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The Tax Relief Act Of 2010: Key Business And Individual Income Tax Provisions And Incentives

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On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"). This article briefly summarizes some of the key federal income tax provisions of the Act affecting individuals and businesses. The Act generally extends various income tax rates and other provisions favorable to individuals and businesses that were set to expire on December 31, 2010 (or that otherwise would have expired at the end of 2009). The Act also contains some new tax relief measures, such as a temporary reduction in payroll tax rates.

Individual Provisions

Extension of Individual Ordinary Income Tax Rates

Under the Act, the six individual income tax rates for ordinary income will remain 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent in 2011 and 2012. Those rates had been set to increase to 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent. For 2011, the highest rate will apply to taxable incomes of more than $379,150.

Extension of Reduced Rates on Dividends and Capital Gains

Under the Act, "qualified" dividends and long-term capital gains (generally, gains from the sale or exchange of capital assets held for more than one year) will continue to be taxed at a maximum rate of 15 percent in 2011 and 2012. Dividends generally are "qualified" if they are paid by domestic corporations or certain qualified foreign corporations and the stock has been held for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date. Without the extension, dividends were set to be taxed at ordinary income rates, and the maximum rate on long-term capital gains was set to increase to 20 percent.

Extension of 100 Percent Exclusion of Gain from Certain Dispositions of Qualified Small Business Stock

Gain from the sale of qualified small business stock ("QSBS") held for more than five years is subject to reduced rates. QSBS generally is stock of a C corporation that is acquired by the holder at original issue if the corporation satisfies a gross assets limit and other tests. Subject to certain limitations, the reduced rate historically was 14 percent. For QSBS acquired after February 17, 2009 and before September 28, 2010, the reduced rate was 7 percent. Under a temporary measure, this reduced rate was 0 percent for QSBS acquired between September 28, 2010 and December 31, 2010. The Act extends the 0 percent rate for stock acquired before January 1, 2012. Gain subject to the 100-percent exclusion will not be considered a preference item for alternative minimum tax ("AMT") purposes.

Overall Limitation on Itemized Deductions and Phase-Out of Personal Exemption

Historically, the total amount of most allowable itemized deductions was limited for higher-income taxpayers. In addition, the ability to take deductions for personal exemptions (taxpayer, spouse and dependents) was limited for taxpayers with incomes over certain thresholds. These limitations on itemized deductions and deductions for personal exemptions were phased out over time and repealed entirely for 2010. The limitations were set to be restored starting in 2011, but under the Act, they will not apply again until 2013. The Act does not change the treatment of itemized deductions under the AMT.

Temporary Payroll Tax Cut for Employees and Self-Employed Persons

The Federal Insurance Contributions Act imposes taxes on wages paid by employers to employees. The old age, survivors and disability insurance ("OASDI") portion of the tax equals 6.2 percent of covered wages up to the wage base (an amount indexed to inflation that is $106,800 for 2011). This tax is imposed both on the employer and the employee (who pays through employer withholding). Self-employed individuals are responsible to pay the full 12.4 percent tax (and they are entitled to an income tax deduction for one-half of this "self-employment tax"). For 2011 only, the Act reduces the employee portion of OASDI tax to 4.2 percent and reduces the self-employment tax to 10.4 percent (without correspondingly reducing the amount of the income tax deduction for one-half of the self-employment tax). The employer portion of OASDI is not affected by the Act.

Alternative Minimum Tax Relief for Individuals

The AMT, which generally prevents many higher-income taxpayers from benefitting from certain deductions and credits, exempts taxpayers with incomes below a certain threshold. The threshold is not indexed for inflation. The Act increases this threshold for 2010 and 2011 and also allows certain credits to be taken against the AMT that otherwise would not have been available (these changes, known as the AMT patch, are designed temporarily to shield a large number of individuals from the AMT).

Business Provisions

Extension and Expansion of Bonus Depreciation and Small Business Expensing

Taxpayers that placed in service certain qualified property in 2008, 2009, and 2010 (2009, 2010, and 2011 for certain longer-lived and transportation property) were allowed a first-year depreciation deduction equal to 50 percent of the tax basis (generally the cost) of the property. This "bonus depreciation" applied before computing the amount otherwise allowable as a depreciation deduction for the year, resulting in a much greater net depreciation allowance than otherwise would have been available. The types of property generally qualified are newly purchased (i.e., not used or reconditioned) tangible personal property used in a trade or business that is depreciable over a period of 20 years or less and that is subject to the MACRS accelerated depreciation schedules; water utility property; computer software; and qualified leasehold improvements. The Act not only extends bonus depreciation but expands it to allow a deduction of 100 percent of the cost of qualified property placed in service after September 8, 2010 and before January 1, 2012 (before January 1, 2013 for certain longer-lived and transportation property). A first-year depreciation deduction of 50 percent will apply to qualified property placed in service after December 31, 2011 and before January 1, 2013 (after December 31, 2012 and before January 1, 2014 for certain longer-lived and transportation property). Under certain circumstances, corporations can elect to increase the minimum tax credit limitation by the amount of allowable bonus depreciation.

In addition, subject to certain limitations, a taxpayer that invests in certain qualifying property may elect to deduct the cost of the property rather than recover the cost through depreciation deductions. Property that qualifies for this provision generally includes tangible personal property that is subject to the MACRS accelerated depreciation schedules and that is acquired by purchase for use in the active conduct of a trade or business, as well as certain other property. Generally, for 2010 and 2011, the maximum deduction that a taxpayer can claim under this provision is $500,000 (reduced by the amount that the property placed in service exceeds a value of $2 million). Beginning in 2012, the limit on deductions was set to be $25,000 (reduced by the amount that the property placed in service exceeded a value of $200,000). Under the Act, for tax years beginning in 2012, the maximum amount of this deduction will be $125,000 (reduced by the amount that the property placed in service exceeds a value of $500,000). Qualified property will continue to include off-the-shelf computer software placed in service before 2013.

Extension of Research Credit

The Act extends the research credit through 2011 (it had expired at the end of 2009). The research credit generally allows taxpayers an income tax credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses exceed a certain base amount (making the credit generally available for incremental increases in qualified research).

Extension of Energy Incentives

A number of expiring incentives for the use of certain forms of energy were extended by the Act, including, among many others, the income and excise tax credits for biodiesel and renewable diesel fuels (extended for 2010 and 2011) and the ability of the Secretary of the Treasury to provide cash grants (through 2011) in lieu of tax credits to taxpayers that place in service depreciable property that is part of a qualified renewable electricity production facility or qualifying property otherwise eligible for the energy credit (e.g., solar energy property). The Act does not include an extension of a 30 percent investment tax credit for domestic manufacturing facilities that produce wind turbines, solar panels and other advanced energy property.

Extension of 15-Year Cost Recovery for Certain Real Property Improvements

The Act extends the ability of taxpayers to depreciate qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property placed in service in 2010 and 2011 over 15 years. Without the extension, such improvements generally would have been depreciable over 39 years.

Extension of Special Expensing Rules for Film and Similar Property

Taxpayers can deduct the cost of qualifying film and television production commencing before January 1, 2010 in the year the expenditure is incurred. To qualify, a certain threshold of expenses must have been incurred in the United States. The Act extends this special expensing rule to cover qualified film and television productions commencing before January 1, 2012.

Extension of Expensing of Certain Qualified Environmental Remediation Costs

Certain qualified environmental remediation costs, generally those incurred in connection with the abatement or control of hazardous substances at a qualified contamination site, paid or incurred before January 1, 2010, were deductible. Under the Act, the deduction is extended to cover qualified expenses paid or incurred prior to January 1, 2012.

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