

December 21, 2010

Dear Clients and Friends of Carbis Walker:

After weeks of intense negotiations between the White House and Congressional leaders, Congress passed and President Obama signed into law a two-year extension of soon-to-have-expired Bush-era tax cuts, including extension of current individual tax rates and capital gains/dividend tax rates. Called the most sweeping tax law in a decade, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (H.R. 4853), was approved by the Senate on December 15, 2010, and by the House on December 16, 2010. The new law is, however, much more than just an extension of existing tax rates. The new law also provides a temporary across-the-board payroll tax cut for wage earners, a retroactive AMT "patch," estate tax relief, education and energy incentives and many valuable incentives for businesses, including 100 percent bonus depreciation and extension of many temporary tax breaks. This letter highlights many of the key incentives in the new law.

## Individuals

**Tax rates.** Among the most valuable tax breaks for individuals in the new law are a two-year extension of individual income tax rate reductions and a payroll tax cut. Both will deliver immediate tax savings starting in January 2011. The new law keeps in place the current 10, 15, 25, 28, 33, and 35 percent individual tax rates for two years, through December 31, 2012. If Congress had not passed this extension, the individual tax rates would have jumped significantly for all income levels. The new law also extends full repeal of the limitation on itemized deductions and the personal exemption phaseout for two years. Married couples filing jointly will also benefit from extended provisions designed to ameliorate the so-called marriage penalty.

**Payroll tax cut.** The payroll tax cut is designed to get more money into workers' paychecks and to encourage consumer spending. Effective for calendar year 2011, the employee share of the Old Age Survivors Disability Insurance (OASDI) portion of Social Security taxes is reduced from 6.2 percent to 4.2 percent up to the taxable wage base of \$106,800. Self-employed individuals also benefit. Self-employed individuals will pay 10.4 percent on self-employment income up to the wage base (reduced from the normal 12.4 percent rate). The payroll cut replaces the Making Work Pay credit, which reduced income tax withholding for wage earners in 2009 and 2010. The payroll tax cut, unlike the credit, does not exclude some individuals based on their earnings and has the potential of significantly higher benefits (with a maximum payroll tax reduction of \$2,136 on wages at or above the \$106,800 level as compared to a maximum available \$800 Making Work Pay credit for married couples filing jointly (\$400 for single individuals)).

**"WE HELP YOU"**

**Capital gains/dividends.** The new law also extends reduced capital gains and dividend tax rates. Like the individual rate cuts, the extended capital gains and dividend tax rates are temporary and will expire after 2012 unless Congress intervenes. In the meantime, however, for two years (2011 and 2012), individuals in the 10 and 15 percent rate brackets can take advantage of a zero percent capital gains and dividend tax rate. Individuals in higher rate brackets will enjoy a maximum tax rate of 15 percent on capital gains, as opposed to a 20 percent rate that had been scheduled to replace it and with dividends taxed at income tax rates. Only net capital gains and qualified dividends are eligible for this special tax treatment. If you have any questions about your capital gain/dividend income, please contact our office.

**AMT patch.** More and more individuals are finding themselves falling under the alternative minimum tax (AMT) because of the way the AMT is structured. To prevent the AMT from encroaching on middle income taxpayers, Congress has routinely enacted so-called "AMT patches." The new law continues this trend by providing higher exemption amounts and other targeted relief.

**More incentives.** Along with all these incentives, the new law extends many popular but temporary tax breaks. Extended for 2011 and 2012 are:

- \$1,000 child tax credit
- Enhanced earned income tax credit
- Adoption credit with modifications
- Dependent care credit
- Deduction for certain mortgage insurance premiums

The new law also extends retroactively some other valuable tax incentives for individuals that expired at the end of 2009. These incentives are extended for 2010 and 2011 and include:

- State and local sales tax deduction
- Teacher's classroom expense deduction
- Charitable contributions of IRA proceeds
- Charitable contributions of appreciated property for conservation purposes

## **Businesses**

**Bonus depreciation.** Bonus depreciation is intended to help businesses depreciate purchases faster against their taxable income, thereby encouraging businesses to invest in more equipment. Bonus depreciation allows businesses to recover the costs of certain capital expenditures more quickly than under ordinary tax depreciation schedules. Businesses can use bonus depreciation to immediately write off a percentage of the cost of depreciable property. The new law makes 100 percent bonus depreciation available for qualified investments made after September 8, 2010, and before January 1, 2012. It also continues bonus depreciation, albeit at 50 percent, on property placed in service after December 31, 2011, and before January 1, 2013. There are special rules for certain longer-lived and transportation property. Additionally, certain taxpayers may claim refundable credits in lieu of bonus depreciation. 100 percent bonus depreciation is a valuable tax break and businesses have only a short window to take advantage of it. Please contact our office so we can help you plan for 100 percent bonus depreciation.

**Code Sec. 179 expensing.** Along with bonus depreciation, the new law also provides for enhanced Code Sec. 179 expensing for 2012. Under current law, the Code Sec. 179 dollar and investment limits are \$500,000 and \$2 million, respectively, for tax years beginning in 2010 and 2011. The new law provides for a \$125,000 dollar limit (indexed for inflation) and a \$500,000 investment limit (indexed for inflation) for tax years beginning in 2012 (but not after).

**Research credit.** Many businesses urged Congress to make the research credit permanent after the credit expired at the end of 2009. While this proposal enjoyed significant support in Congress, its cost was deemed prohibitive. Instead, Congress extended the research tax credit for two years, for 2010 and 2011.

**More incentives.** Other valuable business incentives in the new law include extensions of:

- 100 percent exclusion of gain from qualified small business stock
- Transit benefits parity
- Work Opportunity Tax Credit (with modifications)
- New Markets Tax Credit (with modifications)
- Differential wage credit
- Brownfields remediation
- Active financing exception/look-through treatment for CFCs
- Tax incentives for empowerment zones
- Special rules for charitable deductions by corporations and other businesses
- And more

## **Energy**

In 2010, Congress had been expected to pass comprehensive energy legislation including new and enhanced tax incentives. For a number of reasons, an energy bill did not pass. However, the new law extends some energy tax breaks for businesses. The new law also extends, but modifies, a popular energy tax break for individuals.

**Businesses.** For businesses, one of the most valuable energy incentives is the Code Sec. 1603 cash grant in lieu of a tax credit program. This incentive encourages the development of alternative energy sources, such as wind energy. Other business energy incentives extended by the new law include excise tax and other credits for alternative fuels, percentage depletion for oil and gas from marginal wells, and other targeted incentives.

**Individuals.** Individuals who made energy efficiency improvements to their homes in 2009 or 2010 are likely familiar with the Code Sec. 25C energy tax credit. This credit rewards individuals who install energy efficient furnaces or add insulation, or make other improvements to reduce energy usage. The new law extends the credit through 2011, but reduces some of its benefits. Although 2010 is soon over, there may still be time to take advantage of the more generous credit.

## Education

The Tax Code includes a number of incentives to encourage individuals to save for education expenses. In 2009, Congress enhanced the Hope education credit and renamed it the American Opportunity Tax Credit (AOTC). Like many other incentives, the AOTC was temporary. The new law extends it for two years, through 2012. Along with the AOTC, the new law also extends:

- Higher education tuition deduction
- Student loan interest deduction
- Exclusion for employer-provided educational assistance
- Enhanced Coverdell education savings accounts
- Special rules for certain scholarships

## Estate and gift taxes

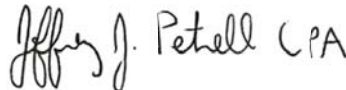
The federal estate tax, along with federal gift and generation skipping transfer (GST) taxes, was significantly overhauled in 2001. At that time, Congress set in motion a gradual reduction of the estate tax until abolishing it for 2010. Under budget rules, however, those changes could extend for only 10 years; starting in 2011, the estate tax had been scheduled to revert to its pre-2001 levels of 55 percent and a \$1 million exclusion.

**Estate tax.** The new law revives the estate tax, but with a maximum estate tax rate of 35 percent with a \$5 million exclusion. The revived estate tax is in place for decedents dying in 2011 and 2012. The new law gives estates the option to elect to apply the estate tax at the 35 percent/\$5 million levels for 2010 or to apply carryover basis for 2010. The new law also allows "portability" between spouses of the maximum exclusion and extends some other taxpayer-friendly provisions originally enacted in 2001.

This far-reaching multi-billion dollar tax package affects almost every taxpayer. Keep in mind that many of its provisions are temporary. It is important to plan early to maximize your tax savings. Please contact me at 412.635.6270, or any Carbis Walker Tax Professional, at 800.452.3003, if you have any questions.

Very truly yours,

**Carbis Walker LLP**



Jeffrey J. Petrell, JD, CPA  
Partner/Director of Tax Services