Key Provisions of the 2010 Tax Relief Act

On December 17, 2010, the President signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Below are explanations of most of the key provisions in the Act that may have an impact on you or your business:

Temporary Extension of Current Rate Structure

The Bill extends the 2001 and 2003 tax cuts for individuals at all income levels through the end of 2012. As a result, the highest individual tax bracket will remain at 35 percent through the end of 2012. Similarly, the current maximum tax rate on long-term capital gain and "qualified dividends" will remain at 15 percent for individuals through the end of 2012. Of note, however, is the fact that the itemized deduction limitation, which currently reduces the total amount that higher income individuals would otherwise be able to deduct, and the personal exemption phaseout have been repealed through the end of 2012. Finally, the Bill provides a two-year "patch" of the alternative minimum tax.

Temporary Payroll Tax Holiday

Under current law, employees pay a 6.2 percent Social Security tax on all wages earned up to $106,800, while self-employed individuals pay a Social Security tax of 12.4 percent on all self-employment income up to the same threshold. For 2011 only, the Bill provides for a 2 percent payroll tax holiday. This means that employees will pay a Social Security tax of 4.2 percent on wages and self-employed individuals will pay at the rate of 10.4 percent on self-employment income. Thus, a taxpayer earning at least $106,800 in 2011 will save $2,136. This provision does not apply to the employer portion of the tax, but it does apply to all income levels. Also, under current law, self-employed individuals are allowed a deduction of one-half of the tax on their self-employment income when calculating adjusted gross income (AGI). The Bill allows self-employed taxpayers to calculate the amount of their deduction as if the full 12.4 percent tax was still in effect, even though they will only pay 10.4 percent.

Temporary 100 Percent Bonus Depreciation

In one of the most expansive benefits for businesses, the Bill increases bonus depreciation to 100 percent for investments in qualified business property acquired and placed in service after September 8, 2010, through December 31, 2011. The Bill also extends 50 percent bonus depreciation for qualified property acquired and placed in service during the period January 1, 2012, through December 31, 2012. Unlike section 179 expensing, bonus depreciation is not limited to smaller businesses or capped at a certain dollar amount.

For property placed in service after September 8, 2010, through December 31, 2011, it appears that taxpayers will have to choose either 100 percent bonus depreciation or regular depreciation. The Bill does not provide the option to elect 50 percent bonus depreciation during this time period. The Bill does not change the types of property eligible for bonus depreciation. In general, eligible property is original use property that has a recovery period of 20 years or less, or is qualified leasehold improvement property, meets certain contract date requirements, and is acquired and placed in service during the required timeframe. The 100 percent and 50 percent bonus depreciation provisions apply for both regular tax and AMT.

Temporary exclusion of gain on sale of small business stock

The Bill extends the 100 percent exclusion of gain recognized upon the sale or exchange of qualified small business stock. In general, noncorporate taxpayers will be able to exclude 100 percent of the gain on the sale or exchange of stock if it is qualified small business stock, is acquired after September 27, 2010, and before January 1, 2012, and is held for more than five years. This exclusion was previously set to expire unless stock was acquired before January 1, 2011, and was described in greater detail in a prior client alert that can be found here.

Business Provisions

The following provisions have been extended until the end of 2011:

- Cost-recovery provisions
  - Section 179 expensing-Beginning in 2012, the maximum dollar amount of property eligible for section 179 expensing and the phase-out threshold are set at $125,000 and $500,000, respectively, and are indexed for inflation.
  - Off-the-shelf computer software continues to be treated as "qualifying property".
  - 15-year cost recovery period for qualified leasehold improvements, qualified restaurant property, and qualified retail improvements.

- R&D Credit
  - The Bill reinstates the research tax credit for 2010 and 2011 (the credit expired at the end of 2009 under current law). Under section 41, taxpayers can claim a tax credit equal to 20 percent of the amount by which their qualified research expenditures exceed a base amount.

- Energy Related Credits
  - Biodiesel and renewable diesel $1 per gallon production tax credit.
  - Energy-efficient new homes manufacturing credit.
  - Alternative fuel 50 cent per gallon tax credit, not including fuel derived from pulp and paper manufacturing (i.e., black liquor).
  - Credit for the US-based manufacturing of energy efficient appliances.
  - Credit for energy-efficiency improvements to existing homes.

- Other provisions
  - Through the Work Opportunity Tax Credit, businesses can claim a tax credit of 40 percent of the first $6,000 in wages paid to new hires from targeted groups, including members of families receiving benefits under the Temporary Assistance to Needy Families program, qualified veterans, designated community residents,

food stamp recipients, supplemental security income recipients, and disconnected youths.

- The new markets tax credit is renewed through 2011, but with a lower allocation amount than in previous years ($3.5 Billion, down from $5 Billion in 2008 and 2009), and an extension of the carryover period for unused new markets tax credits for two years through 2016.
- For S corporations making charitable contributions of property, the Bill extends the provision through 2011 allowing S corporation shareholders to take into account their pro rata share of charitable deductions even if such deductions would exceed a shareholder's adjusted basis in S corporation stock.
- Enhanced charitable deduction for contributions of food inventory, book inventory, and computer equipment.
- The election to expense environmental remediation costs incurred to clean up hazardous substances at sites used in trades or businesses.
- The designation of certain economically depressed census tracts as Empowerment Zones, which provides qualified businesses and individuals within these zones special tax incentives.
- Designation of District of Columbia Enterprise Zones and related incentives, including an employment credit and zero percent capital gains for certain DC Zone property.

The Tax Relief Act will affect most individuals and businesses. If you have any questions concerning the contents of this alert, please contact any member of the firm’s Tax Group listed below.

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