



## 2010 Tax Relief Act: Benefits for Individuals

Many individuals entered 2010 uncertain over the fate of federal tax incentives scheduled to expire at year-end. On December 17, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (H.R. 4853) after passage by the Senate on December 15 and the House on December 16. The new law extends, renews or enhances a large number of individual tax incentives, among the most far reaching being reduced individual income tax rates and an across-the board payroll tax cut for 2011. This letter highlights the key individual tax incentives in the new law.

**Individual tax rates.** Reduced individual tax rates put in place in 2001 were scheduled to expire after 2010. The new law extends the reduced rates for two years. The current rate brackets (10, 15, 25, 28, 33 and 35 percent) remain unchanged for 2011 and 2012. The new law also extends full repeal of the itemized deduction limitation and full repeal of the personal exemption phase-out, both scheduled to expire after 2010, for two years.

**Payroll tax cut.** Social Security is financed through a dedicated payroll tax. Employers and employees each pay 6.2 percent of wages up to the taxable maximum of \$106,800 (in 2010 and 2011), while self-employed individuals pay 12.4 percent. Effective for calendar year 2011, the new law reduces the employee-share from 6.2 percent to 4.2 percent up to the taxable maximum. The employer-share remains unchanged. Self-employed individuals will pay 10.4 percent on self-employment income up to the taxable maximum. The reduction has no effect on an individual's future Social Security benefits.

Let's look at an example.

Tyler, who is single, earns \$106,800 (the maximum taxable wage). For 2011, the new law reduces Tyler's share of Social Security taxes on his earnings to 4.2 percent. Tyler will see \$2,136 in savings for 2011.

The payroll tax cut replaces the Making Work Pay credit, which temporarily reduced income tax withholding in 2009 and 2010. The Making Work Pay credit phased-out for higher-income individuals. The payroll tax cut is across-the-board (up to the taxable maximum of \$106,800).

**Capital gains/dividends.** In 2003, Congress set new maximum tax rates for qualified capital gains and dividends but, like the individual rate cuts, these taxpayer-friendly rates were temporary. For 2010, the maximum tax rate is 15 percent (zero percent for individuals in the 10 and 15 percent tax brackets). The new law extends these rates for two years, through December 31, 2012.

**Child tax credit.** Many individuals enjoy the benefit of the \$1,000 per child tax credit. Without the new law, the child tax credit would have dropped to \$500 for 2011. The new law extends the \$1,000 credit and keeps the refundability threshold at \$3,000 for 2011 and 2012. In related developments, the new law also extends some enhancements to the earned income tax credit and the adoption credit for two years.

**Estate tax.** Under the new law, the federal estate tax will again apply to the estates of decedents dying after December 31, 2009 and before January 1, 2013. The new law sets a maximum estate tax rate of 35 percent with a \$5 million exclusion (\$10 million for married couples). Additionally, executors of estates of individuals who died in 2010 can elect out of the estate tax (and apply modified carryover basis rules) or can elect to have the estate tax apply. This election, and many of the other estate tax provisions in the new law, is very technical. Besides the estate tax, there are provisions in the new law extending and modifying the federal gift tax and the federal generation skipping transfer (GST) tax.

**Education.** A variety of tax incentives are available to help save for and finance education costs. Like so many incentives, they are temporary. The new law extends some of the most popular education tax incentives. They include:

- American Opportunity Tax Credit
- Higher education tuition deduction
- Student loan interest deduction
- Exclusion for employer-provided educational assistance
- Enhancements to Coverdell education savings accounts
- Special rules for certain scholarships

**Energy.** Individuals who made some energy-efficient improvements in 2009 or 2010 may have benefitted from a special tax break. This tax incentive rewarded individuals who installed energy-efficient windows, doors, furnaces, and other items in their homes. The credit, while very valuable, was also very complex. The new law extends the credit but also adds to the complexity by reinstating rules for the credit in place before 2009.

**More incentives.** The new law extends many valuable but temporary tax incentives for individuals. They include the state and local sales tax deduction, the teacher's classroom expense deduction, and special rules for individuals who contribute IRA proceeds to charity. Keep in mind that not all of the expired temporary individual tax incentives were extended. Among the incentives not extended are the additional standard deduction for real property taxes, the \$2,400 exclusion for unemployment benefits, the first-time homebuyer tax credit, COBRA premium assistance, and some others.

Please contact our office if you have any questions about the provisions we have discussed or any of the measures in the new law.

HEINOLD-BANWART, LTD.