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Tax Relief and Job Creation Act Becomes Law

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On December 17, 2010, the President signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Act") (H.R. 4853). The 2010 Tax Act extends the Bush-era federal income tax cuts for all taxpayers for two years, provides a two-year AMT patch for middle income taxpayers, implements a one-year payroll tax reduction, extends certain business tax incentives, and provides significant, albeit temporary, estate, generation skipping and gift tax relief.

Bush Tax Cut Extensions

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), individual income tax rates were scheduled to increase from their current levels (10, 15, 25, 28, 33 and 35 percent) to the pre-EGTRRA levels (15, 28, 31, 36, and 39.6 percent). The 2010 Tax Act extends all current individual rates through December 31, 2012. Similarly, the 2010 Tax Act extends the maximum tax rate of 15 percent (zero percent for taxpayers in the 10 and 15 percent income tax brackets) for long-term capital gains and qualified dividends.

With regard to deductions and credits, EGTRRA repealed the limitation and personal exemption phase-out for high income taxpayers for 2010. The 2010 Tax Act extends full repeal of these limitations on allowable deductions through December 31, 2012. The 2010 Tax Act further extends certain credits and deductions provided to individual taxpayers through the same date (including deductions for teachers, the ability to deduct state and local sales taxes in lieu of income taxes, qualified tuition expenses, and the ability to transfer up to $100,000 from an IRA, annually, directly to charity without tax). Finally, the 2010 Tax Act extends a number of individual tax incentives which had expired at the end of 2009 for two years.

AMT Patch and Payroll Tax Reduction

The 2010 Tax Act provides an AMT patch by providing higher exemption amounts and other relief for 2010 and 2011 to prevent the AMT from applying to middle income taxpayers. Further, the 2010 Tax Act reduces the employee share of the Social Security taxes from 6.2 percent to 4.2 percent for wages earned in calendar year 2011 on all wages up to the taxable wage base.

Business Incentives

For businesses, the 2010 Tax Act increases bonus depreciation to 100 percent, allowing the immediate deduction of all investment, for qualified investments (generally, machinery, equipment and furniture, computer software and certain leasehold improvements) made after September 8, 2010 and before January 1, 2012, and permits 50 percent bonus depreciation for qualified property placed in service during calendar year 2012. The 2010 Tax Act also extends the increased deduction for expenses under Code Section 179 for tax years beginning in 2012. Finally, the 2010 Tax Act extends a number of business credits and deductions which had expired at the end of 2009 for two years, including the research credit, new market tax credit, work opportunity tax credit, expensing of environmental remediation costs, and certain charitable contributions.

Gift and Estate Taxes

In the context of the federal gift and estate taxes, EGTRRA reduced the federal estate tax and repealed it entirely for decedents dying in 2010. Under EGTRRA, the estate tax was scheduled to return at pre-EGTRRA levels (a maximum tax rate of 55 percent on estates and taxable gifts, in excess of $1 million per spouse) beginning in 2011. The 2010 Tax Act, for decedents dying after December 31, 2010, provides instead for a maximum estate tax rate of 35 percent and an exclusion amount of $5 million. For decedents dying in 2010 their estates may choose between (1) a 35 percent estate tax rate on estates in excess of $5 million, and a step-up basis, or (2) no estate tax and modified basis step-up. In addition to raising the exclusion amount, the 2010 Tax Act also permits portability of the exclusion between spouses, allowing the second spouse to die an additional exclusion if the first spouse did not exhaust it in his or her estate. The estate tax changes enacted in the 2010 Tax Act are temporary, however, as the 2010 Tax Act sunsets on December 31, 2012. Finally, the 2010 Tax Act provides the same 35 percent tax rate and maximum exclusion amount of $5 million for gifts and generation skipping transfers made after December 31, 2010.