Senate Introduces Tax Relief Act of 2010

On December 9, 2010, Senate Majority Leader Harry Reid (D-NV) introduced H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Tax Relief Act"). The Tax Relief Act extends President George W. Bush's tax cuts for another two years and provides considerable estate tax relief. In addition, it includes several new tax breaks for individuals and businesses, including a lower Social Security tax for employees and enhanced depreciation deductions for businesses.

Extension of Bush Tax Cuts for Two Years

Shortly after George W. Bush became president, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). By its own terms, EGTRRA was intended to sunset after 2010 and revert to the provisions in place before its enactment. The Tax Relief Act postpones EGTRRA's sunset for two years, leaving EGTRRA's tax breaks in effect through 2012. The income tax rates, for instance, will stay at 10%, 15%, 25%, 28%, and 35% (instead of increasing to 15%, 28%, 31%, 36%, and 39.6%). The itemized deductions and personal exemptions for higher-income taxpayers will not be reduced or phased out (as they otherwise would have been after 2010). In addition, married taxpayers filing jointly will still be entitled to a standard deduction that is 200% of the standard deduction for single taxpayers (instead of decreasing to 167%).

The Tax Relief Act also extends some provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA") through 2012. Under JGTRRA, the long-term capital gain rate was decreased from 20% to 15% and "qualified dividends" paid to individuals were taxed at the same rate as long-term capital gains, instead of ordinary income. Under the Tax Relief Act, both of these tax breaks apply for another two years.

Estate Tax Relief and Gift and Generation-Skipping Tax

Estate tax rates under EGTRRA slowly declined until the estate tax was eliminated altogether in 2010. Because estate assets in 2010 are not subject to an estate tax, Congress felt such assets should not receive a step-up in basis to their fair market value at decedent's death, as is generally permitted under the Internal Revenue Code. Instead, under EGTRRA, estate assets in 2010 have a modified carryover basis, such that a recipient's basis in an estate asset is the lesser of the adjusted basis or the fair market value of the asset at decedent's death. Under EGTRRA's sunset provision, the estate tax rate is supposed to revert in 2011 to its pre-EGTRRA rate of 55%. After EGTRRA's sunset, the step-up basis rule, would apply once again instead of the modified carryover basis rule, and estates worth one million dollars or less would be exempt from tax.

The Tax Relief Act also proposes reinstating the estate tax for at least two years, but it provides a more beneficial tax rate and exemption. The highest tax rate under the Tax Relief Act is 35%, and the exemption is set at five million dollars. In addition, although the estate tax would apply retroactively to 2010, the Tax Relief Act allows estates arising in 2010 to elect no estate tax and a modified carryover basis, instead of an estate tax and a step-up in basis.

The gift tax exemption for gifts made after 2010 is increased to five million dollars and the generation-skipping transfer tax exemption is increased to five million dollars. The generation-skipping transfer tax exemption will be applicable to transfers in 2010.

Reinstated Tax Breaks for Businesses and Individuals

Numerous tax breaks for both businesses and individuals expired at the end of 2009. The Tax Relief Act retroactively restores many of these breaks and extends them through 2011.

The reinstated business tax breaks include:

- Research credit;
- New markets tax credit;
- Employer wage credit for activated reservists;
- Work opportunity tax credit;
- Enhanced charitable deductions for (i) contributions of food inventory, (ii) contributions of book inventories to public schools and (iii) corporate contributions of computer equipment for educational purposes; and
- Expensing of environment remediation costs.

The reinstated individual tax breaks include:

- $250 above-the-line deduction for expenses of elementary and high-school teachers;
- Election to take an itemized deduction for state and local general sales taxes instead of the itemized deduction for state and local income taxes;
- Above-the-line deduction for qualified tuition and related expenses; and
- Ability to make tax-free distributions to charity from an Individual Retirement Account of up to $100,000 per taxpayer, per tax year.

New Tax Breaks for Business and Individuals

The Tax Relief Act also includes several new tax breaks. Businesses can take (a) 100% bonus first-year depreciation deduction for property acquired and placed in service after September 8, 2010, and before January 1, 2012, and (b) a 50% bonus first-year depreciation deduction for property placed in service after December 31, 2011, and before January 1, 2013.

The Tax Relief Act also decreases the current Social Security tax in 2011. Employees will pay a 4.2% Social Security tax (instead of 6.2%) and self-employed individuals will pay a 10.4% Social Security tax (instead of 12.4%). In addition, the Tax Relief Act increases the Alternative Minimum Tax ("AMT") exemption in 2010 and 2011 for individuals and married taxpayers filing jointly.

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