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# significant tax law changes under the new tax act

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*MSK Client Alert*

December 20, 2010

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The deftly titled "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (herein, respectfully, just the "2010 Act") was signed into law by President Obama on December 17, 2010. This Alert provides a brief summary of the following provisions:

## **Tax Relief for Individuals and Investors**

- Continuation of lower income tax rates for individuals
- Payroll tax cut
- Extension of reduced rate on capital gains and dividends
- Modification and extension of estate, gift and generation-skipping taxes after 2009
- Delay of overall limitation on itemized deductions and personal exemption phase-out
- Continuation of marriage penalty relief
- Extension of alternative minimum tax (AMT) exemption amounts
- Extension of 100% exclusion of gains on certain small business stock

## **Charitable Benefits**

- Tax-free distributions from individual retirement plans for charitable purposes

## **attorneys**

David Wheeler Newman

## **practice areas**

nonprofit organizations  
tax and trusts & estates  
tax planning  
transactional tax  
trusts & estates



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- Contributions of capital gain real property made for conservation purposes
- Enhanced charitable deduction for contributions of food inventory and book inventories to public schools, and corporation contributions of computer inventory for educational purposes
- Basis adjustment to stock of S corporations making charitable contributions of property

### Business Tax Relief

- Extension of bonus depreciation and temporary 100 percent expensing for certain business assets
- Extension of enhanced small business expensing
- 15-year straight-line cost recovery for certain real property
- Special expensing rules for certain film and television productions

Individuals, investors, donors, exempt organizations and businesses should take note of new opportunities and improved tax benefits under the 2010 Act.

### Tax Relief for Individuals and Investors

#### Continuation of lower income tax rates for individuals

Taxable income of individuals is generally subject to federal income tax at six brackets ranging from 10% to 35%. Beginning in 2011, the income tax rates were scheduled to increase, from a low of 15% to a high of 39.6%. Under the 2010 Act, the current lower tax brackets continue to apply through 2012.

**Payroll tax cut** Employees are subject to a 6.2% FICA tax on covered wages up to the taxable wage base (\$106,800 for 2010), which is withheld by employers. Employers are also subject to FICA tax equal to the amount of tax imposed on each employee. There is a parallel 12.4% SECA tax on the self-employment income of self-employed individuals. The 2010 Act reduces the FICA tax on employees (but not employers) to 4.2% for 2011 only. Under the current wage base (which is not expected to change for 2011), this provides a tax cut of up to \$2,136 per individual. The SECA tax likewise is reduced by 2% for 2011. **Extension of reduced rate on capital gains and dividends** Currently, net capital gains of individual taxpayers are generally taxed at a maximum rate of 15% (or 0%, if the gain would be subject to 10% or 15% tax rates had it been ordinary income). Individuals are subject to tax on certain qualified corporate dividends at the same preferential rates. Beginning in 2011, the tax rates applicable to net capital gains were scheduled to increase to rates ranging from 8% to 20%, and qualified dividends were to be taxed at ordinary income rates. The 2010 Act extends the current tax rates for individuals' net capital gain and qualified dividend income through 2012. **Modification and extension of estate, gift and generation-skipping taxes after 2009** *Estate and Generation-Skipping Transfer Tax Reinstated for 2010 Deaths, by Election* For 2010 deaths, an election may be made between either (a) paying estate tax with a \$5 million exemption and 35% maximum rate and receiving a stepped-up income tax basis or (b) paying no estate tax but receiving carryover basis, subject to certain modifications. The estate is deemed to choose option (a) unless affirmatively electing



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option (b). The method and deadline for electing have yet to be determined. *Estate Tax Exclusion Increased for 2011 and 2012 Deaths* The estate tax exemption amount will be \$5 million for deaths in 2011, and \$5 million indexed for inflation in 2012. For deaths in 2013 and later, however, the 2001 estate tax exemption amount (\$1 million) will return. *Maximum Estate Tax Rate* The estate tax rate is lowered to 35% for deaths in 2011 and 2012, and for 2010 deaths where the estate tax regime is elected. *Unused Estate Tax Exemption "Portable" to Surviving Spouse* For 2011 and 2012 deaths, any unused estate tax exemption of the first spouse to die can be transferred to the surviving spouse and added to his or her own exemption. There are limitations on receiving unused exemption amounts from more than one predeceased spouse. *Gift Tax Rate and Exclusion Remain As-Is for 2010 Gifts, but Increase for Later Years* For 2010 gifts, the lifetime gift tax exemption will remain \$1 million and the rate for gifts above \$1 million will remain 35%. For gifts in 2011 and 2012, the lifetime gift tax exemption will increase to \$5 million (indexed for inflation in 2012); the rate for gifts above \$5 million will remain 35%. The sunset causes gifts in 2013 and later, however, to be subject to a lifetime gift tax exemption of \$1 million and a maximum rate of 55% for gifts above \$1 million. *No GST Tax Payable in 2010* For gifts and deaths in 2010 only, the Generation-Skipping Transfer (GST) Tax rate is 0%, so no GST tax will be payable with respect to such transfers. This could present significant 2010 year-end planning opportunities for a small number of individuals. *GST Exemption Increased and Rate Decreased* For gifts and deaths in 2010 through 2012, the GST Exemption is \$5 million (indexed for inflation in 2012). GST Exemption may be allocated for 2010 deaths even if the "no estate tax" option is elected. The GST Tax rate is 35% for 2011 and 2012. *Certain Filing Deadlines Extended* For deaths from January 1, 2010 through December 16, 2010, deadlines for filing estate and GST tax returns, paying estate tax and making disclaimers are extended until the later of September 17, 2011 (9 months from the date of enactment) and the regular due date. *Sunset in 2013* Beginning in 2013, everything goes back to the 2001 rules, so the estate tax exemption will be \$1 million, with a 55% rate, the gift tax exemption will be \$1 million with a maximum rate of 55% on gifts over \$1 million, and the GST exemption will be \$1 million (adjusted for inflation from 1997). **Delay of overall limitation on itemized deductions and personal exemption phase-out**

Historically, an individual taxpayer's itemized deductions were reduced by 3% of the taxpayer's adjusted gross income over a specified amount (or reduced by 80% of the itemized deductions, if less). Personal exemptions also were reduced for taxpayers with certain levels of adjusted gross income. These reductions were cut back over time until entirely eliminated for 2010. However, they were scheduled to return beginning in 2011. Under the 2010 Act, the overall limitations on itemized deductions and the phase-out of personal exemptions will continue to be inapplicable for 2011 and 2012. **Continuation of marriage penalty relief** Married taxpayers are generally subject to regular income tax at higher tax rates than if they were not married. Through 2010, there has been partial relief from this "marriage penalty." For married persons filing a joint return, the basic standard deduction (for taxpayers who do not itemize) is twice that for an unmarried individual filing a single return, and the 15% income tax bracket applies to double the income of comparable unmarried individuals. The 2010 Act continues the applicability of the expanded standard deduction and 15% tax bracket to married taxpayers through 2012.

**Extension of alternative minimum tax (AMT) exemption amounts** The alternative minimum tax is a separately-computed tax which excludes certain deductions and tax credits. Individuals may be subject to the AMT in addition to regular income taxes. Provisions giving taxpayers partial relief from this tax by increasing the exemption amounts had expired at the end of 2009. As a result, the AMT exemption amounts for 2010 were scheduled to be \$45,000 (for married individuals filing a joint return and surviving spouses), \$33,750 (for other unmarried individuals), \$22,500 (for married individuals filing separate returns). The 2010 Act retroactively



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increases the AMT exemption amounts for tax years beginning in 2010 to \$72,450 (for married individuals filing a joint return and surviving spouses), \$47,450 (for other unmarried individuals) and \$36,225 (for married individuals filing separate returns). The 2010 Act further increases these exemption amounts to \$74,450, \$48,450 and \$37,225, respectively, for tax years beginning in 2011. **Extension of 100% exclusion of gains on certain small business**

**stock** Generally, non-corporate taxpayers may exclude part of the gain from the sale of "qualified small business stock" (essentially stock (i) acquired at original issue in a C corporation conducting an active business and with assets of \$50 million or less and (ii) held for more than five years). For such stock acquired after September 27, 2010 and prior to 2011, the exclusion is 100%, and the prior-law AMT preference item from such sale is eliminated. The gain eligible for exclusion is limited to the greater of ten times the taxpayer's basis in the stock or \$10 million. The 2010 Act extends the exclusion rule, so that taxpayers may exclude 100% of the gain from the sale of qualified small business stock acquired at original issue after September 27, 2010 and prior to 2012 and held for more than five years. Elimination of the AMT preference item attributable to such sale is also extended.

**Charitable Benefits Tax-free distributions from individual retirement plans for charitable purposes** From 2006 to 2009, individuals age 70-1/2 or older could annually distribute up to \$100,000 tax-free from their IRA to charity, without including the distribution in gross income and taking a corresponding charitable deduction (subject to applicable limitations). To qualify, the distribution must be made directly by the IRA trustee to a public charity (not a supporting organization or donor-advised fund), and the entire distribution must be deductible under the normal rules (i.e., no quid pro quo that is more than de minimis). The 2010 Act extends this exclusion from gross income for qualified charitable distributions made prior to 2012, and also generally permits taxpayers to elect to have distributions made in January 2011 treated as having been made on December 31, 2010 for certain purposes. This allows a distribution made in January 2011 to count against the 2010 \$100,000 limitation and be used to satisfy the taxpayer's 2010 IRA minimum distribution requirement. **Contributions of capital gain**

**real property made for conservation purposes** From 2006 through 2009, a special rule enhanced the deductibility of real property made as a qualified conservation contribution. A qualified conservation contribution generally is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes and protected in perpetuity. Generally, for gifts of appreciated capital assets, the amount of the deduction that the donor may use is limited to 30% of adjusted gross income, with a 5-year carry forward subject to the same 30% limitation every year. The special rule increased the limitation to 50% and the carry-forward period to 15 years for qualified conservation contributions. The 2010 Act extends this enhanced deduction to qualified conservation contributions made prior to 2012. **Enhanced charitable deduction for contributions of food inventory and book inventories to public schools, and corporation contributions of computer inventory for educational purposes**

*Contributions of Food Inventory* From 2005 to 2009, taxpayers could make a donation that qualified for preferred treatment of "apparently wholesome" food inventory, generally defined as food that meets government labeling standards "even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions." The deduction equaled the donor's basis in the food, plus one-half of the ordinary income that would have been realized if the food had been sold at its fair market value at the time of donation, not to exceed twice the donor's basis in the donated food. The deduction for food inventory is limited to 10% of the donor's taxable income for the year with a 5-year carryforward. The 2010 Act extends this enhanced deduction to cover qualified charitable contributions of food inventory made prior to 2012. **Corporate**

**Contributions of Book Inventories to Public Schools** A corporation's charitable deduction is generally limited to



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the corporation's basis in any contributed property. However, from 2005 through 2009, certain contributions of book inventory to public schools for educational purposes qualified for preferred treatment. The deduction for qualified book contributions equaled the donor corporation's basis in the donated books plus one-half of the ordinary income that would have been realized if the books had been sold for their fair market value at the time of donation, not to exceed twice the donor's basis in the donated books. The 2010 Act extends this enhanced deduction to cover qualified book contributions made prior to 2012. *Corporate Contributions of Computer Inventory for Educational Purposes* "Qualified computer contributions" of computer technology and equipment meeting certain requirements for educational purposes qualified for enhanced deductibility, if made prior to 2010. The gift must be made to an "educational organization," a 501(c)(3) entity organized primarily for purposes of supporting K-12 education, or a public library. The corporation could receive a deduction equal to its basis in the donated property, plus one-half of the ordinary income that would have been realized if the computer equipment had been sold for its fair market value at the time of the donation, not to exceed twice the donor's basis in the equipment. The 2010 Act extends this enhanced deduction to cover qualified computer contributions made prior to 2012. **Basis adjustment to stock of S corporations making charitable contributions of property** The amount of losses and deductions that a shareholder of an S corporation may claim is generally limited to her adjusted basis in her stock and indebtedness of the corporation. When an S corporation makes a charitable gift of appreciated property, the amount of its deduction, passed through pro rata to its shareholders, is equal to the fair market value of the property. Under the general rule, each shareholder's basis is reduced, but not below zero, by such pro rata amount of the deduction. Under the special rule, in effect from 2006 - 2009, stock basis was only reduced by the shareholder's share of the S corporation's basis in the contributed property, rather than its (higher) fair market value. The 2010 Act extends this special rule relating to basis reduction on account of charitable contributions of property to contributions made prior to 2012. **Business Tax Relief Extension of bonus depreciation and temporary 100 percent expensing for certain business assets** In addition to normal first-year depreciation deductions, an additional first-year 50% depreciation deduction is available (to offset both regular tax and AMT) for qualified property placed in service during 2008, 2009 and 2010. The 2010 Act extends and expands the additional first-year depreciation deduction to 100% for qualified property purchased and placed in service after September 8, 2010 and prior to 2012. There is also a 50% first-year depreciation deduction available for qualified property purchased and placed in service during 2012. **Extension of enhanced small business expensing**

Taxpayers generally may deduct, in the year of acquisition, the costs of certain tangible personal property purchased for use in the active conduct of a trade or business (in lieu of future depreciation). For qualifying property placed in service in the taxable year beginning in 2010 and 2011, taxpayers may deduct up to \$500,000 of such capital expenditures subject to a phase-out once such expenditures exceed \$2,000,000. After 2011, the thresholds are set to revert to \$25,000 and \$200,000, respectively, but pursuant to the 2010 Act, such amounts will be indexed for inflation. **15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements** Taxpayers generally capitalize the cost of property used in a trade or business and recover such cost over time through depreciation or amortization. Qualified leasehold improvements, restaurant buildings and improvements, and qualified retail improvement property are eligible for temporary accelerated depreciation periods (generally 15 years instead of 39 years). The 2010 Act extends those beneficial temporary accelerated depreciation rules for two years, so that they now apply to qualified property placed in service prior to 2012. **Special expensing rules for certain film and television productions** Generally, many costs of film and television production are required to be capitalized for



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income tax purposes. However, for qualified film and television productions commencing prior to 2010, taxpayers could elect to expense many production costs. The 2010 Act retroactively extends the ability of taxpayers to elect to expense such costs for productions commencing prior to 2012. This Tax Alert is meant to give our readers a brief overview of the 2010 Act. Many provisions are subject to special rules, exceptions, and exceptions to the exceptions (this is, after all, federal tax law that we're talking about). We anticipate that future Alerts will delve into some of these provisions in greater detail. If you have any questions about this Tax Alert or the 2010 Act, please contact any of the MSK attorneys.