Individual Tax Provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

After much speculation and anticipation, Congress finally passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act). The president signed it into law on December 17. The Act, in essence, is an extension of the 2001/2003 Bush-era tax cuts for two years. Also, the Act provides a payroll tax holiday for 2011 and a change in the exemption amount and maximum tax rate for estate taxation. The Act extends and modifies many of the provisions first enacted in the 2009 American Recovery and Relief Act. Finally, the Act incorporates many individual extensions of the so-called annual extenders. The following is a list of individual provisions that will certainly affect your tax liability for 2011, 2012, and possibly 2010, as well.

Individual Tax Rate Provisions

• **Income tax rates.** The Act extends the 10% individual income tax bracket as well as the 25%, 28%, 33%, and 35% individual income tax brackets for an additional two years, through 2012.

• **Capital gains rates.** The Act allows the capital gains rates to remain at 0% for taxpayers below the 25% bracket and 15% for taxpayers in the 25% rate and above, through 2012. Without the legislation, the capital gains rates were scheduled to expire at the end of 2010, and revert to 10% and 20%, respectively.

• **Dividends taxed at capital gains rates.** The current dividend rates of 0% for taxpayers below the 25% bracket and 15% for taxpayers in the 25% bracket and above are extended through 2012. Without the legislation, these rates were set to expire at the end of 2010, taxing dividends at the ordinary income rates.

• **Phaseout of marriage penalty in the 15%bracket.** The 15% regular income tax bracket for married couples filing joint returns set at twice the corresponding bracket for an unmarried individual filing a single return (marriage penalty relief for the 15% bracket) is extended through 2012.

• **Employee payroll tax cut.** For 2011 only, the Act reduces the Social Security (OASDI) tax rate on employees to 4.2% (from 6.2%)and reduces the self-employment tax (SECA) rate to 10.4% (from 12.4%). However, the Act does not reduce the OASDI contribution base, which is $106,800 for 2011. Thus, the maximum OASDI tax in 2011 for employees is $4,485.60. In addition, the rate reduction is not taken into account in determining the SECA tax deduction allowed for determining net earnings from self-employment. As a result, the deduction for 2011 remains 7.65% of self-employment income (determined without regard to the deduction).

Alternative Minimum Tax Relief

• **Alternative minimum tax exemption amount and credit relief.** The Act puts in place a 2-year patch for the AMT. The Act increases the AMT exemption amount to $72,450 for tax years beginning in 2010, and $74,450 for tax years beginning in 2011. For an individual who is not married and is not a surviving spouse, the exemption amount is $47,450 for tax years beginning in 2010, and $48,450 for tax years beginning in 2011. For married taxpayers filing separate returns, the exemption amount is $^1/_2$ of the married filing jointly amount. In addition, both the personal credits and nonrefundable credits can offset AMT through 2011.

Individual Deductions and Credits

• **Elimination of marriage penalty in standard deduction.** The Act extends, from 2010, the basic standard deduction for married couples filing joint returns that is twice the basic standard deduction for an unmarried individual filing a single return, through 2012.

• **Repeal of phaseout for personal exemptions.** You may recall that the phase out of the personal exemption (referred to as PEP) for higher income individuals had been gradually decreasing, so that by 2010, the phaseout was entirely repealed. The Act extends the repeal of PEP for an additional two years, through 2012. Thus, personal exemption amounts will continue to be allowed regardless of the taxpayer's income.

• **Phaseout of overall limitation on itemized deductions.** Similar to the PEP, the phase-out of the overall limitation on deductions for higher income taxpayers had gradually decreased until its 2010 complete repeal. The Act extends this repeal for an additional two years, through 2012.

• **Modifications to child tax credit.** Generally, taxpayers with income below certain threshold amounts may claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17. Prior legislation increased the credit from $500 to$1,000 (per child), allowed the credit to offset AMT as well as regular tax, and converted it from nonrefundable to refundable for certain taxpayers. The Act preserves the child tax credit amount at $1,000 per child, extends the allowance against the regular tax as well as AMT, and maintains the refundability provision by allowing earnings above $3,000 to count towards the refundable portion of the credit(subject to the 2009 special rules discussed below) through 2012.

• **Expansion of adoption credit and adoption assistance programs.** EGTRRA increased the adoption credit amount and the income exclusion for employer-assistance programs to $10,000(adjusted for inflation each year). Health reform law increased the amount again to $13,170 for 2010 and 2011 ($13,360 as adjusted for inflation) and made the credit refundable. After 2011, the amounts would revert back to lower pre-EGTRRA limits. The Act extends for one additional year, through 2012, the EGTRRA increased adoption credit amount and income exclusion for employer-assistance programs. Therefore, for 2012, the amount will be $12,170 (the amount before health reform law to be further adjusted for inflation). Note, however, that although the current refundable credit will still exist through 2011, the 2012 credit will become nonrefundable. For 2013 and after, barring further legislation, the credit will revert back to its pre-2001 levels and *only adoptions for special needs children will qualify for the credit or assistance exclusion*.

• **Dependent care credit.** This is a credit based on an applicable percentage of child and dependent care expenses for children under age 13 and disabled dependents. Eligible expenses of $3,000 for one eligible child/disabled dependent and $6,000 for two or more eligible children/disabled dependents, along with the increased applicable percentage of 35% are extended for an additional two years, through 2012.

• **Earned income credit.** Legislation in 2009 increased the earned income credit to 45% of a working family's first $12,570 (inflation-adjusted $12,590 for 2010) of earned income for families with three or more children and also increased the beginning point of the phase-out for married couples filing a joint return. The Act extends, through 2012, the increases to the credit percentage and the married filing jointly phase-out threshold.

• **Refunds disregarded in the administration of Federal programs and federally assisted programs.** The Act disregards all refundable tax credits, such as the refundable portion of the EITC and the child tax credit, as income for means tested programs. However, this provision does not apply to amounts received after December 31, 2012.

• **Deduction for certain expenses of elementary and secondary school teachers.** The Act extends, from 2009, the $250 above-the-line deduction for professional expenses incurred by elementary and secondary schoolteachers through 2011.

• **Deduction of state and local taxes.** The Act extends, from 2009, the election available to taxpayers who itemize their deductions to deduct state and local sales taxes in lieu of state and local income taxes.

• **Contributions of capital gain real property made for conservation purposes.** The Act extends, from 2009, the increased contribution limitations and carryover period for charitable contributions of certain conservation property for contributions made through December 31, 2011.

• **Tax-free distributions from individual retirement plans for charitable purposes.** Through 2011, the Act allows taxpayers age $70^1/_2$ or older to make tax-free distributions to charities from their traditional individual retirement accounts (IRAs) and Roth IRAs up to $100,000 per taxpayer, per taxable year. Although this provision expired at the end of 2009, the Act permits individuals to make charitable transfers during January of 2011 as if they were made during 2010.

• **Employer-provided mass transit and parking benefits.** The Act extends the increase (set at $230 in 2010) in the combined monthly exclusion for employer-provided transit and vanpool benefits through the end of 2011.

• **Deduction for mortgage insurance premiums.** The Act extends for one year, through 2011, the itemized deduction for the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10% for each $1,000 by which the taxpayer's adjusted gross income(AGI) exceeds $100,000, so that the deduction is unavailable for a taxpayer with an AGI in excess of $110,000.

Education Benefits

• **Above-the-line deduction for qualified tuition and related expenses.** The Act extends, from 2009, the above-the-line deduction for qualified tuition and related expenses through 2011. The maximum deduction is $4,000 for taxpayers with adjusted gross incomes not exceeding $65,000 ($130,000 for joint returns) and $2,000 for taxpayers with adjusted gross incomes not exceeding $80,000 ($160,000 for joint returns).

• **Coverdell education savings accounts.** These are tax-exempt savings accounts used to pay the higher education expenses of a designated beneficiary. The $2,000 annual contribution amount and expanded definition of education expenses to include elementary and secondary school expenses are extended by the Act for an additional two years, through 2012.

• **Exclusion for employer-provided educational assistance.** An employee may exclude from gross income up to $5,250 for income and employment tax purposes per year of employer-provided education assistance. Earlier legislation expanded this provision to include graduate as well as undergraduate education through the end of 2010. The Act extends this expansion of the exclusion for an additional two years, through 2012.

• **Student loan interest deduction.** Individuals who have paid interest on qualified education loans may claim an above-the-line deduction for the interest expenses up to $2,500. Before 2001, taxpayers were allowed this deduction only for 60 months and it was phased out for taxpayers with incomes between $40,000 and $55,000 ($60,000 and $75,000 for joint filers). Legislation in 2001 eliminated the 60-month rule and increased the income phase-out to $55,000 to $70,000 ($110,000 and $140,000 for joint filers). The Act extends the 2001 changes to this provision for an additional two years, through 2012.

• **Exclusion of certain amounts received under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program.** The National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program provide education awards to participants on the condition that the participants perform certain services. Legislation in 2001 created an exclusion from gross income for scholarships to apply to these programs.

The Act extends the income exclusion for these programs for an additional two years, through 2012.

• **American Opportunity Tax Credit.** The Act extends this temporary expansion of the Hope Credit through 2012. Generally, the credit is for up to $2,500 of the cost of tuition and related expenses paid during the taxable year. The credit is allowable for the first four year of post-secondary education and 40% of the credit is refundable. The credit is subject to a phase-out for taxpayers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly).

Energy Incentives

• **Extension of grants for specified energy property in lieu of tax credits.** The Act extends through 2011 the 2009 American Recovery and Reinvestment Act provision that allows taxpayers to apply for grants for specified energy property in lieu of tax credits.

• **Credit for non-business energy property.** The Act extends, from 2010, the non-business energy property credit to property placed in service on or before December 31, 2011, but utilizes the credit structure and rates that existed before the 2009 American Recovery and Reinvestment Act. Thus, for property installed after December 31, 2010, the credit is 10%, with a maximum of $500, with $200 of that for windows. The Act prohibits taxpayers from taking the credit for expenditures for qualified energy efficiency improvements made from subsidized energy financing.

• **Alternative fuel vehicle refueling property.** The Act extends, from 2010, the alternative fuel vehicle refueling property credit to any non-hydrogen related property placed in service on or before December 31, 2011.

Stock/Bond Provisions

• **Empowerment Zone tax incentives.** Qualified Zone Academy bonds (QZABs) are a form of tax credit bond designed to provide funds for state and local governments in cooperation with businesses to enhance the academic curriculum and increase public school graduation and employment rates within a qualified zone or enterprise community. QZABS offer the holder a federal tax credit instead of interest. The Act extends the QZAB program by providing an additional $400 million for 2011.

• **Exclusion of 100 percent of gain on certain small business stock.** The Act extends the 100% exclusion of the gain from the sale of qualifying small business stock acquired before 2012, and held for more than five years. In addition, the alternative minimum tax preference item attributable for the sale remains eliminated. Qualifying small business stock is stock from a C corporation whose gross assets do not exceed $50 million (including the proceeds received from the issuance of the stock) and that meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of 10 times the taxpayer's basis in the stock or $10 million of gain from stock in that corporation.

Disaster/Economic Development Incentives

• **Empowerment Zone tax incentives.** The Act extends for two years (through 2011) the designation of certain economically depressed census tracts as Empowerment Zones, within which individual residents are eligible for special tax incentives.

• **Tax incentives for investment in the District of Columbia.** The Act extends for two years (through 2011) the designation of certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone, within which individual residents are eligible for special tax incentives. The Act also extends for two years (through 2011) the$5,000 first-time homebuyer credit for the District of Columbia.

• **Increase in rehabilitation credit.** The increased rehabilitation credit for qualified rehabilitation buildings and certified historic structures located in the Gulf Opportunity Zone expired after December 31, 2009. The Act extends the increased credit for two years, through December 31, 2011.

• **Low-income housing credit rules for buildings in GO zones.** Additional allocations of low-income housing credits made in 2006, 2007, and 2008 for buildings located in the GO Zone, the Rita GO Zone, or the Wilma GO Zone require that the buildings be placed in service before January 1, 2011. The Act extends the placed-in service date for one year, through December 31, 2011.

As you can see, the Act extends many, but not all, of the various provisions proposed and discussed throughout 2010. Please contact us so that we can review your particular circumstances in order to maximize your tax benefits for 2010, as well as discuss plans for 2011.

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