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Dear Clients and Friends,

With the signing of the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act* on December 17, 2010, the tax rates and rules that were in effect in 2010 were extended for another two years. The new law (short title: *2010 Tax Relief Act*) also extended unemployment benefits for an additional 13 months.

Here's an overview of the tax provisions included in the law.

- **Individual Income Tax Rates.** A tax law passed in 2001 created what has become known as the "Bush-era tax cuts." Those tax cuts, including the tax rates in effect for 2010, were set to expire December 31, 2010, and, had that occurred, everyone's taxes would have gone up in 2011. The *2010 Tax Relief Act* extends the Bush tax rates for all taxpayers for another two years. Therefore, the federal income tax rates for 2011 and 2012 will be 10%, 15%, 25%, 28%, 33%, and 35%.
- **Tax Rates on Capital Gains and Dividends.** The new law continues the 2010 tax rates on capital gains and dividends through 2011 and 2012. The maximum rate remains at 15% for taxpayers in the top four regular tax brackets and at 0% for those in the 10% and 15% tax brackets. Without this extension, the maximum capital gains rate would have risen in 2011 to 20%, and dividends would have been taxed at ordinary income rates as high as 39.6%.
- **Itemized Deductions and Personal Exemptions.** Higher-income taxpayers are entitled to full deduction of their personal exemptions and itemized deductions for 2010. The new law continues this full deduction for 2011 and 2012. Without this extension, those whose incomes exceeded certain threshold amounts would have had their itemized deductions limited and their personal exemptions phased out.
- **Marriage Penalty Relief.** The new law extends the current marriage penalty relief for two years. The standard deduction for married couples filing a joint return will be twice the amount for a single taxpayer, and the size of the 10% and 15% tax rate brackets for couples will be twice that of single taxpayers.
- **Child Tax Credit and Earned Income Credit.** The \$1,000 tax credit for each child under age 17 was set to revert to \$500 in 2011. The new law extends the credit at \$1,000 for two years and continues the increase in the refundable portion of the credit. The law also extends the enhanced earned income tax credit through December 31, 2012.

● **American Opportunity Tax Credit.** A 2009 tax law expanded the Hope education credit and renamed it the American Opportunity Tax Credit. The 2010 law extends the credit through 2012, providing a \$2,500 maximum credit for qualified higher education expenses. The law also extends the higher income limitations through 2012. Phase out of the credit will begin at \$80,000 of income for individuals and at \$160,000 for married couples.

● **Other Education Breaks.** The new law keeps the income exclusion for up to \$5,250 of employer-provided education assistance for an additional two years. The student loan interest deduction as structured for 2010 will be extended through 2012.

Coverdell Education Savings Accounts (ESAs) were enhanced by the 2001 tax law, and those enhancements will continue for another two years. The maximum ESA contribution will remain at \$2,000, and qualified expenses will continue to include elementary and secondary education costs as well as higher education expenses.

● **Alternative Minimum Tax (AMT).** Without Congressional action, the AMT would have applied to more than 20 million taxpayers in 2010. The AMT is a separate tax calculation originally designed to keep the wealthy from escaping all income tax through the use of various tax breaks. Because the exemption from the tax did not include inflation adjustments, the tax has begun to hit more and more middle-income taxpayers each year.

The new law provides a two-year “patch” to the AMT by raising the exemption amounts. For 2010, the exemption is \$47,450 for individuals and \$72,450 for married couples filing jointly. For 2011, the exemption is \$48,450 for singles and \$74,450 for couples. Without this patch, the exemption amounts for 2010 and 2011 would have been \$33,750 for singles and \$45,000 for couples.

● **Payroll Tax Cut.** The law creates a new tax break for working taxpayers who pay social security taxes. For 2011, the social security portion of payroll tax paid by employees will be reduced from 6.2% to 4.2% on wages up to \$106,800. This new tax break replaces the Making Work Pay credit which expires after 2010. Self-employed individuals will pay 10.4% on self-employment income up to \$106,800.

The employer share of social security tax paid on employee wages up to \$106,800 will continue to be 6.2%. The payroll tax rate cut does not affect the Medicare portion of the tax.

● **“Extenders” for Individuals.** Certain tax breaks known collectively as “extenders” are typically allowed to expire and then extended retroactively for a year or two. The new law extends a number of these breaks that had expired at the end of 2009, making them effective for 2010 and 2011 tax returns.

The items extended include the following:

- the option for deducting state and local sales taxes in lieu of deducting state and local income taxes.
- the above-the-line deduction for up to \$4,000 for higher education expenses.
- the above-the-line deduction of up to \$250 for classroom supplies purchased by teachers.
- allowing taxpayers 70½ or older to make tax-free contributions of up to \$100,000 from an IRA to a charity.

● **Estate and Gift Taxes.** The 2001 tax law eliminated the estate tax for 2010. The tax was scheduled to return in 2011 with a 55% top rate and an exclusion amount of \$1 million. Under the new law, the estate tax is retroactively reinstated for 2010 with a maximum estate tax rate of 35% and an exclusion amount of \$5 million (\$10 million for married couples). The new rate and exclusion amount will apply through December 31, 2012. Along with these changes, the new law reinstates the step-up in basis for inherited property.

For deaths occurring in 2010, estates have a choice between applying the estate tax with a step-up in basis to fair market value for estate property or no estate tax with a modified carryover of the decedent's basis.

The new law allows a surviving spouse to utilize the unused portion of the deceased spouse's estate tax exclusion amount, providing the surviving spouse with a larger exemption from the estate tax.

Under the new law, the gift tax maximum rate is set at 35%, with an exclusion amount of \$5 million, effective through 2012.

● **Business Provisions**

100% bonus depreciation. The new law increases the current 50% bonus depreciation to 100% for qualified business equipment purchases made from September 9, 2010, through December 31, 2011. 50% bonus depreciation will be available for purchases made in 2012.

Section 179 expensing. The first-year expensing option was increased to \$500,000 for 2010 and 2011 by the *Small Business Jobs Act of 2010*. The investment limit was set at \$2 million. The new law provides a \$125,000 expensing limit for tax years beginning in 2012. The investment limit for 2012 is set at \$500,000; both limits will be adjusted for inflation.

Research tax credit. The research tax credit had expired at the end of 2009. The new law extends the credit retroactively through 2010 and 2011.

Work Opportunity Tax Credit. The new law extends the Work Opportunity Tax Credit through 2011. It had been scheduled to expire after August 31, 2011.

The *2010 Tax Relief Act* gives taxpayers some certainty, if only for the next two years. Had the law not passed, all taxpayers would have seen their taxes increase in 2011. The new law will have a significant impact on individuals: cutting payroll taxes for workers, preventing the AMT from hitting millions more taxpayers, continuing tax breaks for education expenses, and cutting estate taxes. For more information and planning guidance under this latest tax law, contact my office by phone at 253-4121 or via email at ras@rogervtcpa.com.

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