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The Twenty Top Tax Breaks In The New 2010 Tax Act

The 2010 Tax Relief Act includes dozens of tax breaks for individuals and businesses. Here are 20 of the top provisions.

1. No increase in income tax rates. Rates in the top two income brackets had been scheduled to rise from 35% to 39% and from 33% to 36%. The new law also preserves relief from the "marriage penalty" for joint filers.

2. Status quo for capital gains and dividends. The maximum tax rate for long-term capital gains was supposed to jump to 20% (10% for low-income individuals), and dividends would have been taxed as ordinary income. Now, the existing 15% rate for long-term gains and dividends remains for most taxpayers through 2012.

3. Lower payroll taxes. For 2011 only, the law authorizes a two percentage point drop—to 4.2%—in employees' share of the Social Security tax, due on the first $106,800 of wages. You get the same break if you're self-employed.

4. Alternative minimum tax (AMT) relief. The new law slightly increases the exempt amounts on 2010 and 2011 returns for avoiding exposure to the AMT and its bigger tax bite. The amounts had been scheduled to revert to low, pre-2001 levels.

5. No phaseouts for itemized deductions and personal exemptions. Before 2010, itemized deductions and personal exemptions were phased out for high-income taxpayers. But those limits were repealed for 2010, and the new tax act extends that relief through 2012.

6. A bigger break for owning qualified small business stock (QSBS). The maximum 50% exclusion for investments in QSBS had been temporarily increased to 75%. Now, under the new tax act, there's a 100% exclusion for QSBS acquired before January 1, 2012.

7. An enhanced education credit. The American Opportunity Tax Credit (AOTC), which expanded the Hope credit for college expenses, was scheduled to expire after 2010. Now, the maximum $2,500 AOTC is extended through 2012, though it's still phased out for high-income taxpayers.

8. A bigger deduction for college savings. The maximum $2,000 deduction for contributions to Coverdell Education Savings Accounts, slated to drop to $500 after 2010, is extended through 2012.

9. A partial reprieve for Section 179 deductions. The maximum Section 179 deduction, which rose from $250,000 to $500,000 for qualified business property placed in service in 2010 and 2011, was then scheduled to drop to $25,000. The new law allows a maximum $125,000 deduction for 2012.

10. A bonus for bonus depreciation. The tax act retroactively reinstates this business perk, which had expired after 2009. A 100% bonus depreciation deduction is generally available for qualified property placed in service in 2011, and there's a 50% deduction for 2012.

11. Revived credit for going green. The credit for home energy-saving devices, scheduled to expire after 2010, is

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Meet The "New" Face At FSA!

If you haven't already heard, I'm sure it's no surprise that we have reconnected with Jared Lund, our beloved intern for the last few summers. Jared recently got married, finished school, and moved back to Maryland.

But he is now back on board to help clients with questions, paperwork, and billing needs. We're excited to have him back with us. The next time you call or visit, be sure to say hello.

Now that tax season is behind us, many clients have been asking about the most efficient way to retrieve their account statements and tax documents.

The answer is the FSA Vault. If you haven't been there, give it a try and discover what others are finding is a great place to view and store documents. Go to FSAinvest.com, click on "Client Service Center" and then click "FSA Vault Login."

If you don't have the login information, click the "Forgot Password" button and enter your email address as the "username." Happy surfing!

In this issue, we've incorporated some timely articles that help understand how to take advantage of recent legislation. For small businesses, this includes tax relief strategies around health law and unemployment insurance. Also enjoy stories about the benefits the 2010 Tax Relief Act provides individuals.

And as always, please don't hesitate to call us if you have any questions.

Happy Summer!
Jim Joseph, CFP®
Vice President

Health Law Relief For Small Biz Owners

The monumental new health care law—the Patient Protection and Affordable Care Act of 2010—will have a lasting impact. Yet while many provisions are to be phased in during the next several years, a few have already taken effect. For small businesses, one of the most important is a special tax credit that can help offset the cost of providing health insurance for employees.

Though this credit, too, will take several years to be fully implemented, some businesses may immediately qualify for the tax break. The IRS recently issued guidance on these complex rules, and it has posted examples, in the form of frequently asked questions (FAQs), on the web at http://www.irs.gov/newsroom/ article/0,,id=220839,00.html.

The new credit is available to a qualified small business that purchases health insurance for its employees. For this credit, a small business is generally defined as a business employing no more than 25 full-time employees whose average annual wages don't exceed $50,000. For tax years from 2010 through 2013, the credit—which is subtracted from the tax bill the business would otherwise owe—equals 35% of the portion of employee health insurance premiums that a business pays. For tax-exempt organizations, there's a 25% credit that is subtracted from the income and Medicare taxes the group withholds for employees and the employer's Medicare contribution. The maximum credit increases to 50% (35% for tax-exempt organizations) in tax years 2014 and 2015, for a maximum of two years, if a company participates in a state insurance exchange and meets other requirements. Some 80% of small businesses may qualify for the tax credits, according to Families USA, a health care advocacy group.

Some businesses will do even better, qualifying for a credit that offsets 100% of their health insurance premiums. That extra benefit applies to companies with 10 or fewer full-time employees whose average annual wages are less than $25,000. There's a phase-out formula for businesses with more than 10 workers or higher average salaries.

All of these rules are based on "full-time equivalents," so if your company employs more than 25 workers but has part-timers and seasonal workers, it still may qualify for a credit. And though compensation paid to owners and other highly paid employees would normally raise the average annual wages of a business—and might disqualify it from receiving the health insurance tax credit—the IRS has clarified that the calculation may exclude wages paid to a sole proprietor, a partner, a shareholder with a share of an S corporation of 2% or more, and any owner of more than 5% of another business. However, a single person business with no employees would not qualify for this tax credit.

Because all of this is complicated, be sure to work with your tax advisor to see whether your business can take advantage of the new rules. ●

Grantor Annuity Trusts Remain Viable

Recently proposed legislation would have severely reduced the tax benefits of the grantor retained annuity trust (GRAT). However, this popular estate planning technique has dodged the cutting block, at least for the time being. As a result, now is a good time to review your options.

GRATs, which are irrevocable trusts, are typically funded with income-producing property such as company stock or real estate. The trust pays you annual income for a set period of time that may be only a few years. When the term expires, the assets that remain in the trust go to beneficiaries you have designated—perhaps your children or grandchildren.

The IRS treats the transfer of those remaining assets as a potentially taxable gift—but it determines the value of that gift when the trust is set up, not when its term expires. To calculate the remainder, you take into account two factors: how much the trust assets would increase if they grew at a specified IRS interest rate; and how much they will be reduced by the annuity payments to you. For this calculation, you use the "Section 7520" rate in effect when the trust is established. (The rate is adjusted up or down each month to reflect prevailing interest rate conditions.)

With current rates quite low—the Section 7520 rate in April 2011 was 3.0%, compared with 6.2% as recently as August 2007—this can be a good time to transfer property to a GRAT. If the actual appreciation of the trust assets exceeds the specified rate, you and your beneficiaries come out ahead, because that additional amount won't be taxed.

Suppose you transfer $1 million in company stock to a GRAT with a three-year term. You can structure the trust so that the payouts to you exactly equal the hypothetical value of the assets if they grow at the Section 7520 rate.

Giving Up Luxuries For Peace Of Mind

Michael and Susan Walker thought they had it made in the shade. After years of ups and downs, Michael's business had finally turned the corner and he was able to give himself annual compensation of $250,000. After staying at home raising their two kids, Susan had reentered the workforce and had worked her way up to making $100,000 a year. The couple had managed to pay off their home mortgage and to fund their children's college costs without taking any drastic measures. It looked like a worry-free retirement was in the cards.

But that was before the stock market went into free-fall at the end of 2008. The stocks and other retirement plan assets that the Walkers were counting on to help pay for luxuries when they retired—a seaside cottage, a new top-of-the-line Mercedes, and lavish weddings for their children—lost about a third of their value. The recession hit Michael's business, too, forcing him to cut back his salary to $200,000. Now, with Michael at age 60 and Susan 58, they are left with stocks worth $1 million, a combined $700,000 in their 401(k) plans, and $500,000 in Michael's IRA. Their home, which had been worth $900,000, now would sell for$750,000.

In this hypothetical example, analyzed with a professional software package, it turns out that the Walkers will do well to live comfortably during retirement, let alone be able to afford all of those nice extras they'd been anticipating. By giving up the second home and the fancy new car, they can increase their probability of success to 82%, based on the software package. But they'll likely have to watch what they spend, and another downturn could leave them in perilous circumstances.

In today's post-recession world, there are millions of people forced to come to grips with new financial realities. Yet there are still ways to improve the odds of success and reduce anxiety over what's ahead. If your situation is similar to the Walkers, here are several ways to improve your future outlook.

Tighten the monthly budget. Take a long, hard look at how you're spending your money. Do you really need to dine out at pricey restaurants each week or keep season tickets for the local sports teams? By making a few sacrifices now that won't dramatically alter your lifestyle, you may be able to preserve more cash for the future. Furthermore, whatever you save can be invested, generating even more income. This reduction in standard of living has the most dramatic impact on your retirement because you get used to spending less which continues for your 20-30 years in retirement.

Ramp up retirement plan contributions. In our example, both Walkers were deferring just 5% of their salaries to their retirement plans. But that's considerably less than the maximum they could give to their tax-deferred accounts. The current ceiling for annual 401(k) contributions is $16,500—or $22,000 for those, like the Walkers, who are over age 50. In addition, as a business owner, Michael could consider switching the company to another kind of retirement plan that permits much larger tax-deductible contributions.

Postpone retirement. In this example, Michael and Susan will both retire at age 66, the normal age at which they can collect full Social Security benefits. Yet if each one delays retirement by a single year, together they'll earn an additional $300,000 from their jobs, or more if Michael's business rebounds. That will also knock a year off the length of their retirement, and if they delay taking Social Security, they'll be able to draw larger monthly amounts. Putting off retirement longer would help that much more.

Get off the sidelines. The recent bear market hurt the Walkers, and after most of the damage had been done, they moved all of their 401(k) assets out of stock mutual funds and into cash. But that means they'll have trouble keeping up with inflation and gives them no chance to make up lost ground. Over extended periods, stocks have outperformed other assets, and with a few years left until retirement—and perhaps decades of life after they stop working—they need to consider moving part of their money back into equities.

How much or little you'll need to adjust your post-recession retirement savings depends in part on how long you have until you leave the work force. The closer you are to your retirement date, the more you may have to skimp now in order to be comfortable later. If you'd like us to review your plan and see what changes may be needed, please call our office for an appointment. ●

Such a GRAT is said to be "zeroed out"—because the remainder, and thus your tax liability, is projected to be zero.

If you die before the trust expires, the property remaining in the trust reverts to your taxable estate. That defeats one purpose of establishing a GRAT—to reduce the value of your estate—and the shorter the term of the GRAT, the better the likelihood that you'll outlive it. But under the bill that passed the House of Representatives, a GRAT would be required to last at least 10 years, and you would no longer be allowed to zero out the trust.

Currently, the GRAT remains a valuable estate planning tool for some families. But proposals restricting the benefits are sure to surface in Congress again. We can work with you and your attorney to determine the right move in your situation. ●

Pay Unemployment Tax Now, Save Later

Your business may pay several thousands of dollars a year into a state unemployment fund that your employees can tap if they're laid off. That tax is just a necessary part of doing business. But because of the way each year's payment is calculated, chipping in a little more than you're required to pay could result in a much larger reduction in your ultimate bill. As illogical as it may seem, you could save tax by paying it.

Typically, a company pays unemployment tax into a state unemployment insurance fund. Formulas used to calculate your payment vary from state to state, but the amount is generally determined by the ratio of your company's average payroll (in some states, the average taxable payroll) to the reserve in the company's unemployment account. If you increase your reserve, you might push your business into a lower tax bracket.

Consider XYZ Corp., a business with five full-time employees. It has an annual payroll of $500,000 and a net credit of $14,900 in its unemployment tax account. At the current payroll-to-credit ratio, XYZ Corp. is required to pay unemployment tax of $2,000 a year. However, a company with an unemployment credit of $15,000—just $100 more than XYZ's current credit—has to pay only half as much, or $1,000, in unemployment tax. (These figures are hypothetical and don't apply to a particular state.) Assuming its state allows voluntary contributions, XYZ need pay only an extra $100 to qualify for the lower tax rate and save $1,000. That's a net savings of $900.

The numbers will vary from state to state, but in some cases it may be possible to pay as little as $10 to save thousands of dollars. Because current rates are based on the prior year's wages, this can be especially valuable to a rapidly growing business. States that permit voluntary contributions include Arizona, Arkansas, California, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Pennsylvania, South Dakota, Texas, Washington, West Virginia, and Wisconsin.

How can you know how much to pay voluntarily? Your state notifies your company about the reserve balance in its account, and you can compare that figure to your average payroll to determine the reserve ratio. Each state provides tables showing the tax rates for different reserve ratios. Your tax advisor can help you determine your reserve ratio and recommend whether additional payments would save you money. But it's also important to look ahead to calculate how an extra payment now might affect your unemployment tax rates in future years. ●

Top Tax Breaks

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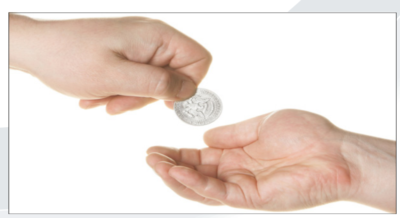
extended through 2011, but the credit is limited to 10% of the cost of improvements (it had been 30%) and a maximum of $500.

12. Offspring benefit. The child tax credit of $1,000 per child was going to lapse after 2010; now it will be in force through 2012.

13. Help with adoption costs. The new law extends the credit for adoption expenses—now a maximum of $12,170, down from $13,170 in 2010—through 2012.

14. Money for hiring. The Work Opportunity Tax Credit, available to businesses for employing workers from "target" groups, now won't expire as planned on August 31, 2011, but will stay in force through 2012.

15. Reward for taking the bus. The maximum monthly $230 tax-free benefit for transit passes, scheduled to decrease to $120 after 2010, is extended through 2011.



16. A renewed deduction for corporate largesse. Enhanced deductions for companies' contributions of food inventory, books and computer equipment, which expired after 2009, are retroactively extended through 2011.

17. Option to deduct sales tax. The chance to write off sales tax, rather than state and local income taxes, ended after 2009 but now is back for 2010 and 2011.

18. Deduction for IRA transfers to charity. The ability to direct an annual maximum of required IRA distributions to charitable organizations, which had expired after 2009, is retroactively extended through 2011.

19. Generous estate tax rules. Following the temporary repeal of the tax for 2010, it's reinstated but with a $5 million exemption and a top tax rate of only 35% and the reunification of estate and gift taxes through 2012. And heirs will again benefit from a step-up in basis on inherited assets.

20. A break on generation-skipping tax (GST). The new law coordinates the GST with the estate tax rules through 2012, with the same maximum exemption of $5 million. ●

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