

December 17, 2010

Tax Relief Bill to Become Law: A Sensiba San Filippo Summary

[Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010](#)

Last night, the House of Representatives voted in favor of legislation that had been approved earlier this week by the Senate which, from a tax perspective, will (i) extend the existing federal income tax rates for a two-year period, including those on dividends and capital gains, (ii) extend various other taxpayer-favorable tax provisions for businesses and individuals, and (iii) reestablish the estate tax. Additionally, the legislation will extend federal unemployment benefits for 13 months and reduce the Social Security payroll tax. It is anticipated that President Obama will sign the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act") very shortly, and it will promptly go into effect.

What follows is a description of the tax-related provisions of the Act that we believe to be of most significance to Sensiba San Filippo clients, with brief commentary relative to particular provisions as appropriate.

[Tax rates, personal exemption and itemized deduction benefits and the AMT "patch"](#)

1. Extension of existing federal income tax brackets: The top four income tax brackets (35%, 33%, 28% and 25%) will continue to be in place through 2012, rather than expiring at the end of 2010.

SSF comment: These upper brackets were scheduled to increase beginning January 1, 2011 (e.g., the highest two brackets were scheduled to increase to 39.6% and 36%, respectively), so a significant tax hike for high bracket taxpayers has been averted for two years.

2. Extension of existing capital gain and "qualified" dividend rate: For those taxpayers whose income tax bracket is 25% or higher, the capital gain and "qualified" dividend rate of 15% will continue to be in place through 2012, rather than expiring at the end of 2010.

SSF comment: The capital gain rate was scheduled to increase to 20% and the dividend rate to 39.6% beginning January 1, 2011, so another set of significant tax rate hikes have been averted for two years.



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3. Extension of "repeal" of personal exemption phase-out and itemized deduction limitation: The benefit of personal exemptions and itemized deductions have eroded in the past for taxpayers with an adjusted gross income above particular levels. However, the amount of the erosion of those benefits has steadily been reduced over the past decade to a point where, with respect to 2010, there is no personal exemption phase-out and no itemized deduction limitation, regardless of the taxpayer's adjusted gross income. That "repeal" of the exemption phase-out and the itemized deduction limitation will continue to be in place through 2012.

SSF comment: These two meaningful tax benefits can be fully utilized by taxpayers with relatively high adjusted gross incomes for an additional two years, through 2012.

4. Alternative minimum tax "patch": The legislation contains AMT relief in 2010 and 2011 to avoid a scenario in which an enormous number of additional taxpayers would otherwise be subject to AMT. The relief is achieved through a combination of (i) increasing the exemption which is part of the AMT calculation, and (ii) allowing personal tax credits to be applied to the AMT.

SSF comment: Unlike the previously discussed tax rates, itemized deductions and personal exemptions, Congressional agreement regarding the AMT "patch" was achieved with no perceptible partisan rancor; annual AMT "patch" relief has become a relatively certain and very significant part of the tax law landscape for individual taxpayers.

Other taxpayer-favorable provisions for businesses and individuals

1. Extension and increase of Section 179 expenses: As you may know, Section 179 of the Internal Revenue Code allows a taxpayer to choose to treat the cost of certain property as an expense and deduct such expense in the year in which the property is placed in service instead of capitalizing the cost and then depreciating it over a number of years. The recently enacted Small Business Jobs and Credit Act of 2010 ("Small Business Jobs Act") increased, for each of the years 2010 and 2011:

(i) to \$500,000 the maximum Section 179 expense, and

(ii) to \$2,000,000 the "investment limitation" that begins the phase-out of the Section 179 benefit.



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The new Act addresses this area again by setting the maximum Section 179 expense at \$125,000 and the "investment limitation" at \$500,000 for 2012 and, thereafter (starting in 2013), at \$25,000 and \$200,000, respectively, adjusted for inflation.

SSF comment: Businesses as well as tax preparers will need to be mindful of the moving target relative to utilizing the liberalized Section 179 ceilings (in 2010 and 2011) and then the reduced amounts applicable for 2012 and the even more reduced amounts applicable thereafter, albeit adjusted for inflation. Interestingly, the Small Business Jobs Act expansion of Section 179 benefits for the first time to certain types of real estate did not carry over to the new Act – there is presently no ongoing Section 179 benefit applicable to real estate subsequent to 2011.

- Extension and increase of bonus depreciation: The Small Business Jobs Act referred to above extended through 2010 a "bonus" depreciation deduction that can be claimed on 50% of the cost of certain types of new property (generally of a type that is depreciable over a period of 20 years or less) with respect to the first year in which such property is placed in service (following a reduction of such cost by the amount of any Section 179 deduction). Now, the Act superimposes a 100% bonus depreciation deduction with respect to the same type of property addressed by the Small Business Jobs Act for the period September 8, 2010 through December 31, 2010 and then continues that 100% bonus depreciation level through 2011 (through December 31, 2011). For 2012 (through December 31, 2012), the Act reduces the bonus depreciation deduction back to the 50% level.

SSF Comment: Unlike Section 179 expenses, the bonus depreciation benefit is not limited in amount. It should also be noted that the two year bonus depreciation extension through 2012 applies to the \$8,000 increase in bonus depreciation for new automobiles, light trucks and vans (resulting in a bonus depreciation amount of \$11,060 for new automobiles and \$11,160 for new light trucks or vans).

- Extension of research credit: The research credit is extended for two years (through December 31, 2011).



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4. Extension of favorable 15 year depreciation for certain types of real estate: Real estate that is defined as qualified leasehold property, qualified restaurant property or qualified retail improvement property will continue to be able to be depreciated over a 15 year period if placed in service by December 31, 2011 (rather than by December 31, 2009) and consistent with other requirements of the tax code.
5. Extension of 100% exclusion of gain/no AMT relating to certain qualified small business stock: Qualified small business stock ("QSBS") is stock issued by a C corporation where the tax basis of the gross assets of the corporation on the date of issuance is not in excess of \$50 million (and the corporation also meets a number of other requirements). With respect to a taxpayer's disposition of such stock that was issued between September 28, 2010 and December 31, 2010, the Small Business Jobs Act (i) increased to 100% the exclusion from federal tax of any capital gain, and (ii) eliminated the characterization of the excluded gain as a tax preference item for AMT purposes. The Act extends for one year (to December 31, 2011) the period of time during which an issuance of QSBS will receive that same very favorable tax treatment upon ultimate disposition of such shares.

SSF Comment: To call this an extremely advantageous tax provision relative to federal taxation (i.e., there is none, subject to particular rules) on gain (up to a specific generous limit) realized on the disposition of shares of QSBS issued during the period now extended through December 31, 2011 would not be an overstatement. The details of the pertinent QSBS tax rules are many and murky, however; do-it-yourself tax planning in this area is fraught with risk.

6. A host of other existing tax credits, incentives and benefits for businesses and individuals have been extended for an additional two years.

One year payroll tax cut

During 2011, there will be a payroll tax cut during which (i) employees will pay a 4.2% Social Security tax on all wages (up to \$106,800), a 2% reduction from the current rate of 6.2%, and (ii) self-employed individuals will pay a 10.4% Social Security self-employment tax on their self-employment income (also up to \$106,800), a 2% reduction from the current rate of 12.4%.



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Estate tax reinstited

The Act reinstates the estate tax with exemptions of \$5 million per person and \$10 million per married couple, and a maximum tax rate of 35% for the estate, gift and generation skipping transfer tax for a two-year period ending December 31, 2012. Thereafter, the exemption amount is to be adjusted for inflation.

While the reinstating of the estate tax is effective as of January 1, 2010, with respect to decedents dying in 2010 there is an election to choose no estate tax and a modified carryover basis. There are a myriad of associated provisions that go beyond the parameters of this summary.

We hope that this Sensiba San Filippo Summary has been helpful to you. It should be noted that the descriptions of the Act's provisions are only general in nature. Your Sensiba San Filippo tax partners are available to discuss the all-important details of any of these provisions with you, or contact us at info@ssfilp.com.

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