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Tax Relief Act Includes Incentives for Business and Investment

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On December 17, President Obama signed into law H.R. 4853, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act). The 2010 Tax Relief Act extends the Bush-era individual and capital gains/dividend tax cuts for two years, reduces payroll taxes, strikes a compromise on estate tax, and provides a host of other tax cuts and incentives for individuals and businesses. Highlights of the $858 billion package include the following:

- **Extension of Marginal Individual Income Tax Rate Reductions.** Individual income tax rates will remain at the reduced 10%, 25%, 28%, 33%, and 35% levels for 2011 and 2012. Beginning in 2013, unless Congress acts again, the rates will return to the 15%, 28%, 31%, 36%, and 39.6% levels.

- **Overall Limitation on Itemized Deductions and the Personal Exemption Phaseout (PEP) Are Deferred.** Beginning in 2011, itemized deductions were going to be reduced by 3% of the amount by which the taxpayer's adjusted gross income (AGI) exceeded a certain threshold amount. In addition, the personal exemption was going to be reduced or eliminated for taxpayers with income over certain thresholds. These limitations did not apply in 2010, and now will continue to not apply for an additional two years (through 2012).

- **Reduced Rate on Capital Gains and Dividends.** Beginning in 2011, net long-term capital gains were going to be taxed at 20% and "qualified" dividends were going to be taxed at 20%. Instead, the favorable 15% rate for these income items will continue for an additional two years (through 2012).

- **The AMT Patch.** The individual alternative minimum tax (AMT) exemption amount for taxable years beginning in 2010 will be $72,450 ($74,450 in 2011) for married individuals filing a joint return and surviving spouses; $47,450 ($48,450 in 2011) for unmarried individuals; and $36,225 ($37,225 in 2011) for married individuals filing separate returns. Without this patch, the exemption amounts for these three classes of taxpayers would have plummeted in 2010 to $45,000, $33,750, and $22,500, respectively.

- **Compromise on Estate, Gift, and Generation-Skipping Transfer Taxes.** Beginning in 2011, the estate tax rate was scheduled to return to 55% with only a $1 million exemption amount, compared to 0% in 2010. Instead, for 2011 and 2012, the estate tax rate is no higher than 35% and the exemption amount is increased to $5 million. As for decedents dying during 2010, executors may choose between estate tax based on a $5 million exemption, a 35% top rate, and a basis step-up, or no estate tax and no basis step-up. As for gifts made in 2011 and 2012, the exemption amount is increased from $1 million to $5 million, and the top gift-tax rate is also 35%. Unless Congress acts again, these favorable rates and exemption amounts will expire at the end of 2012.

- **Extension and Increase of Bonus Depreciation.** The new law provides for an extension of first-year depreciation to equal 100% of the cost of qualified property placed in service after September 8, 2010 and before January 1, 2012, and provides for an additional 50% first-year depreciation deduction for qualified property placed in service after December 31, 2011 and before January 1, 2013.

- **Payroll and Self-Employment Tax Cut.** The new law reduces the employee share of the old age, survivors, and disability insurance (OASDI) portion of Social Security taxes from 6.2% to 4.2% for wages earned during 2011. A similar 2% reduction is given to self-employed individuals for 2011. This tax cut is worth up to 2% of the OASDI threshold of $106,000, or $2,136.

- **Extension of Incentives for Biodiesel and Renewable Diesel.** The biodiesel and renewable (biomass) diesel income tax credit and excise tax credit provisions are extended two years for 2010 and 2011.

- **Extension of Credit for Refined Coal Facilities.** The placed-in-service period and related tax credit for refined coal facilities are extended two years for 2010 and 2011.

- **Extension of Cash Grants in Lieu of Tax Credits for Wind, Solar, and Other Alternative Energy Property.** Eligible taxpayers may receive a cash grant from the Treasury equal to the 30% investment tax credit that could be claimed on the cost of wind, solar, biomass, geothermal, and other alternative energy property, provided the property is placed in service in 2009 or 2010, or construction begins in 2009 or 2010 and the property is placed in service by specified dates. The new law extends cash grants for property placed in service in 2011, or for which construction begins in 2011, provided it is placed in service by specified dates.

- **Extension of Research Credit.** The 20% research credit is extended two years for qualifying research expenses incurred in 2010 or 2011.

- **Extension of New Markets Tax Credit.** The new markets tax credit for qualified equity investments made to acquire stock in a corporation (or capital interest in a partnership) that is a qualified community development entity (CDE) is extended two years for 2010 and 2011. The carryover period for unused new markets credits is also extended for two years (through 2016).

- **Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations**. For payments received or accrued before 2012, special rules regarding unrelated business income derived by an exempt organization from a controlled subsidiary will remain in effect for two more years.

- **Extension of the Look-Through Rules for Payments Between Related Controlled Foreign Corporations.** The section 954(c)(6) look-through rules are extended for two years, and thus will apply to taxable years of foreign corporations beginning before January 1, 2012.

- **Extension of 100% Exclusion of Gain on Certain Small Business Stock.** The 50% gain exclusion for sales of "qualified small business stock" had been increased to 100% for the sale of qualified small business stock acquired after September 27, 2010 and before January 1, 2011. The new law extends the 100% exclusion one year for stock acquired before January 1, 2012.

If you have any questions regarding the information contained in this LawFlash, please contact any of the following Morgan Lewis attorneys:

Washington, D.C.		
Gary B. Wilcox	202.739.5509	gwilcox@morganlewis.com
Steven P. Johnson	202.739.5741	steven.johnson@morganlewis.com
Philadelphia		
William P. Zimmerman	215.963.5023	wzimmerman@morganlewis.com
Casey August	215.963.4706	caugust@morganlewis.com
San Francisco/Palo Alto		
Barton W.S. Bassett	650.843.7567	bbassett@morganlewis.com
Christina K. Harper	415.442.1130	christina.harper@morganlewis.com

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