

## 2010 - 2011 TAX PLANNING STRATEGIES - SUPPLEMENTAL OUTLINE

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On December 17, 2010 President Obama signed into law the most significant tax bill in nearly a decade - the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

The Act is a sweeping tax package that includes, among many other items, an extension of the Bush-era tax cuts for two years, estate tax relief, a two-year "patch" of the alternative minimum tax (AMT), a two percentage point cut in employee-paid payroll taxes and in self-employment tax for 2011, new incentives to invest in machinery and equipment, and a host of retroactively resuscitated and extended tax breaks for individuals and businesses.

We will talk about two major areas of the Act - Income Tax and Estate Tax.

### I. Income Tax Area:

- A. The current income tax rates will be retained for two years (2011 and 2012), with a top rate of 35% on ordinary income and 15% on qualified dividends and long-term capital gains. The lower dividend and capital gains tax rates originally enacted in 2003 are also extended through 2012. Accordingly, long-term capital gains will continue to be taxed at a maximum rate of 15% instead of increasing to 20% generally. The zero percent rate continues to apply to certain low-income taxpayers. Qualified dividends will also continue to be taxed at the long-term capital gains rates rather than increasing to the same rate applicable to ordinary income.
- B. Employees and self-employed workers will receive a reduction of two percentage points in Social Security payroll tax in 2011, bringing the rate down from 6.2% to 4.2% for employees, and from 12.4% to 10.4% for the self-employed.
- C. A two-year AMT "patch" for 2010 and 2011 will keep the AMT exemption near current levels and allow personal credits to offset AMT. Without the patch, an estimated 21 million additional taxpayers would have owed AMT for 2010.
- D. Key tax credits for working families that were enacted or expanded in the American Recovery and Reinvestment Act of 2009 will be retained. Specifically, the new law extends the \$1,000 child tax credit and maintains its expanded refundability for two years, extends rules expanding the earned income credit for larger families and married couples, and extends the higher education tax credit (the American Opportunity tax credit) and its partial refundability for two years.

- E. Businesses can write off 100% of their equipment and machinery purchases, effective for property placed in service after September 8, 2010 and through December 31, 2011. For property placed in service in 2012, the new law provides for 50% additional first-year depreciation.
- F. Many of the "traditional" tax extenders are extended for two years, retroactively to 2010 and through the end of 2011. Among many others, the extended provisions include the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes; the \$250 above-the-line deduction for certain expenses of elementary and secondary school teachers; and the research credit.
- G Not included in the new law: There was no extension beyond 2010 of the Build America Bonds program, which permits state and localities to issue federally-subsidized municipal bonds. The partial exclusion of unemployment compensation benefits was not extended beyond 2009. Nor were there extensions beyond 2009 of the qualified motor vehicle tax deduction or of the addition to the standardized deduction for real estate taxes paid by those taxpayers who do not itemize.
- H. The so-called "Marriage Penalty Relief" provisions are extended as well. Thus, the 15% bracket for married taxpayers filing a joint return (and surviving spouses) remains twice that of the 15% tax bracket for individual filers. The standard deduction for those taxpayers also remains twice that of the standard deduction for single taxpayers. If a married couple files separate returns, the standard deduction is one-half of that for joint filers. Without extension, both the 15% bracket and the standard deduction would revert to lower levels and result in higher taxes for those married taxpayers.
- I. Itemized deductions of higher-income taxpayers are not subject to reduction as a percentage of the taxpayer's Adjusted Gross Income (AGI). Likewise, such high-income taxpayers' personal exemptions are not subject to phase out when AGI exceeds certain levels.
- J. Extension of the rule that permits withdrawals from both traditional and Roth IRA's for taxpayers over 70-1/2 years of age to make direct gifts to charities.
  - 1. Applies to 2010 and 2011.
  - 2. Gifts made from IRA's in January 2011 can count toward 2010 or 2011.

## II. Estate Tax

Tax Relief Act contained a number of favorable estate tax provisions. Without these provisions, the federal estate tax would have returned in 2011 to pre-2001 levels - which provided for only a \$1 million exemption per individual and a top tax rate of 55%.

- A. The Tax Relief Act includes a \$5 million unified and indexed exemption amount per individual from the federal estate (and Generation Skipping Transfer) taxes. A new addition to the tax code will permit the executor of a deceased spouse's estate to transfer any unused exemption from his or her estate to the surviving spouse. Thus, for married couples, the provisions effectively permit them to shield up to \$10 million in assets from the estate tax even if they have previously failed to properly title assets or otherwise make appropriate provisions for the use of both of their individual exemptions from the estate tax.
- B. The lifetime exemption from the federal gift tax will, nevertheless, remain at \$1 million per person in 2010, but rises to \$5 million in 2011 and 2012.
- C. The top marginal rate will be 35% and applies to all of the federal transfer taxes, including the estate, gift and generation-skipping transfer taxes.
- D. An election will now be permitted to allow the personal representative of a decedent who died in 2010 to choose whether to apply the 2010 or the 2011-2012 rules in determining their estate tax liability. Under EGTRRA, estates of decedents dying in 2010 were subject to no estate tax but were instead subject to modified carryover basis rules that permitted a limited amount of the estate's assets to be stepped up to their market value on the date of death. Under the Tax Relief Act, the personal representative may instead elect to apply the \$5 million exemption and 35% tax rate, but will receive a full step-up in basis of all the assets in the estate. The election to apply the new estate tax rules might be particularly beneficial to the estates of unmarried decedents who died in 2010 while holding a substantial amount of appreciated property.

**This table summarizes the Federal Estate and Gift Tax rules in 2010 and 2011 under the 2010 Tax Relief Act:**

	Estate Tax		Gift Tax		GST Tax	
	2010 [1]	2011	2010	2011	2010	2011
Tax rate	35%	35%	35%	35%	0%	35%
Exemption	\$5M	\$5M	\$1M	\$5M	\$5M	\$5M
Is the exemption indexed for inflation?	No	No	No	No	No	No
Is the exemption portable between married couples?	No	Yes	No	Yes	No	No
Is the exemption unified?	No	Yes	No	Yes	-	-

Estate Tax, Gift Tax, & GST Tax Rules For 2011". Forbes Jan 2011.

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