



December, 2010 ©

CONGRESS AGREES ON SOMETHING....AT LAST!

Talk about last minute.....pew! In an attempt to give the American taxpayer and the American economy some certainty as to the tax law going forward, our exalted elected representatives and senators have finally given us some tax law that will allow taxpayers to plan their lives and businesses to plan their investments without being concerned as to whether or not the tax rates are going up, down or sideways. Something permanent. Something we can count on going forward. NOT!

What has actually transpired is that businesses and taxpayers have been taken out of limbo and put on a temporary treadmill for 2 years. At that point – we’re back to square one – right back where we started. So – if you’re doing any long term planning – forget it! You’ve got a two year window and after that (maybe even before that) – it’s anybody’s guess. As that famous wise man Yogi Berra said – It will be “dèjà vu all over again”.

No matter if you call it, an extension of the Bush era tax cuts or an extension of the current tax rates – the result is the same. Here are some things they did and did not do with the “Tax Relief/Job Creation Act of 2010:

1. **The current tax rates are extended for everyone** through 2012– even those millionaires and billionaires who make over \$250,000. (This also includes all you billionaires who have 2 wage earner families trying to put a few kids through college.) This includes keeping the 15% rate for long term capital gains and qualified dividends. Keep in mind that in 2013 according to the new Health Care bill –these “higher” income individuals will be subject to an additional of .09% Medicare tax (on all wages) PLUS a 3.8% income tax on all investment income (including S corporation earnings, interest, dividends, etc.).

The low capital gain and dividend rate of 15% is an incentive to disburse C corporation retained earnings while the iron is hot – before 2013. This also applies to S corporations which had prior C Corporation retained earnings at the time the “S” election was made.

2. **There will be no limitation on itemized deductions and dependency exemptions** through 2012.
3. **The \$1,000 child tax credit is extended** through 2012 although it will continue to be phased out

above \$110,000 for joint filers and \$75,000 for single filers. In order to take this credit the child must be *under* 16 years of age.

4. **The Alternative Minimum Tax (AMT) has been “patched” for 2 years – 2010 and 2011.** The “patch” comes in the form of an increase in the exemption amount. Ahhhhhh! One year of no machinations on this subject in Congress. December 2011 can be quiet on this issue.
5. **The “above the line” student loan interest deduction has been extended** through 2012.
6. **The American Opportunity Tax Credit has been extended through 2012.** Qualified taxpayers will be allowed a maximum credit of \$2,500 for each of the 4 years of postsecondary education. The benefit begins to phase out at income levels of \$80,000 (single) and \$90,000 (joint filers). Keep in mind that the **first 40% of this credit is “refundable”**. That means that you get it refunded even if you paid in no tax and owe no tax. *Whoopee!*
7. Taxpayers 70-1/2 and over can use **their annual Required Minimum Distribution (RMD) to transfer assets directly to a charity**. This will decrease their AGI which affects many other types of deductions. This benefit has been extended through 2010 and 2011. If you are charitably inclined and over 70-1/2, this technique works well. **ALERT: Taxpayers will be allowed to make charitable transfers during January of 2011**

and still treat them as if made in 2010.

8. Also extended through 2011 are:
 - a. The deduction for state and local sales tax
 - b. The higher education tuition (maximum \$4,000) “above the line” deduction
 - c. Teacher’s classroom expense “above the line” deduction (up to \$250)
 - d. Mortgage insurance premiums on a primary residence will be deductible as “mortgage interest”.
9. THIS IS A **“BIGGIE”**....for 2011 ONLY – **there will be a 2% reduction in FICA tax paid by an employee on his/her wages**. If you make \$100,000- you have just received a \$2,000 raise in your net check – FOR ONE YEAR ONLY. This does NOT apply to the employer portion or the Medicare portion of the payroll tax.
10. **The Estate tax has returned in its’ pre-2010 format with some major changes:**
 - a. The estate and gift tax have been re-united with a \$5 million lifetime exclusion per person and a 35% top tax rate. (The current lifetime gift tax exclusion is \$1 million and the current estate tax is \$0.) So those of you who have relatives with over \$10 million in assets who were considering throwing Granny off the train before 1/1/11 when the

tax is reinstated—have only a few more days to do the dastardly deed!

- b. For decedents dying in 2010 – the executor may choose to utilize the current \$0 estate tax with limited step-up in basis for assets or to file under the new and improved method with the tax kicking in over \$5 million and a 35% top rate.
- c. **BRAND NEW FOR DECEDENT DYING AFTER 12/31/10 – “PORTABILITY”**. This provision will allow a surviving spouse to utilize any of his/her unused \$5 million exclusion. But there is a stickler here. A surviving spouse can only take advantage of the last spouse’s unused exclusion. That means you can’t collect unused exclusions by marrying and killing off multiple spouses.

This provision will make some changes in current estate planning in that it may not be necessary to maneuver asset ownership in order to make sure each spouse has enough assets to cover their exclusion amount. However, there is a difference between transferring an unused portion of a

deceased spouse’s exclusion amount and using that exclusion amount when that spouse dies.

Here’s the rub: If a spouse has \$5 million in assets in his/her name at date of death and puts that \$5 million in a family trust – the appreciation on that \$5 million is forever out of the reach of the estate tax. On the other hand, if a spouse has \$2 million in assets at date of death – and the unused \$3 million is transferred to the surviving spouse – the appreciation on that \$3 million will then be subject to estate tax when the second spouse dies. Adding insult to injury, the estate tax rates could be much higher at that time as well. So – it is still a valid planning technique to ensure the least amount of tax is paid overall. This is a question that will have to be examined by those taxpayers with assets values at or close to the limit.

In order to transfer an unused exclusion amount to a surviving spouse – **an election to do so must be made on the estate tax return for the deceased spouse.**

This will require the filing of many estate tax returns for decedents whose assets are under the exclusion amount. In the past – there was no requirement to do so.

Just in case you are into the acronyms used by Congress – the deceased spousal unused exclusion amount will henceforth be known as “**DSUEA**”.

Using 100% depreciation or using Section 179 in a current year will leave less depreciation to shelter income in future years. Most times – a bird in the hand is worth more than one in the bush. However – in these instances as in most planning techniques – you have to be aware of how the future will look as a consequence of the current planning decisions. Be aware – **bonus depreciation applies only to new property.**

11. The GST (Generation Skipping Tax) allows a \$5 million exemption for 2010 with a GST rate of 0%. For 2011-2012 the exemption remains at \$5 million but the GST rate is at 35%.

12. The **annual gift tax exclusion amount remains at \$13,000 per person per year.** This allows a married couple to give away \$26,000 per person per year.

13. Additional popular Business incentives include:

a. **100% bonus depreciation (not the same as Section 179 expensing) for assets acquired after 9/8/2010 and by December 31, 2011.** This provision is more than it seems at first glance. Section 179 cannot be used to create or add to a net operating loss. Using bonus depreciation can still be used to create or increase a loss. **ONE HUGE CAVEAT:** What you gain today will have to be paid back in the future.

b. Going forward **50% bonus depreciation will be allowed for assets acquired during 2012 only.**

c. **Section 179 dollar and expensing limits remain at \$500,000/\$2 million through December 31, 2011.** This includes the \$250,000 investment allowed for qualified real property which includes qualified leasehold improvements **and restaurant and retail improvement property (NOT INCLUDING LAND IMPROVEMENTS) THROUGH 2011 ONLY.** For 2012 only – the limits will revert to \$125,000/\$500,000 with no ability to utilize Section 179 for real property.

d. The **Work Opportunity Tax Credit (WOTC)** originally scheduled to expire after August 31, 2011 has been

**extended through
December 31, 2011.**

However two targeted groups (unemployed veterans and disconnected youths) will not be eligible beyond 2010.

Just FYI – The IRS assumed that the individual tax breaks that expired at the end of 2009 were NOT going to be renewed and programmed their computers and 2010 forms to reflect that. Now – they have to go back and

re-program everything. Business as usual!

As we exit the year 2010 and leave behind all its' tax law uncertainties and move towards 2011 and a new set of uncertainties...may the force be with you. You're gonna need it!

Stay tuned!

From our house to yours – happy holidays and best wishes for a healthy and prosperous New Year.

