

# 2010 Tax Relief Act - What Does it Mean for 2010?

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For years, most American taxpayers were not looking forward to 2011 because of the expected tax increases that were slated to hit on January 1 after the expiration of the “Bush Era tax cuts” from 2001 and 2003. However, the President and American lawmakers struck a compromise earlier this month to extend the tax rates for two more years. After passing in the Senate and the House, on December 17<sup>th</sup> the President signed into law the **2010 Tax Relief Act**.

The tax legislation benefits all Americans in 2011 with lower tax rates than we expected and the extension of many popular tax incentives, including the following:

- \$1,000 child tax credit that was scheduled to decrease to \$500 per child
- American Opportunity Tax Credit for higher education that has a higher maximum credit and higher income limits than the Lifetime Learning or Hope Credits.
- Maximum 15% federal tax rate on most dividends and capital gains
- Elimination of personal exemption phaseout for higher income individuals



We will have a more comprehensive update on the legislation in the coming weeks, but wanted to provide an idea of what this significant tax law means for 2010.

## Tax Rates

Many individuals considered bumping income into 2010 and deductions into 2011 and future years because of the tax rate increase originally scheduled for January 1, 2011. The 2010 Tax Relief Act effectively extends all tax brackets and rates from 2010 into the 2011 and 2012 tax years; therefore, anyone who previously planned on the unconventional tax planning tactic of accelerating income and deferring deductions should now rethink that strategy. In most cases, it now again makes sense to defer income and accelerate certain deductions where possible.

## Roth IRA Conversions

2010 is a unique year for the Roth IRA in that it is the first year where there is no income limitation on converting from a traditional IRA to a Roth IRA. Additionally, 2010 is the only year where individuals have the option of converting to a Roth IRA in one year (2010) and reporting the income equally over the subsequent two years (2011 and 2012). Because of the scheduled tax increase, many individuals who performed Roth IRA rollovers in 2010 were not planning on using the election to report the income in 2011 and 2012. While it was tempting to defer the income into later years, it did not make sense in many cases to choose to pay income tax at rates that were as much as 5% higher than in 2010. The 2010 Tax Relief Act changes the rules for the better, thereby resulting in a situation where most individuals who planned on reporting a Roth IRA conversion in 2010 will now benefit from the extension.

## **Alternative Minimum Tax**

The most significant impact felt by Americans in 2010 will undoubtedly be the passing of the Alternative Minimum Tax (AMT) "patch" retroactive to January 1, 2010 through 2011. The federal AMT is a complex alternate set of tax rates meant to limit the benefit of specific deductions that was intended to affect less than 2% of Americans when it was created. Due to a flaw in the design of the AMT, it was expected to impact over 33% of taxpayers in 2010. The AMT "patch" in the 2010 Tax Relief Act lowers that percentage to around 5%, saving millions of tax dollars. The AMT "patch" most benefits married couples with taxable income of \$125,000 to \$250,000 and individuals with taxable income of \$70,000 to \$125,000, saving as much as \$7,000 in 2010 taxes.

## **What Should You Do Now?**

Please contact us should you want to discuss your specific situation. Virtually no political postulators expected this significant of tax law to make its way through the lame duck legislature in 2010, so few people planned for the "what if" that is now upon us. The 2010 Tax Relief Act benefits just about everyone, but there are complicated situations where decisions need to be made prior to December 31<sup>st</sup> to get the most favorable tax situation.

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