MARKET STREET OVERVIEW
The Tax Relief Act of 2010

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INTRODUCTION

In our year-end tax letter issued in early December, we felt it was likely Congress would act by the end of the year to address the uncertainty regarding estate, gift and income taxes. On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (The Tax Relief Act of 2010) into law. A pleasant surprise included in the law was the reunification of the gift and estate tax exclusions and an increase in the exclusion amount to $5m. The law also keeps the income and capital gains taxes (including the qualified dividend taxes) at 2009 rates. This will lend some certainty—at least through 2012 when the provisions are due to expire— for income tax planning and create opportunity to those who are inclined, during their lifetimes, to pass wealth on to succeeding generations with lower tax consequences than in the past.

ESTATE PLANNING LANDSCAPE

Surpassing predictions of many commentators, The Tax Relief Act of 2010 reunites the estate tax exclusion with the gift tax exclusion and increases the amount to $5m with a top tax rate of 35% through 2012. The Act also restores the full step up in tax basis for inheritors and includes an inflation adjustment for the exclusion amount beginning in 2012. Interestingly, for those who die in 2010, an executor can elect the 2010 rules (no estate tax but carry over basis) or the rules for 2011 and 2012 (estate tax with $5m exclusion and basis step up).

GIFT AND GENERATION SKIPPING TRANSFER (GST) TAXES

Perhaps most surprisingly, the Act increases the lifetime gift tax exclusion, which has historically been capped at $1m per person. Through 2012, individuals may make lifetime gifts, tax free, of up to $5m. (The gift tax exclusion is reduced for any exclusion already used.) Given the estate tax savings associated with lifetime gifts (so-called tax exclusivity of the gift and the opportunity for appreciation to amass outside of the wealth owner's estate), this is a valuable planning opportunity.

Although the GST tax is reinstituted in 2011 with a top rate of 35%, the exclusion has risen to $5m per person. For the first time in many years, clients will be able to fund a GST trust for the benefit of grandchildren and subsequent generations up to $10m per couple without paying gift tax on the transfer. The equalization of the exclusion amounts (estate, gift and GST) presents a tremendous opportunity to move substantial resources outside of your estate, tax free, to grow and supplement the needs of grandchildren and beyond for many years to come.

A FINAL WORD ON ESTATE PLANNING

These benefits, while welcome, do not obviate the need for careful estate planning. This bandage helps with the immediate uncertainty so many families face, but postpones further action until 2012 when Congress will have to act again if it wishes to avoid reversion to pre-2001 estate tax law. It does, however, provide a two-year window for wealth transfer to occur with gift tax savings to lock in the attendant estate tax savings.

INCOME TAXES

The income tax news resulting from the enactment of the Act has saved most taxpayers from experiencing a significant increase in their tax bills beginning in 2011. Many benefits of the Bush tax cuts were extended and some new benefits were introduced that should help stimulate the economy.

TAX RATES

Income tax brackets will remain at 10%, 15%, 25%, 28%, 33%, and 35%. Qualified dividends and capital gains rates will remain at 0% and 15%. Additionally, the Personal Exemption Phase Out and the limitation on itemized deductions, repealed under the Bush-era cuts, did not come back. These repeals have now been extended for two more years. These extensions, along with the extension of marriage penalty relief and certain credits should result in significant savings for almost everyone.

PAYROLL TAXES

Employees will note changes in withholding amounts for social security this year. The social security tax has been reduced by 2%, from 6.2% to 4.2%, on all wages earned up to the social security wage base (currently $106,500). This will, however, apply only to the employee's portion of the social security tax. Employers will still be taxed at the 6.2% rate.

CHARITABLE CONTRIBUTIONS

Some taxpayers have been able to save tax dollars by making charitable contributions of up to $100,000 directly from an IRA to a charitable organization. The benefit of this type of transaction is twofold. First, the contribution amount counts toward satisfaction of the required minimum distribution rules for withdrawals from IRAs. Additionally, the amount drawn does not have to be included in income figures on tax returns. This can be a huge planning tool for individuals who normally make charitable contributions and find themselves in higher tax brackets. This was scheduled to disappear after 2009, but has been extended through the end of 2011. Because the law was adopted so late in the year, 2010 contributions of this nature can be made through January 31, 2011. If you have charitable pledges or a general interest in giving more to charity over the next several years, transferring money from an IRA may make sense.

We are continually monitoring the tax environment and will keep you apprised of any other changes that occur.
If you have any questions, please contact your Wealth Advisor and/or Tax Professional for details.