Tax Relief Act of 2010

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Summary

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, was signed into law. In addition to providing a 13-month extension of benefits for the long-term unemployed, the legislation includes an extention of the "Bush tax cuts" that were scheduled to expire on January 1, 2011. Other significant provisions include a new alternative minimum tax (AMT) "patch", a major modification of the estate tax, and a new 1-year 2% employee Social Security payroll tax reduction.

Tax Rates

The Act extends existing federal income tax rates for two additional years. As in 2010, the federal tax bracket rates for 2011 and 2012 will be 10%, 15%, 25%, 28%, 33%, and 35%.

Existing tax rates for long-term capital gains and qualifying dividends are also extended through 2012 and will be taxed at a maximum rate of 15%. If you're in the 10% or 15% marginal income tax brackets, a special 0% rate will generally continue to apply.

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Alternative Minimum Tax

The alternative minimum tax (AMT) is essentially a parallel federal income tax system, with its own rates and rules. To prevent a dramatic increase in the number of individuals subject to AMT, the Act retroactively increases AMT exemption amounts for 2010, and extends the increased exemption amounts to 2011. Nonrefundable personal income tax credits will also continue to be allowed to offset AMT liability in 2010 and 2011.

Estate Tax

The Act makes major, though temporary, changes to the federal estate tax. For 2011 and 2012, the estate tax exemption amount (the applicable exclusion amount, renamed the basic exclusion amount) will be $5 million per person (the $5 million will be indexed for inflation in 2012); the top transfer tax rate for these years will be 35%. The $5 million exemption amount and 35% top estate tax rate will apply retroactively to 2010 as well, but for individuals who died in 2010, an election can be made to choose the estate tax provisions effective prior to this legislation (i.e., no estate tax applies, but special modified carryover basis rules apply); an extended due date is provided for individuals who died on or after January 1, 2010, and before December 17, 2010. For 2011 and 2012, when one spouse dies, any unused portion of that spouse's estate tax exemption amount may be transferred to the surviving spouse.

One-Year Reduction In Social Security Payroll Tax

If you're an employee, 6.2% of your covered wages up to the taxable wage base ($106,800 in 2011) is generally withheld for your portion of the Social Security retirement component of FICA employment tax. If you're a self-employed individual, you pay 12.4% for the Social Security portion of your self-employment tax. The Act implements a one-year 2% reduction in this tax. That means for 2011, you'll pay the tax at a rate of 4.2% if you're an employee, and 10.4% if you're self-employed.

Depreciation and IRC Section 179 Expensing

If you're a business owner or self-employed individual, you may know that an additional 50% depreciation deduction has been available for qualifying property placed in service during 2010. The Act increases the bonus depreciation percentage allowed to 100% for property acquired and placed in service after September 8, 2010, and before January 1, 2012. The Act also extends bonus depreciation at the 50% level through 2012 (the 50% bonus depreciation will apply for property placed in service after December 31, 2011, and before January 1, 2013).

For 2011, the maximum amount that can be expensed under IRC Section 179 is $500,000 with a phaseout threshold amount of $2 million. In 2012 the expense limit and phaseout threshold were to be signifcantly reduced. As a result of the new Act, the 2012 IRC Section 179 expense limit is $125,000, with a phaseout threshold of $500,000 that will be indexed for inflation.

Education Provisions

The Act extends the American Opportunity tax credit (known as the Hope tax credit). The American Opportunity tax credit's higher maximum credit amount, increased income limits, expanded applicability to the first four years of college, and potential refundability, available in 2009 and 2010, are extended through 2012.

The current rules that apply to Coverdell education savings accounts (e.g., $2,000 annual contribution limit, education expenses expanded to include elementary and secondary school expenses) are also extended through 2012. Without this change, the annual contribution limit would have dropped to $500 beginning January 1, 2011.

For the student loan interest deduction, increased income limits and the suspension of the 60-month rule, which would have expired at the end of 2010, are extended for two years (the deduction was, prior to 2001, limited to interest paid in the first 60 months of repayment).

The deduction for qualified higher education expenses, which expired at the end of 2009, is retroactively reinstated for 2010, and extended through 2011.

Other Changes

The Act prevents itemized deductions and personal and dependency exemptions from being reduced for higher income individuals for two additional years (2011 and 2012). The Act also extends "marriage penalty" relief, in the form of an expanded 15% tax bracket and an increased standard deduction amount for married individuals filing jointly, through 2012.

Provisions extended through 2011 include: the $250 above-the-line deduction for elementary school and secondary school teacher classroom expenses; tax-free IRA distributions to charitable organizations by individuals age 70½ or older; and the deductibility of mortgage insurance premiums. Provisions extended through 2012 include: rules relating to the earned income credit; the child tax credit; the credit for child and dependent care expenses; and the adoption tax credit and exclusion amount for employer-paid adoption assistance.