

December 17, 2010

INDIVIDUAL/ESTATE TAX ALERT: Massive tax bill extends tax cuts; compromise includes higher estate/gift tax exemption and keeps capital-gains tax rate at 15%

Both business and individual taxpayers will benefit from major legislation signed into law by President Obama on December 17, 2010. This tax alert addresses the impact for individuals and estates; a separate tax alert will address the impact on businesses and other employers. Among its numerous effects, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the 2010 Tax Relief Act) extends the Bush tax cuts of 2001 and 2003 as well as many other tax-relief measures. That means federal income tax rates remain stable instead of rising in the range of 3-5% in 2011.

We wanted to get this tax alert out to you as quickly as possible, but as we review the full final legislation signed into law, as we learn of relevant new information, we may provide additional updates.

Now that 2011 federal tax rates and other tax-relief measures are set, if you have not already discussed your year-end tax plans with your AGH professional, we encourage you to do so as soon as possible. If you had implemented tax-minimization strategies based on the likelihood of higher tax rates in 2011 – such as accelerating income into 2010 or deferring expenses into 2011 – you will want to review your plans to determine if those strategies are still appropriate.

The tax-relief measures expected to have the most impact on individuals and estates are the following:

- Rather than rising to a top rate of 39.6%, **federal income tax rates remain level, topping out at the current 35% tax rate.** The tax cut extension holds rates in place for two years.
- 2011 estate tax rates were set at a maximum of 35% with an exemption of \$5 million per person. Estate tax rates would have gone up anyway in 2011 since 2010's estate tax rate is zero, but unless new legislation was passed, estate tax rates were set to return to much higher levels – a top tax rate of 55% with a \$1 million exemption.

However, heirs of high-net-worth individuals who died in 2010 may be able to choose between applying the 2010 or 2011 estate tax rules. In certain situations, heirs may gain an advantage by applying the 2011 rules if the estate falls under the \$5 million exemption and would otherwise face significant capital gains taxes under the 2010 rules for valuation of assets.

For gifts made after Dec. 31, 2010, the Act also “re-unifies” the estate tax and gift tax exemptions so that the **combined total lifetime estate and gift tax an individual can make without causing tax liability is \$5 million.** Previously the gift tax exemption was \$1 million per individual; now an additional \$4 million per individual can be gifted without incurring current tax liability beginning Jan. 1, 2011. However, “unification” of the estate and gift tax means that use of the gift tax exemption reduces the exemption available for estate tax exemption. For example, if an individual makes a \$1 million gift, only \$4 million of the estate tax exemption will remain.

The Act also includes a very significant **new way for couples to reduce estate taxes**. In prior years, each person in a married couple could exempt up to a set amount from taxes on his or her estate – for example, \$5 million for each spouse. Now, a married couple's joint exemption will be set at \$10 million – but **if one spouse dies and does not use his or her entire \$5 million exemption, the executor of the estate can transfer the unused balance of the exemption to the surviving spouse.**

- **Current tax rates on both capital gains and qualified dividends would be extended for two years, with a top rate of 15%** -- meaning that investments delivering capital gains instead of ordinary income still provide a 20% reduction from the top tax rate of 35%.
- **Yet again, an alternative minimum tax (AMT) "patch"** has been passed to keep the AMT exemption at or near current levels.
- **Social Security payroll taxes for employees (but not employers) decrease from 6.2% by two percentage points for 2011**, increasing employees' take-home pay; however, no matching payroll tax holiday for employers is forthcoming. An employee currently earning enough annually to pay the Social Security maximum of nearly \$7,000 would take home more than \$2,000 extra for the year. The payroll tax cut replaces the 2010 Making Work Pay tax credit for low- and middle-income workers.

Self-employed individuals receive the same 2% payroll tax break in 2011. Instead of the 12.4% Social Security self-employment tax, they will pay only 10.4%.

- Many more tax measures affecting individual taxpayers are included in the Tax Relief Act. Topics ranging from charitable contributions to mortgage interest are addressed.

With only a few weeks remaining in 2010, your window of opportunity to affect your 2010 taxes is closing rapidly. If you have questions about this alert or other tax questions, please contact your AGH professional or Shawn Sullivan, vice president of tax services, at (316) 291-4110 or shawn.sullivan@aghlc.com. **NOTE: If you did not receive a copy of the related alert covering the Tax Relief Act's business and other employer tax changes and you would like one, please ask your AGH tax professional.**

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