MARKETING INTELLIGENCE Report

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From evolving market trends to new legislation, change is a constant in our industry. M Marketing Intelligence Reports are designed to support Member Firms with insightful commentary that addresses these changes, and their impact on the life insurance market, and adds value to client and advisor relationships.

The 2010 Tax Relief Act

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Relief Act). The Act, which took effect on January 1, 2011, contains a two-year extension of income and capital gains tax law changes that were introduced with the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Jobs and Growth Tax Relief Reconciliation Act, and subsequent legislation. In addition, the 2010 Tax Relief Act reintroduces the estate tax with a $5 million exemption and a 35 percent top tax rate, and allows executors for decedents who died in 2010 the ability to choose how the estate is treated for estate tax purposes.

Federal Income Taxes

Marginal income tax rates in 2011 will remain unchanged from 2010 levels. The taxable income amounts within the brackets will be indexed upward slightly.

2011 Tax Brackets, Incremental by Taxable Income				
Tax Bracket	Married Filing Jointly	Married Filing Separately	Head of Household	Single
10% Bracket	$0 – $17,000	$0 – $8,500	$0 – $12,150	$0 – $8,500
15% Bracket	$17,000 – $69,000	$8,500 – $34,500	$12,150 – $46,250	$8,500 – $34,500
25% Bracket	$69,000 – $139,350	$34,500 – $69,975	$46,250 – $119,400	$34,500 – $83,600
28% Bracket	$139,350 – $212,300	$69,975 – $106,150	$119,400 – $193,950	$83,600 – $174,400
33% Bracket	$212,300 – $379,150	$106,150 – $189,575	$193,350 – $379,150	$174,400 – $379,150
35% Bracket	Over $379,150	Over $189,575	Over $379,150	Over $379,150

Standard Deduction for Married Couples Filing Jointly

Married individuals filing jointly will continue to be able to take advantage of a standard deduction equal to 2x that of a single taxpayer.

Itemized Deductions and Personal Exemptions

Certain itemized deductions and personal exemption rules for higher-income taxpayers instituted by EGTRRA will also remain unchanged. Under the EGTRRA "sunset" rule, which no longer applies, itemized deductions would have been reduced by 3 percent of Adjusted Gross Income above an inflation-adjusted figure. Personal exemptions would have been phased out when Adjusted Gross Income exceeded a similar inflation-adjusted threshold.

Capital Gains & Qualified Dividends

Long-term capital gains and qualified dividends will continue to be taxed at 15 percent for most taxpayers. Taxpayers in the 10 and 15 percent tax brackets will not be subject to taxes on capital gains or dividends.

Other Extensions of Federal Income Tax Provisions for 2011

- Eligible taxpayers will be able to deduct mortgage insurance premiums as qualified residence interest.
- Employees will pay 4.2 percent Social Security tax on wages up to $106,800 and self-employed individuals will pay 10.4 percent Social Security self-employment taxes on self-employment income up to $106,800. This is a reduction from the respective 6.2 percent and 12.4 percent rates that would have otherwise applied for 2011.
- Alternative Minimum Tax (AMT) exemptions will remain available based on 2009 amounts indexed for inflation. Without the continuation of these exemptions, a significantly higher amount of taxpayers would have been subject to the AMT in 2011.

These provisions apply to 2011 only, unless further action is taken by Congress.

Federal Estate and Gift Taxes

The 2010 Tax Relief Act provides an Estate Tax exemption of $5 million.[1] The exemption amount is subject to an inflation adjustment in 2012. The Act also resets the Estate Tax rates, with a new top tax rate of 35 percent.

For gifts made on or after January 1, 2011, the estate tax and the gift tax are reunified with an applicable exclusion amount of $5 million and a top estate and gift tax rate of 35 percent.

The Act also introduces a new estate planning concept — the deceased spouse unused exclusion amount (DSUEA). Under this new provision, any portion of the exemption that remains unused as of the death of a spouse who dies after December 31, 2010 will generally be available for use by the surviving spouse. The DSUEA can be used in addition to the surviving spouse's own exclusion amount.

Estate Tax Option for Decedents Dying in 2010

Prior to 2010, the general "Step-Up" rules for inheritances from a decedent's estate were as follows:

- Under IRC Section 102, the recipient of the inheritance was generally not subject to income tax for the value of the property.
- The recipient's basis in the inherited property was generally the fair market value (FMV) of the property at the decedent's death. If the executor of the decedent's estate elected the "alternate valuation date" (six months from the date of death), then the taxpayer took a basis equal to the FMV at that time.
- Appreciation in the property prior to the decedent's death escaped federal income taxation because of this basis step-up.

2010 saw the introduction of the "Modified Carryover Basis" rules, which are simplified as follows:

- Under IRC Section 1022, property acquired from a decedent dying after 2009 is treated the same as if acquired by gift.
- The basis of inherited property generally will be the lesser of the decedent's basis or the property's FMV at the date of death.
- Basis can be increased on eligible property up to $1.3 million, however no asset's basis can be adjusted above FMV. An additional allocation of $3,000,000 of basis increases is allowed for properties deemed to be passing to a surviving spouse.

Executors of estates for decedents dying in 2010 will have the option of choosing between:

1) Subjecting the estate to taxation, based on a $5 million exemption and a 35 percent top tax rate and giving heirs a step up in basis OR
2) No estate tax and modified carryover basis.

[1] Technically, the Act raises the Applicable Exclusion Amount, effectively exempting $5 million from taxation.

Generation Skipping Transfer (GST) Tax

The amount of GST tax imposed on any generation skipping transfer is the "taxable amount" multiplied by the "applicable rate." The "applicable rate" is the product of (1) the maximum federal estate tax rate imposed on the estates of decedents dying at the time of the transfer on which the GST tax is imposed, and (2) the "inclusion ratio" with respect to the transfer.

Under the Act, the GST tax rate for transfers made during 2010 is 0 percent. For transfers made in 2011 and 2012, the GST tax rate will be 35 percent. In addition, up to $5 million of GST tax exemption may be allocated to a trust created or funded any time after December 31, 2009.

Extension of EGTRRA "Sunset"

Under the Act, the sunset of the EGTRRA estate, gift, and GST tax provisions is extended to apply to estates of decedents dying, gifts made, or GSTs after December 31, 2012. Therefore, neither the EGTRRA rules nor the new rules will apply to estates of decedents dying, gifts made, or GSTs made after December 31, 2012. Absent any additional legislation from Congress, estate, gift, and GST tax provisions will revert to pre-EGTRRA rules on January 1, 2013.

Conclusion

The 2010 Tax Relief Act has stabilized income, gift, and estate tax law for the next two years. However, the next Congress, which will convene in January 2013 (following a Presidential election), will be faced with an urgent need to maintain this stability. The economic climate of 2011 and 2012—and the politically charged nature of the social issues surrounding government, taxes, and deficits—are expected to have a tremendous impact on the outcomes.

One positive that has emerged from these developments is the opportunity to review the importance of planning in this environment. Certainty with regard to reunification, and the continued low interest rate environment, make this an ideal time to identify planning objectives and execute accordingly.

Additional information and analysis of the 2010 Tax Relief Act will be provided in 2011.

For More Information

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