President Signs Tax Relief Act of 2010

On December 16, 2010, Congress voted in favor of H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). President Barack Obama signed the Act into law the next day, December 17, 2010. The Act extends President George W. Bush's tax cuts for another two years and provides a number of new tax breaks, including estate tax relief.

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"). Many of EGTRRA's provisions were supposed to sunset after 2010 and revert to the provisions in place before its enactment. The Act postpones this sunset for two years, which means that certain EGTRRA tax breaks will continue through 2012. For example, income tax rates will remain at their current rates (instead of increasing). Furthermore, 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, the standard deduction for married taxpayers filing jointly will stay the same (instead of decreasing).

The 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 dividends were taxed at the more favorable long-term capital gains rate, instead of the rate for ordinary income. The Act provides these tax breaks for another two years.

Estate and Gift Tax Relief

Under EGTRRA, estate tax rates gradually 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. Therefore, under EGTRRA, estate assets in 2010 have a modified carryover basis instead, such that a recipient's basis in an estate asset is the lesser of the adjusted basis or fair market value of the asset at death. In 2011, when EGTRRA sunsets, the estate tax rate was intended to revert to its pre-EGTRRA rate of 55%. The step-up basis rule, however, would once again apply, instead of the modified carryover basis rule, and estates of one million dollars or less would be exempt from tax.

The Act also reinstates the estate tax for at least two years, but it provides a more beneficial tax rate and exemption. The highest tax rate under the Act is 35%, and the exemption for estates is set at five million dollars. In addition, although the estate tax would apply retroactively to 2010, the Act permits 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.

Under the Act, taxpayers also obtain gift tax relief. For the year 2010, EGTRRA imposed a maximum gift tax rate of 35% and a one million dollar exemption. The Act reunifies the estate and gift tax for two years, such that the 35% rate and five million dollar exemption applies to both through 2012.

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:

- Employer wage credit for activated reservists;
- Enhanced charitable deductions for donations of food, and donations of books to public schools;
- Special expensing of U.S. television and film production costs; and
- Expensing of environment remediation costs.

The reinstated individual tax breaks include:

- $250 deduction for classroom 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;
- 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.

Additional Tax Breaks for Business and Individuals

The Act allows businesses to take a first-year depreciation deduction for the entire cost of an asset obtained and placed in service sometime after September 8, 2010, through 2011. In addition, it extends a provision allowing Regulated Investment Companies, who properly notify their shareholders, to treat some dividends as “interest-related dividends.” This provision benefits foreigners, because foreigners can exempt interest-related dividends when calculating their U.S. gross-basis tax. The Act also increases the Alternative Minimum Tax exemption in 2010 and 2011, and temporarily lowers the current Social Security tax from 6.2% to 4.2%.

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