

Individual Income Tax Update

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Sunset Relief

- Economic Growth and Tax Relief Reconciliation Act of 2001
 - Reduced tax rates generally 5% for all tax brackets
 - Provided equalization of standard deduction and tax rates between married and single individuals (marriage penalty relief)
 - Provided new education related deductions and credits
 - Temporarily increased the alternative minimum tax exemption amount
 - Estate tax provisions to increase the exemption amount and eliminate the estate tax completely in 2010.
- These provisions were set to sunset and no longer apply to tax years beginning after 2010
 - Tax rates would have increased by 5% for each bracket to 15%, 28%, 31%, 36% and 39.6%

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Sunset Relief

- Under the 2010 Tax Relief Act most of the provisions are extended by two years (one year in the case of adoption rules). All the favorable tax rules remain in place through 2012.
- What happens after 2010?
 - Depends on the 2012 elections
 - Anybody's guess

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Tax Rates

For 2011 and 2012:

	Single	Married Joint	Head of Household	Married Separate
■ 10%	8,500	17,000	12,150	8,500
■ 15%	34,500	69,000	46,250	34,500
■ 25%	83,600	139,350	119,400	69,675
■ 28%	174,400	212,300	193,350	106,150
■ 33%	379,150	379,150	379,150	189,575
■ 35%	Unlimited			

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Estate and Trusts

Tax rates are:

- 15% Not over \$2,300
- 25% Over \$2300 but not over \$5,450
- 28% Over \$5,450 but not over \$8,300
- 33% Over \$8,300 but not over 11,350
- 35% Over \$11,350

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Capital Gains and Qualified Dividends

- Adjusted net capital gain will be taxed at a maximum rate of 1 -15% through 2012
- Qualified dividend income taxed at 15% rate
- 25% rate still applies for section 1250 unrecaptured gain.

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No Limitation on Itemized Deductions

- For tax years beginning in 2010 there was no overall limitation based on the taxpayer's adjusted gross income although limitations on medical deductions, casualty losses and other itemized deductions remain.
- Extended for two years through 2012

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Personal Exemptions

- Under prior law, the personal exemptions was reduced by 2% for each \$2,500 over threshold amounts for married, single and head of household.
- Beginning in 2010 and extending for two years, 2011 and 2012, a higher- income taxpayer's personal exemptions are not phased-out
- The 2011 personal exemption is \$3,700

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Child Tax Credit

- Child tax credit remains at \$1,000 for each qualifying child under age 17 claimed as a dependent. Income limitations still apply
- The credit can still be used against regular tax and alternative minimum tax
- The credit is still refundable for the years 2011 and 2012 with limitations.

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Earned Income Tax Credit

- Beginning in 2010, a 45% credit applies for a taxpayer with three or more qualifying children. They could claim a credit as high as \$5,666 (45% of earnings up to \$12,590)
- This along with the following has been extended for two years, 2011 and 2012:
 - Simplified definition of earned income
 - Simplified relationship test
 - Use of AGI instead of modified AGI
 - Simplified tie-breaking rules

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Expanded Adoption Credit

- The 2010 Patient Protection and Affordable Health Care Act provided a one year postponement of the sunset provisions. It also increased the maximum per child credit to \$13,170 for two years, however those years are 2010 and 2011, and made the credit refundable.
- For 2012, the maximum benefit is \$12,170 and is phased out for modified AGI between \$182,500 and \$222,520 and is not refundable.

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Dependent Care Tax Credit

- The maximum credit is \$1,050 (35% of \$3,000 of expenses) for one child or \$2,100 (35% of \$6,000) for two or more children with a reduction based on income.
- This remains for two more years, 2011 and 2012

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Tax-Free IRA Distributions

- Pension Protection Act of 2006 amended the IRA distribution rules to allow tax-free treatment of distributions from IRAs where the distributions are donated to charity.
- Taxpayer may exclude from gross income “qualified charitable distributions” not exceeding \$100,000 in a tax year

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Tax-Free IRA Distribution

- Under pre-2010 Tax Relief Act law, this applied only to distributions made in tax years beginning in 2006 through 2009.
- The 2010 Tax Relief Act extends the exclusion to distributions made in tax years beginning after December 31, 2009 and before January 1, 2012.

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Tax-Free IRA Distribution

- Advantages of direct charitable contribution:
 - Reduces adjusted gross income which may reduce the amount of social security income included in taxpayer income
 - Reduced adjusted gross income may increase the medical deduction for taxpayers who itemize.
 - For taxpayers who do not itemize, make the charitable contribution “deductible” and preserves the standard deduction.

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Tax-Free IRA Distribution

Example:

	Total	Taxable
■ Interest income	\$ 1,000	\$ 1,000
■ IRA or pension	\$35,000	\$35,000
■ Social Security	\$18,000	\$13,850
less: Standard deduction		\$(7,100)
Exemption		\$(3,650)
■ Taxable Income		\$39,100
■ Tax		\$ 5,963

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Tax-Free IRA Distributions

Example

	Total	Taxable
■ Interest	\$ 1,000	\$ 1,000
■ IRA or pension	\$35,000	\$30,000
■ Social security	\$18,000	\$ 9,600
Less: Standard deduction		\$(7,100)
Exemption		\$(3,650)
Taxable Income		\$29,850
Tax		\$ 4,063
Savings		\$ 1,900

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Estate Tax Rules

Estate tax exists for all of 2010 with a credit equivalent to a \$5 million estate tax exemption and a maximum marginal rate of 35%.

For estate of decedents dying at any time during 2010 including after enactment date may *elect* to have the modified carryover basis rules apply rather than be subject to the estate tax.

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Estate Tax Rules

- These rules apply to decedents passing away during 2010, 2011 and 2012.
- Budget proposal includes a provision that would extend the estate, gift and generation-skipping transfer taxes at their 2009 parameters, \$3.5 million exemption amount and 45% marginal tax rate.

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Estate Tax Rules

- For large estates far in excess of the \$5 million, we expect the executor would make the election to opt out of the estate tax and into the modified carryover basis regime:
 - Limited step-up in basis of \$1.3 million for any heir of the decedent
 - Additional \$3 million for bequests to the surviving spouse
 - Note: all \$4.3 million may be used for bequests to the surviving spouse

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Estate Tax Rules

- Portability of exemption amount
- Effective in 2011, the executor may elect to transfer any unused estate tax exemption-equivalent amount to the surviving spouse, i.e. if decedent's estate is only \$3 million, the remaining \$2 million may be added to the spouse for a total exemption amount of \$7 million.

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Gift Tax Rules

- The exemption-equivalent amount for taxable gifts during 2010 remained at \$1 million. Those that made gifts in anticipation of a rate increase may want to rescind or reverse the gift.
- Commencing in 2011, the gift tax and estate tax became unified again with the same \$5 million exemption-equivalent amount
- The maximum gift tax rate for 2010 and 2012 is rate 35%.

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Gift Tax Rules

- The Act is designed so that, absent further congressional action, the tax laws in place prior to 2001 will again become effective beginning January 1, 2013. \$1 million exemption equivalent amount with a 55% maximum tax rate.

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Gift Tax Rules

- Problem: If a client takes advantage of the \$5 million exemption-equivalent amount by making gifts during 2011 or 2012, it is unclear what will happen if the client dies after 2012 and the estate-tax equivalent amount has returned to \$1 million. Based on the existing Form 706 instructions, a recapture of the tax would occur, i.e., the tax payable with the Form 706 could effectively include additional gift tax based on the reduced exemption-equivalent amount. The exemption-equivalent amount has never decreased so it is unclear what will happen.

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Making Work Pay Credit

- For the 2010 tax year, a refundable credit against income tax was provided to an eligible individual in an amount equal to the lesser of (1) 6.2% of earned income or (2) \$400 or \$800 in the case of married filing jointly.

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Payroll Tax Cut for 2011

- For wages received during 2011, the Social Security portion of FICA is reduced from 6.2% to 4.2% for employees only. The employer portion remains at 6.2%. For an employee earning the social security maximum of \$106,800 that equals \$2,136.00.

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Energy Credits

- Extended for one year through December 31, 2011
- Taxpayer can claim a 10% credit for qualified energy property placed in service in 2011 up to \$500 lifetime limit (with no more than \$200 from windows and skylights).

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Bonus Depreciation

- 100% of the cost of qualified property placed in service after September 8, 2010 and before January 1, 2012.
- Qualified property:
 - Property with a MACRS recovery period of 20 years or less
 - Computer software other than Section 197 assets
 - Qualified leasehold improvements
 - Certain water utility property
 - Original use must commence with the taxpayer (new property only)

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Questions?

Thank you!

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