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Special Edition

## Tax Certainty - For A While

Income and transfer (estate, gift, and generation-skipping) taxes for many U.S. taxpayers were scheduled to increase in 2011. The well-publicized “compromise” reached by Republican lawmakers and the administration changed the near-term tax landscape in major ways through a bill enacted into law on December 17.

### Income Tax

In broad terms, the new law’s income tax provisions retain 2010 income tax rates on ordinary income (top rate of 35%), capital gains (15%), and dividends (15%) through 2012, and they retain many other features of our 2010 income tax system through 2012 (2011 in some cases). A noteworthy income tax benefit, designed to spur capital spending by businesses, expands the 50% bonus depreciation on qualifying new property additions to 100% (full expensing) for such property acquired and placed in service after September 8, 2010 (note retroactivity) and by December 31, 2011.

### Payroll Tax

In the payroll tax area, the big change is a 2% point reduction (from 6.2% to 4.2%) in the Social Security tax rate for the *employee’s portion only* of wages and salaries. For self-employed individuals, the rate changes from 12.4% to 10.4%. These changes are effective for 2011 only.

### Estate, Gift, and Generation-Skipping Taxes

The most dramatic changes relate to transfer taxes, and in this area vast planning opportunities are presented for many families. The now current status of the law perhaps can best be summarized by segregating into time segments: 2011 and 2012; 2010; and post-2012. We’ll mention the last first:

#### Post 2012:

Absent intervening Congressional action, we will approach 2013 with the same concerns about the much lower exemptions (\$1 million each) and much higher rates (up to 55%) that we had as we approached 2011. In other words, the 2011 and 2012 expanded exemptions and reduced rates (described next) are temporary.

#### 2011 and 2012:

- The exemption goes to \$5 million per person for estate, gift, and generation-skipping taxes. This compares very favorably with previous highest exemptions of \$3.5 million for estate and generation-skipping taxes and \$1 million for gift taxes.

**Observation -** A tremendous incentive will exist for wealthy families to make large gifts over the next two years.

- The top transfer tax rate goes to 35%.
- The concept of “portability” of a deceased spouse’s unused exemption is adopted. In short, this provision allows a surviving spouse to use both his or her exemption, plus any unused exemption of the “last deceased spouse.”

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**Observation** - Conventional planning has involved trying to make sure each spouse had sufficient assets to fully utilize each exemption. Under the new provision, this generally won't be necessary.

Portability applies to estate and gift taxes, but not to generation-skipping taxes.

**2010:**

- The most complex provisions involve individuals dying in 2010. Recall that there was no 2010 estate tax. Now, under the new law, there is, but an estate's executor can elect out of the estate tax and into the carryover basis regime that had been in place for individuals dying in 2010.

**Observation** - Executors and their advisors, in the case of 2010 deaths, will need to carefully assess which approach - estate tax with "stepped-up basis," or no estate tax with carryover basis - is better. For those estates below the estate tax exemption (set by the new law at \$5 million for 2010), the former choice, in most if not all cases, will be advisable.

\* \* \* \* \*

The new law makes many more changes, but we hope this summary will give you, like us, a clearer picture of the present and near-term future. Time passes quickly, though, and we likely will be back in the same uncertain place as we have been before we expect it.

We remain available to answer your questions and to help you discern how the new law impacts you.

The matters discussed in these articles provide general information only. You should consult with us about your specific situation before undertaking action based on such general information.

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