

CSTC Last Minute Federal Updates for 2010

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was signed into law, extending most of the provisions of EGTRRA 2001. Because Congress waited until the last minute, the IRS has announced that the processing of tax returns will be delayed. The IRS needs to reprogram its processing systems for three provisions that were extended in the Act: the tuition and fees deduction, educator expense deduction, and general sales tax deduction. Additionally, any taxpayer who is itemizing deductions (whether or not the sales tax deduction is being claimed) will need to wait until the processing systems are ready, which the IRS estimates will be mid- to late February. The delay affects both electronic and paper returns.

Most of the provisions that were due to expire at the end of 2009 were extended for an additional two years. A few provisions were not extended, or only had a one year extension.

Provision	Previous Expiration Date	Extension Date
Tax-free distributions from IRAs for charitable purposes	12/31/09	12/31/11
\$250 Deduction for educator expenses	12/31/09	12/31/11
Tuition and fees deduction	12/31/09	12/31/11
Increased standard deduction for state or local sales or excise taxes for purchase of new vehicle	12/31/09	Not extended.
Increased deduction for real estate taxes or net disaster loss	12/31/09	Not extended.
Itemized deduction for state and local general sales taxes	12/31/09	12/31/11
Exclusion of first \$2,400 of unemployment benefits from taxation	12/31/09	Not extended.
Waiver of RMD rules for IRAs and defined contribution plans	12/31/09	Not extended.
Increased AMT exemptions	12/31/09	12/31/11
Exclusion of personal credits from AMT	12/31/09	12/31/11

In addition to the extenders, TRUIRJCA 2010 (the Extension Act) made significant changes to Bonus Depreciation, Energy Credits, and Estate Taxes. It also adds a one-year reduction in payroll taxes as a stimulus measure.

Employee Payroll Tax Cut

For 2011 only, the employee's share of Social Security tax (OASDI) has been reduced from 6.2% to 4.2%. This is known in the new law as "the payroll tax holiday." Self-employed taxpayers have their SE tax calculated for 2011 at a rate of 10.4% instead of 12.4%. Notice that the Medicare taxes are not being reduced, nor are the employer's portion of the OASDI.

This temporary reduction will not reduce the taxpayer's Social Security earnings for purposes of calculating future benefits.

Energy Credits

The \$1,500 maximum non-business energy property credits expired as of 12/31/2010. In place of these credits, the Extension Act extended the original \$500-maximum credits for one year only, 2011.

Energy efficient property installed in the taxpayer's personal residence located in the United States will qualify for a 10% credit, maximum of \$500, if the property is purchased and placed in service during 2011. However, the original lifetime limit of \$500 is back in place and credits claimed in 2006 and 2007 must be considered against this lifetime maximum.

In 2011, the maximum allowed credit is:

- \$50 for advanced main air circulation fans,
- \$150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and
- \$300 for energy-efficient building property.

The standards for qualification now include Energy Star program requirements. A natural gas, propane, or oil furnace or hot water boiler must achieve an annual fuel utilization efficiency rate of 95 or more. Biomass fuel stoves must have a thermal efficiency rating of at least 75%.

Estate Taxes

Congress included changes to estate tax in their Extension Act that was passed this December. For decedents dying in 2010 or later, there is a \$5 million exclusion, and a 35% maximum tax rate, which has been reunified with the gift tax rate. Although this is

a retroactive change, the Act allows the estate to elect to apply the EGTRRA'01 provisions to estates of decedents dying in 2010 instead of the new laws¹.

The EGTRRA'01 provisions do not give an automatic step-up in basis in 2010 on inherited assets. The estate is allowed to allocate up to \$1,300,000 of estate fair market value to an aggregate basis increase. A surviving spouse will be able to allocate an additional \$3,000,000 of property for basis increases. The estate must identify which assets for which it is electing to apply the increase. This is done on Form 8939, Allocation of Increase in Basis for Property Acquired From a Decedent.

If the estate does not elect the EGTRRA'01 provisions, the estate will receive a step-up to fair market value as of date of death (or alternate valuation date) for all estate assets and owe estate tax on values in excess of the \$5 million exclusion.

For decedents dying after December 31, 2009 and before December 17, 2010, Form 706 will be due no earlier than September 17, 2011 (nine months from enactment date) in order to give these estates time to determine their filing.

For estates of decedents dying after December 31, 2010, the executor of a deceased spouse's estate may transfer any unused exemption to the surviving spouse. This election is made by filing Form 706 for the first to die.

Example: Martin died January 2, 2011. His estate was valued at \$4 million and he had not made any lifetime gifts. If the executor of his estate files Form 706 (even though it is below the filing requirements), the election can be made on it to transfer the unused \$1 million exemption (\$5 million - \$4 million) to his surviving spouse to be used at her death.

Bonus Depreciation

For property placed in service after September 8, 2010 and before January 1, 2012, qualifying property has a bonus depreciation rate of 100% of cost (rather than 50%). This total write-off is not affected by a short tax year, AMT, or any income thresholds.

¹ The law allows the IRS to designate the manner for making the election. Look for further clarification from the IRS soon.

Taxpayers may elect out of the bonus depreciation allowance for any class of property for the tax year. There is no limit on the total amount of bonus depreciation that may be claimed, and bonus depreciation could create a net operating loss.

The Act also extends 50% bonus depreciation for property placed in service after December 31, 2011 and before January 1, 2013.

Provisions Affecting 2011 Returns

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended most of the EGTRRA'01 provisions that were due to expire at the end of 2010 for another two years, through 2012. The chart below shows the extension dates of these provisions and also what will happen to the law after the extension date is over (depending upon Congress).

EGTRRA '01 Sunset Provisions

Provision	Expected Change after final sunset	Extension Date
Exemption phase-outs	High income taxpayers might lose their entire personal and dependent exemptions (inflation adjusted income levels not yet released).	12/31/11
Itemized deduction phase-outs	High income individuals can lose up to 80% of deductions subject to phase-out.	12/31/11
Income tax rates	28%, 31%, 36%, and 39.6% rates return for higher income taxpayers. 10% bracket disappears. 15% tax bracket reduced for MFJ taxpayers (return of marriage penalty).	12/31/12
Capital gains rates	Capital gains rates generally 10% (if in 15% or lower bracket) or 20% (if in 25% or higher bracket).	12/31/12
AMT exemption	MFJ \$45,000 S \$33,750 MFS \$22,500	12/31/11
Child Tax Credit	\$500 maximum	12/31/12
Additional Child Tax Credit	Threshold increases from \$3,000 to \$12,550 before refundable credit applies.	12/31/12
EITC	Maximum credit based on 2 or more children	12/31/12

Provision	Expected Change	Extension Date
Child care credit	Returns to maximum \$2,400 (\$4,800 for 2 or more kids)	12/31/12
American Opportunity Tax Credit	No longer applies. HOPE Scholarship credit returns (max. \$1,800).	12/31/12
Tuition & Fees adjustment	Not available	12/31/11
Student Loan Interest	Lower MAGI ranges and can only be deducted for first 60 months.	12/31/12
Coverdell	Returns to \$500 maximum contribution per child	12/31/12
Casualty Losses	10% limitation (even for Pres. disaster losses), \$100 floor.	
Making Work Pay credit	No longer applies.	
Non-business Energy Credits	Expired.	12/31/11 WITH CHANGES (SEE TEXT)
Interest Deduction for Mortgage Insurance Premiums	Expired.	12/31/11