tax exemption and zero percent rate will apply for the 2010 year.

Effective for estates of decedents dying after Dec. 31, 2010, the 2010 Reform Act will allow the executor of a deceased spouse's estate to transfer any unused exemption to the surviving spouse.

For gifts made after Dec. 31, 2010, estate and gift taxes will be reunified.

Incentives for Businesses to Invest in Machinery and Equipment

The bill OKs the following major new incentives for businesses to invest in machinery and equipment:

(1) A 100% bonus first-year depreciation allowance under Code Sec. 168(k) for property acquired and placed in service after Sept. 8, 2010, and before Jan. 1, 2012;
(2) A 50% bonus first-year depreciation allowance under Code Sec. 168(k) 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; and
(4) For tax years beginning after Dec. 31, 2011, setting the maximum expensing amount under Code Sec. 179 at $125,000 and the investment-based phaseout amount at $500,000 (under current law, the expensing figures drop from $500,000/$2 million for 2010 and 2011 to $25,000/$200,000 after 2011).

Temporary Employee Payroll Cut for 2011

Under current law employees pay a 6.2% Social Security tax on all wages earned up to $106,800 (in 2011) and self-employed individuals pay 12.4% Social Security self-employment taxes on all their self-employment income up to the same threshold. The 2010 Tax Reform Act provides a payroll/self-employment tax holiday during 2011 of two percentage points. As a result, employees will pay only 4.2% Social Security tax on wages and self-employment individuals will pay only 10.4% Social Security self-employment taxes on self-employment income up to the threshold.

Host of Expired Business Tax Breaks Retroactively Reinstated and Extended Through 2011

A host of business tax breaks that expired at the end of 2009 will be retroactively reinstated and extended through 2011, including:

- the research credit
- the new markets tax credit
- employer wage credit for activated reservists
- 15-year write-off for qualifying leasehold improvements, restaurant buildings and improvements, and retail improvements
- 7-year write-off for motorsports entertainment facilities
- enhanced charitable deductions for contributions of food inventory, for contributions of book inventories to public schools and for corporate contributions of computer equipment for educational purposes
- expensing of environmental remediation costs
- allowance of the Code Sec. 199 domestic production activities deduction for activities in Puerto Rico
- the work opportunity tax credit

Long List of Tax Breaks for Individuals Retroactively Reinstated and Extended Through 2011

Many tax breaks for individuals that expired at the end of 2009 will be retroactively reinstated and extended through 2011, including:

- the $250 above-the-line deduction for certain expenses of elementary and secondary school teachers;
- the election to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction permitted for State and local income taxes;
- increased contribution limits and carry forward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes;
- the above-the-line deduction for qualified tuition and related expenses;
- the provision that permits taxpayers age 70 1/2 or older to make tax-free distributions to charity from an Individual Retirement Account (IRA) of up to $100,000 per taxpayer, per tax year (additionally, individuals will be allowed to make charitable transfers during January of 2011 and treat them as if made during 2010);
- the increase in the monthly exclusion for employer-provided transit and vanpool benefits to that of the exclusion for employer-provided parking benefits.

  In addition, the 2010 Tax Reform Act will extend for an additional year (i.e., through 2011), the rule allowing premiums for mortgage insurance to be deductible as interest that is qualified residence interest.

Other Provisions Extended Through 2011

The list of energy-related provisions that will be extended through 2011 include: the $1.00 per gallon production tax credit for biodiesel, as well as the small agri-biodiesel producer credit of 10 cents per gallon; the $1.00 per gallon production tax credit for diesel fuel created from biomass; the placed-in-service deadline for qualifying refined coal facilities; the credit for manufacturers of energy-efficient residential homes; the $0.50 per gallon alternative fuel tax credit (but the credit will not be extended for any liquid fuel derived from a pulp or paper manufacturing process); the suspension on the taxable income limit for purposes of depleting a marginal oil or gas well; the Code Sec. 45M credit for US-based manufacture of energy-efficient clothes washers, dishwashers and refrigerators (with modified standards); the Code Sec. 25C credit for energy-efficient improvements to existing homes (reinstating the credit as it existed before passage of the American Recovery and Reinvestment Act (standards for property eligible under Code Sec. 25C are updated to reflect improvements in energy efficiency); and the 30% investment tax credit for alternative vehicle refueling property.

Various disaster relief provisions also will be extended through 2011, including: the time for issuing New York Liberty Zone bonds, effective for bonds issued after Dec. 31, 2009; the increased rehabilitation credit for qualified expenditures in the Gulf Opportunity Zone; and the additional depreciation deduction claimed by businesses equal to 50% of the cost of new property investments made in the Gulf Opportunity Zone (expenditures in 2011 will be eligible if the property is placed in service by Dec. 31, 2011).