



TAX RELIEF ACT OF 2010

Client Advisories

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On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010. The new tax law resolves much tax uncertainty -- for a couple of years. The new law extends the "Bush tax cuts" for two years and includes new and more generous Estate and Gift Tax provisions. In this Alert, we at Archer, P.C., draw your attention to a few highlights of the new law, and also remind you of some important tax planning opportunities in this unusual low interest rate environment.

NEW TAX LAW PROVISIONS

The new law preserves 2010 Income Tax rates and includes other favorable breaks for individual taxpayers:

- Income tax rates of 10%, 15%, 25%, 28%, 33% and 35% will remain the same through 2012.
- The current law providing for a maximum rate of 15% on long-term capital gains will continue through 2012.
- Qualified dividends will continue to be taxed at a maximum rate of 15% through 2012.
- All wage earners, and the self-employed, will benefit from a one-year break on "payroll" and self-employment taxes -- saving up to \$2,100 in 2011.
- Several credits, deductions and "fixes" targeting middle income taxpayers, including the child tax credit, are extended.
- Itemized deduction and personal exemption phase outs for higher income taxpayers will *not* be implemented for another two years.
- The "Transit Pass" benefit is preserved at 2010 rates through 2011.
- A short term fix in the Alternative Minimum Tax is provided for 2010 and 2011.

- “Marriage penalty” relief has been extended through 2012.
- The election to deduct state sales tax (instead of state income tax) is preserved for 2011.
- The election to treat up to \$100,000 of IRA distributions going to charity as non-taxable distributions has been extended for 2010 and 2011 -- and taxpayers may elect to treat such gifts made through January 31, 2011 as effective for 2010.
- There are expanded enhancements for business capital investment and credits for research and development, including a 100% first-year write-off for qualifying property placed into service between September 8, 2010 and January 1, 2012 and a 50% write off for such property placed in service in 2012.
- The §179 election is expanded to permit expensing of qualifying capital purchases in 2010 and 2011.

The Federal Estate Tax will be reinstated with a higher exemption than we had in 2009 AND a more favorable rate, effective through 2012:

- Each individual will have a \$5 million Estate Tax exemption (\$10 million for a couple) and that exemption amount will be indexed for inflation.
- The new law reinstates the full basis-step up for all assets included in the decedent’s taxable estate.
- The new law includes “portability” of the \$5 million federal estate tax exemption, which means that if the first spouse to die does not use the full exemption, the surviving spouse will have a combined estate tax exemption equal to his or her own exemption *plus* the unused exemption of the first-to-die.
- The Generation Skipping Transfer Tax (“GST”) exemption will also be \$5 million, indexed for inflation.
- Transfers in excess of available exemptions will be taxed at 35%.
- An individual may apply all of his or her \$5 million exemption to lifetime gifts (i.e., taxpayers are no longer limited to a \$1 million exemption for lifetime gifts).

Some important Estate Tax details of the new law:

- The new law will apply to estates of decedents who died in 2010.
- However, 2010 estates may “opt out” of the new law and choose instead to be governed by the 2010 carry-over basis regime with no Federal Estate Tax.
 - 2010 estates of \$5 million or less (provided the decedent did not make substantial taxable gifts during lifetime) will not opt out, as they will incur no federal estate tax liability and will benefit from fully stepped-up basis on estate assets.
 - 2010 estates greater than \$5 million should analyze whether to “opt out,” considering a few factors, including:



- whether the Federal Estate Tax on assets that exceed \$5 million will be greater or less than the eventual capital gains tax on all assets that are not eligible for basis step-up under the carry-over basis regime, and
- whether there is sufficient liquidity in the estate to pay the Federal Estate Tax that will be due in September 2011.
- Portability continues after remarriage.
 - However, if the surviving spouse remarries *and if* that new spouse also predeceases, the (still) surviving spouse will forfeit the first spouse's unused exemption and will be limited to his or her own exemption plus the *new spouse's* unused exemption, if any.
 - On the other hand, if the surviving spouse remarries and then dies *before* the new spouse, the new spouse may use the surviving spouse's exemption *plus* the portable exemption from the first spouse to die.
- The GST exemption is *not* portable.

SOME LAST MINUTE REMINDERS FOR 2010

Transfer tax planning opportunities that expire at the end of 2010

- The 0% tax on generation skipping transfers: Grandchildren may still benefit from a gift in 2010, as there is no GST tax on 2010 transfers and no need to allocate GST exemption to such transfers.
 - Beginning in 2011, the GST tax returns, with a \$5 million lifetime exemption and 35% rate on non-exempt transfers .
 - 2010 gifts to trusts exclusively for grandchildren also qualify as GST tax-free -- without allocation of any GST exemption -- and future distributions from those trusts will be GST tax-free.

Do not forget about the Roth Conversion opportunity:

- Beginning in 2010, all individuals may elect to accelerate income tax on traditional IRAs and roll the proceeds over to a Roth IRA.
 - Previously, there were severe AGI limitations on eligibility for roll-overs to Roths.
- For 2010 conversions, the account owner may stretch the income tax liability over two years: 2011 and 2012.
 - With income tax rates locked in for those years, this deferral opportunity is even more attractive.

OTHER IMPORTANT PLANNING OPPORTUNITIES

- With interest rates continuing at historic lows, several popular estate freeze techniques offer potentially significant opportunities: GRATs, IDGTs, CLATs and Intra Family Loans, all of which leverage the IRS's low



expectations of growth in our economy.

- GRATs -- Practical consideration: The annual pay-back to the donor will be substantial and most likely made in-kind. For example, for a five-year “zeroed out GRAT,” the annual payout will be more than 20% of the original principal value.
 - Note that the proposal to limit GRATs to ten years (effectively eliminating the “rolling GRAT” strategy, which uses a series of short-term GRATs) is *not* included in the new law
- IDGTs -- Practical consideration: The interest payments on the Note held by the donor will likely be relatively modest (3.5% of original principal at current long-term rate) and paid in cash.
- CLATs -- Practical consideration: The annual payouts to charity will likely represent something in the range of 5% of original principal value -- and will be paid in cash.
- Intra-Family Loans -- Practical Consideration: As with IDGTs, the Note will call for interest at current rates -- the December 2010 short-term rate is 0.32%, the mid-term rate is 1.53% and the long-term rate is 3.5% -- which may be paid in cash or even forgiven as a gift to the debtor.

The new tax law changes and the current low interest rate environment present some significant opportunities for transfer and income tax savings. We encourage our clients to consider how these opportunities may be used to enhance your personal tax planning. Attorneys at Archer, P.C., welcome the opportunity to discuss these tax law changes and the opportunities they present.

For more details about any aspect of the new legislation, please contact a member of our Estate Planning and Tax Law Groups in Pennsylvania, New Jersey or Delaware.

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