

Special Edition: December 17, 2010

Obama-GOP Tax Cut Compromise to Be Signed into Law

In the early hours of Friday, December 17, 2010, by a vote of 277 to 144, a bi-partisan House approved S.A.4753 (nominally entitled “The Reid-McConnell Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010,” hereinafter referred to as “the Act”). The Act is the legislative embodiment of the controversial compromise struck between President Obama and Republican leaders of the Senate and House of Representatives on the topic of, primarily, the temporary extension of unemployment benefits, the so-called “Bush tax cuts,” a reduction of Social Security taxes, and a host of other tax benefits. The Act is expected to be signed by the President later today, Friday, December 17, 2010.

The Act comprises 74 pages of legislation broken out into eight separate titles. Primarily, the Act extends until the end of 2012 most of the provisions of two separate tax relief laws that were scheduled to expire at the end of 2010, *viz.*, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). The provisions of the Act expire on January 1, 2013, and the affected provisions of the IRC revert back to pre-EGTRRA status. This summary will concentrate on the estate tax and individual income tax provisions affected by the Act.

Estate, Gift, and Generation-Skipping Transfer Tax Provisions

The Act begins its estate, gift and generation-skipping transfer (GST) tax section by repealing the 2010 repeal of the estate tax and reinstating the pre-EGTRRA step-up in basis. The Act provides that the estate of a decedent dying during 2010 may elect the EGTRRA provisions (“no estate tax, carryover basis”) or the Act provisions. Absent such an election, the default rule is that the increased applicable exclusion amount and reduced tax rates below obtain for estates of decedents dying during 2010. The deadline for filing any required return or election with respect to an estate of a decedent dying during 2010 is a date not earlier than nine months after the date of enactment of the Act.

Reunification and Applicable Exclusion Amount. Under the Act, gift and estate taxes are reunified (as they were before EGTRRA), minimizing the effect of the choice to make a gift during life or at death. The “applicable exclusion amount” under IRC §2010 is set at \$5,000,000, and this amount is indexed by IRC §2505, with the result that beginning January 1, 2011, the so-called “unified credit” for gift and estate taxes is \$5,000,000. Although this reunification and increase in exclusion amount is

effective under the Act for only two years (2011 and 2012), the \$5,000,000 amount is indexed for inflation in multiples of \$10,000 beginning in 2012. On January 1, 2013, the applicable exclusion amount will revert back to \$1,000,000, as it was scheduled under prior law. (N.B. As noted above, the new \$5,000,000 estate and GST exemption amounts are the default rule for 2010, depending on elections made, but the reunification of the gift and estate taxes is effective January 1, 2011.)

Estate Tax Rates. Estate tax rates are simply truncated by the Act at the top marginal rate of 35%. The brackets between 18% and 34% remain exactly the same, and the 35% bracket is imposed as the maximum rate.

Portability. Section 303 of the Act introduces “portability” to the applicable exclusion amount (unified credit), the ability for a surviving spouse to use any applicable exclusion amount left unused by his or her predeceased spouse. Thus, for example, under the Act if Spouse A dies using only \$2,000,000 of his \$5,000,000 applicable exclusion amount, then upon the subsequent death of Spouse B, she may use her \$5,000,000 plus his unused \$3,000,000, for a total of \$8,000,000. To prevent serial credit collection, the Act allows the portability of the unused applicable exclusion amount of only the last spouse to die.

Generation-Skipping Transfer Tax. As under current law, under the Act the so-called GST exemption is equal to the applicable exclusion amount, now \$5,000,000, as imported by reference by IRC §2631(c). With respect to any generation-skipping transfer made during 2010, the Act extends the deadline for filing a return under IRC §2662 until a date not earlier than nine months after the date of enactment of the Act.

Individual Income Tax Provisions

Individual Income Tax Rates. Very simply, the Act did nothing more than substitute the expiration year of “2012” for “2010” for the temporary income tax rate changes introduced by EGTRRA and JGTRRA, each of which was previously scheduled to expire at the end of 2010 and revert to prior rates. This has the effect of extending, through the end of 2012, the following rate changes made by these acts:

- The lowest income tax bracket is 10% (not 15%);
- The following brackets are 25%, 28%, 33%, and 35% (rather than 28%, 31%, 36%, and 39.6%); and
- Capital gains are taxed at 0% for taxpayers below the 25% bracket and at 15% for those above (rather than 10% and 20%).

Marriage Penalty Relief. The Act extends through 2012 the provisions of EGTRRA that ameliorated (though did not eliminate) the so-called “marriage penalty” that results from aggregating income across graduated rate brackets. These provisions double the size of the 15% income tax bracket (after 2008) and the standard deduction for married filers.

Limitation of Itemized Deductions. The Act extends for two years the 2010 repeal of the so-called “Pease limitation,” which reduces by three percent the amount of itemized deductions that a taxpayer may claim above indexed amounts of adjusted gross income.

Social Security Tax. The Act provides a one-year 2% reduction in the amount of Old-Age, Survivors, and Disability Insurance (OASDI) taxes paid or withheld from an employee’s payroll. Thus, employees will have 4.2% withheld and self-employed taxpayers will pay 10.2% in OASDI taxes in 2011.

Alternative Minimum Tax (AMT). The Act provides that single taxpayers will be entitled to an exemption from AMT in the amount of \$47,450 for tax year beginning in 2010 and \$48,450 tax year beginning in 2011 (rather than \$33,750 under current law) and married taxpayers filing jointly \$72,450 for tax year beginning in 2010 and \$74,450 for tax year beginning in 2011 (rather than \$45,000).

Land Conservation Easements

The Act also extends through the end of 2011 the charitable deduction limitation and carry-forward provisions under IRC §170(b)(1)(E) relating to “qualified conservation contributions” under IRC §170(h). Under these provisions, generally a taxpayer may take a charitable deduction for a qualified conservation contribution up to 50% of AGI in the year of the contribution (100% of AGI for a contribution by a “qualified farmer or rancher”) and may carry forward and apply as a charitable deduction any unused deduction for 15 successive years at the limitation (50% or 100%) first applied until expended.

Conclusion

It is important to remember that the Act is essentially a two-year patch to prevent economic damage from tax provisions that are expiring at an inconvenient time. This will all have to be revisited in two years, when the party balance in Washington may be very different than it is today. It is probably not a coincidence that the provisions of the Act expire in the year of a Presidential election and elections in both the Senate and House. In the meantime, however, for those who have been watching and wondering when the House and Senate would address the looming threat of EGTRRA sunset, you have your address, albeit for only two years.

For a discussion of planning opportunities in this tax environment, stay tuned for our upcoming JHAM Radio broadcast featuring Larry Brody with Randy Zipse. Meanwhile, to hear our other broadcasts, go to www.jhsalesnet.com and click on “Advanced Markets Group” then “JHAM Radio.”

Federal Individual Income Tax Rates for 2011

If taxable income is:	Then income tax equals:
Single Individuals	
Not over \$8,500	10% of the taxable income
Over \$8,500 but not over \$34,500	\$850 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$83,600	\$4,750 plus 25% of the excess over \$34,500
Over \$83,600 but not over \$174,400	\$17,025 plus 28% of the excess over \$83,600
Over \$174,400 but not over \$379,150	\$42,449 plus 33% of the excess over \$174,400
Over \$379,150	\$110,016.50 plus 35% of the excess over \$379,150
Heads of Households	
Not over \$12,150	10% of the taxable income
Over \$12,150 but not over \$46,250	\$1,215 plus 15% of the excess over \$12,150
Over \$46,250 but not over \$119,400	\$6,330 plus 25% of the excess over \$46,250
Over \$119,400 but not over \$193,350	\$24,617.50 plus 28% of the excess over \$119,350
Over \$193,350 but not over \$379,150	\$45,323.50 plus 33% of the excess over \$193,350
Over \$379,150	\$106,637.50 plus 35% of the excess over \$379,150
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over \$17,000	10% of the taxable income
Over \$17,000 but not over \$69,000	\$1,700 plus 15% of the excess over \$17,000
Over \$69,000 but not over \$139,350	\$9,500 plus 25% of the excess over \$69,000
Over \$139,350 but not over \$212,300	\$27,087.50 plus 28% of the excess over \$139,350
Over \$212,300 but not over \$379,150	\$47,513.50 plus 33% of the excess over \$212,300
Over \$379,150	\$102,574 plus 35% of the excess over \$379,150
Married Individuals Filing Separate Returns	
Not over \$8,500	10% of the taxable income
Over \$8,500 but not over \$34,500	\$850 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$69,675	\$4,750 plus 25% of the excess over \$34,500
Over \$69,675 but not over \$106,150	\$13,543.75 plus 28% of the excess over \$69,675
Over \$106,150 but not over \$189,575	\$23,756.75 plus 33% of the excess over \$106,150
Over \$189,575	\$51,287 plus 35% of the excess over \$189,575

Effective Date: The provision applies to taxable years beginning after December 31, 2010.

ONE YEAR LIBOR RATE
As of December 1, 2010: 0.79%

PRIME RATE
As of December 1, 2010: 3.25%

IRC SECTION 7520 RATE		
December	2010	1.8%
November	2010	2.0%
October	2010	2.0%

The §7520 rate is used to value GRITs, QPRTs, CRATs, CLUTs, CLATs, private annuities, life interest, remainder and reversionary interests. To value a charitable gift for income, gift, or estate tax charitable deduction purposes, use either the rate for the month of the actual gift/transfer or the rate from either of the two previous months (use the highest of the three months for the largest charitable deduction).

APPLICABLE FEDERAL RATES – NOVEMBER				
	Annual	Semi Annual	Quarterly	Monthly
Short-term AFRs – loans (3 years or less)	0.32%	0.32%	0.32%	0.32%
Mid-term AFRs – (More than 3 years up to and including 9 years)	1.53%	1.52%	1.52%	1.52%
Long-term AFRs – (More than 9 years)	3.53%	3.50%	3.48%	3.47%

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