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MARCH 2011

## NATURE ABHORS A VACUUM (AND WE HATE UNCERTAINTY)

Seventh grade science taught us that empty or unfilled spaces are unnatural as they go against the laws of nature and physics. Similarly, decision makers and their advisors abhor uncertainties as they complicate rationally choosing between alternatives – sometimes to the point of impossibility.

Whether good law or bad, the arrival of the new income and estate tax law late last December is welcomed by most of us for the certainty that it brings to near-term rules and rates of taxation. Decision makers and their advisors now know at least the basic tax rules for the next 22 months. A review of the 2011 and 2012 death tax and income tax provisions

of the law is included in the accompanying *Tax and Business Alert*. Uncertainty, however, continues to abound in longer-term planning as taxation is a major element in most decisions of businesses and investors, and in personal financial planning. Without tax rules and rates that apply for more than 22 months, decision makers will continue to be unnecessarily stressed and led to deferral of decisions and possibly to regrettable decisions.

We can now more confidently plan for taxable transactions through December 31 of next year. Tax rules and rates for January 1, 2013 and thereafter, however, remain, at least to us, unknowable.

## NOTE TO INDIVIDUAL INCOME TAX CLIENTS FILING YOUR 2010 LOUISIANA AND FEDERAL INCOME TAX RETURNS

As mentioned in previous newsletters, federal and Louisiana laws now require that we prepare individual income tax returns for electronic filing. Accordingly, we furnish paper “client copies” of the federal and Louisiana returns for your review. We also furnish a federal Form 8879, *IRS e-file Signature Authorization*, which, when signed (by both taxpayers in the case of joint returns) and returned to us, authorizes us to file both the federal and Louisiana returns as Louisiana

accepts the federal form as authorization to file the Louisiana return.

Because the additional step of the post-review transmittal to us of the signed Form 8879 will require additional time, we are trying to complete the preparation of all of our individual returns several days before the due date of the returns. We are asking our clients to please furnish their data as soon as is convenient. We also ask that they review

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their delivered returns as soon as possible and promptly return the signed filing authorization form to us. All taxpayers may, of course, defer mailing their payment of any tax due along with the payment voucher until the due date of the payment – that is, until April 18, 2011 for federal taxes due and May 16, 2011 for Louisiana taxes due.

**IRA and HSA Contributions.** If you are making an Individual Retirement Account

(IRA) or Health Savings Account (HSA) contribution for the year 2010 and have not already done so, you will need to make your deposits on or before April 18, 2011. This due date is applicable whether or not you obtain an extension to file your individual income tax return and applies to both Roth and traditional IRAs as well as to HSAs. Please let us know if you have any questions about your HSAs, IRAs, or other retirement accounts.

### HEALTH SAVINGS ACCOUNTS

By now, you probably know that we believe Health Savings Accounts (HSAs) can be of benefit to many of our readers. We have suggested consideration of HSAs in articles in our newsletters many times in the past. If you are or can become eligible for an HSA (they are not available to taxpayers enrolled in Medicare), you might want to consider creating one. If your company provides health insurance to its employees

(either at company expense or at the expense of the employees through a cafeteria plan or by payroll deduction), you might want to consider including HSA availability in your plan. We have used the website, [www.hsainsights.com](http://www.hsainsights.com), and believe that it is worth visiting.

We will be happy to discuss HSAs with you and to answer your questions.

### LESS PAPER?

Electronic data storage is becoming more and more prevalent and affordable. Many of us receive our bank statements in electronic format rather than on paper. Investment portfolio reports are likewise available in electronic format, alleviating the use of paper copies and some of the attendant problems of storage. And, as you might expect, we are storing more and more of our

firm's file information electronically rather than on paper. A spin-off benefit of electronic data storage is that we are easily able to provide you a copy of your income tax returns as a portable document format (PDF) file.

If you are interested in receiving an electronic copy of the returns that we prepare for you please let us know.

### DEADLINE FOR BEGINNING MINIMUM ANNUAL DISTRIBUTIONS FROM RETIREMENT PLANS AND IRAS

Participants in qualified retirement plans, tax-sheltered annuities, or IRAs (other than Roth IRAs) are generally required to withdraw minimum annual amounts from the plan by April 1 following the year in which they reach age 70½. This rule generally applies to all such tax-favored plans. Individuals who are still employed at age 70½

and are not five percent owners, however, are not required to begin receiving distributions from their employer's qualified plan until April 1 following the year in which they terminate employment. Distributions from IRA accounts must begin by April 1 following the year in which the account holder attains age 70½.

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## TTAX AND BBUSINESS Alert™

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The recent Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Act) includes many taxpayer-friendly provisions for individuals and businesses. Listed below is information on several of them.

**Lower Tax Rates.** The Act extends the 10%, 15%, 25%, 28%, 33%, and 35% federal income tax rates on ordinary income through 2012. It also extends the 0% and 15% federal income tax rates on most long-term capital gains and dividends through 2012. Without the new law, most long-term capital gains would have been taxed at 10% or 20%, and dividends would have been taxed at ordinary rates of up to 39.6%.

**Marriage Penalty Relief.** Getting married can cause a couple's combined federal income tax bill to be higher than if they were single. Tax reduction legislation in 2001 eased this marriage penalty by tweaking the lowest two tax brackets for married couples and giving them bigger standard deductions. The Act extends this relief through 2012.

**Social Security Tax Reduction.** The Act cuts the Social Security tax withholding rate on employee salaries from 6.2% to 4.2% for 2011.

## New Law Provides Tax Relief for Individuals and Businesses

This temporary change affects the first \$106,800 of 2011 wages. The maximum savings are \$2,136 for unmarried individuals and \$4,272 for couples.

The Social Security tax component of the self-employment tax is cut from 12.4% to 10.4% for 2011, so self-employed folks will benefit, too.

**Alternative Minimum Tax (AMT).** As you may know, it has become an annual ritual for Congress to "patch" the AMT rules to prevent millions of additional households from getting socked with this add-on tax. The patch primarily consists of allowing bigger AMT exemptions and allowing personal tax credits to offset the AMT. The Act provides an AMT patch for 2010 and 2011.



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The information contained in this newsletter was not intended or written to be used and cannot be used for the purpose of (1) avoiding tax-related penalties prescribed by the Internal Revenue Code or (2) promoting or marketing any tax-related matter addressed herein.

Alert

# New Estate and Gift Tax Rules

Estate tax legislation has been debated in Congress for several years. The recent Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Act) includes estate tax provisions for individuals who died in 2010, as well as those who die in 2011 and 2012. Here is a brief summary.



**\$5 Million Estate Tax Exemption and 35% Rate.** For estates of individuals who die in 2010 through 2012, the Act establishes a \$5 million federal estate tax exemption with the 2012 amount indexed for inflation. Big estates are taxed at 35% above the \$5 million threshold.

**Electing out of the Estate Tax in 2010.** For estates of decedents who died in 2010, executors are permitted to elect out of the estate tax rules (the default rules), and instead choose the modified carryover basis rules for property transferred at death. Although no estate tax will be due, assets transferred at death will not get the step-up in basis to date of death fair market value, and the transferees will owe income tax on the appreciation on those assets. Determining whether to follow the default rules or elect out of the estate tax will depend on many factors that will require professional guidance.

**Unused Estate Tax Exemption.** For the first time, married individuals who do not use up their estate tax exemptions will be able to pass along unused amounts to surviving spouses. In other words, unused exemptions of individuals

who die in 2011 or 2012 (but not 2010) will be “portable.”

**Unlimited Basis Step-ups for Inherited Assets.** For heirs of decedents who die in 2011 and beyond, the rule is reinstated that allows the federal income tax basis of inherited capital-gain assets (such as real estate and stock) to be stepped up to reflect fair market value on the date of death. This favorable rule is also reinstated for decedents who died in 2010, unless the estate elects to instead use the modified carryover basis rule. With the restoration of the unlimited basis step-up rule, heirs will not owe any federal capital gains taxes on appreciation that occurs through the date of death—as long as that date is after 2010 or, for decedents who died in 2010, if their estate does not elect to use the modified carryover basis rules.

**Estate and Gift Tax Exemptions and Rates Are Equalized.** The Act sets the lifetime federal gift tax exemption for 2011 and 2012 at \$5 million—with the 2012 amount indexed for inflation (likewise for the generation-skipping transfer tax exemption). Thus, the gift and estate tax exemptions are equalized for 2011 and 2012. This is a huge improvement over the previous \$1 million gift tax exemption (which continued to apply for 2010). An unmarried person can now give away up to \$5 million while alive without paying any gift tax, and a married couple can give away up to \$10 million. However, to the extent you dip into your gift tax exemption, your estate tax exemption is reduced dollar-for-dollar. The tax rate on 2011 and 2012 gifts in excess of the \$5 million exemption is 35%, the same as the estate tax rate. Again, due to sunset provisions, the gift tax exclusion reverts back to \$1 million after 2012.

Minimizing estate and gift taxes is a complex process. So, please contact us for information on how to reduce these onerous taxes.

## New Law Provides Tax Relief for Individuals and Businesses

(Continued from page 1.)

### American Opportunity Education Credit.

The American Opportunity credit can be worth up to \$2,500, be claimed for up to four years of undergraduate education, and is 40% refundable. It was scheduled to expire at the end of 2010. The Act extends this credit through 2012.

**College Tuition Deduction.** This write-off, which can be as much as \$4,000, or \$2,000 at higher income levels, expired at the end of 2009. The Act retroactively restores the deduction for 2010 and extends it through 2011.

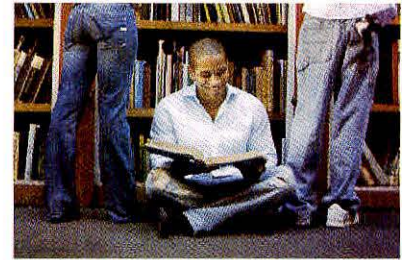
**More Generous Student Loan Interest Deduction.** This write-off, which can be as much as \$2,500 (whether you itemize or not), was scheduled to fall under less favorable rules in 2011 and beyond. The Act extends through 2012 the more favorable rules established by 2001 legislation.

**Education Savings Accounts (ESAs).** For 2011, the maximum contribution to federal-income-tax-free ESAs was scheduled to drop from \$2,000 to only \$500, and a stricter phase-out rule would have limited contributions by many married joint-filing couples. The Act extends through 2012 the more generous contribution rules established by 2001 legislation.

**State and Local Sales Taxes.** For the last few years, individuals who paid little or no state income taxes had the option of claiming an alternative itemized deduction for state and local general sales taxes. The sales tax deduction option expired at the end of 2009. The Act retroactively restores it for 2010 and extends it through 2011.

**Smaller Tax Credit for 2011 Energy-efficient Home Improvements.** The 2009 Stimulus Act provided that 30% of 2009 and 2010 expenditures for energy-efficient insulation, windows, doors, roofs, and heating and cooling equipment in U.S. residences could qualify for a credit, up to

a maximum credit amount of \$1,500, over the two years combined. The Act extends the credit through 2011, but the credit percentage is scaled back to only 10%, and the lifetime credit limit is only \$500. The \$500 credit cap is reduced by any credits claimed in 2006–2010.



### First-year Bonus Depreciation.

The Act generally allows 100% first-year bonus depreciation for qualifying new assets that are acquired and placed in service after September 8, 2010, through December 31, 2011. It also allows 50% first-year bonus depreciation for qualifying new assets that are placed in service in calendar year 2012. For a new passenger auto or light truck that is used for business and is subject to the luxury auto depreciation limitation, the bonus depreciation breaks increase the maximum first-year depreciation deduction by \$8,000 for vehicles acquired and placed in service by December 31, 2012.

**15-year Depreciation for Leasehold Improvements, Restaurant Property, and Retail Space Improvements.** The 15-year straight-line depreciation privilege for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail space improvements is retroactively restored for property placed in service in 2010 and extended to cover property placed in service in 2011. (Without the favorable 15-year depreciation rule, these assets would have to be depreciated straight-line over 39 years.)

**100% Gain Exclusion for Qualified Small Business Stock (QSBS).** The Small Business Jobs Act of 2010 (enacted last September) created temporary 100% gain exclusion (within limits) for sales of QSBS issued after September 27, 2010, through December 31, 2010. The Act extends the window for taking advantage of this change by one year to cover QSBS shares issued after September 27, 2010, through December 31, 2011.

# Taxpayer Advocate Reports to Congress

In her recent report to Congress, National Taxpayer Advocate Nina Olson identified the need for tax reform as the number one

priority in tax administration. The Advocate expressed continuing concern that the IRS's increasing use of hard-core enforcement actions,

particularly tax liens, is inflicting unnecessary harm on financially struggling taxpayers.

The report also examines challenges the IRS is facing in implementing the new health care law. The Taxpayer Advocate Service (TAS) is an independent organization within the IRS.

The report discusses why efforts at tax reform—which usually focus on eliminating tax breaks in exchange for lower rates—have not succeeded. “It is sometimes suggested that taxpayers are looking for a free lunch—that they want to see lower tax rates but keep their tax breaks and retain their government benefits, all while

balancing the budget,” Olson said. “But this perspective overlooks the fact that federal tax and spending policies are complex, and most people don't have the time to study these policies in detail. Our aim is to improve public knowledge of the trade-offs involved and to help policymakers and the taxpaying public conduct a more informed conversation about tax reform alternatives.”

The report attempts to improve awareness of the extent to which taxpayers benefit from tax breaks by discussing the subject in detail. The report attempts to improve awareness of the connection between taxation and spending by recommending that the government provide all taxpayers with a “taxpayer receipt” each year that presents a breakdown showing how their federal dollars are spent.

The National Taxpayer Advocate is launching a web page to solicit taxpayer suggestions regarding tax reform. “What would taxpayers be willing to give up if they knew that others are giving up their breaks and the end result would be a much simpler system?” Olson asked. “What particular provisions of the existing tax system are especially burdensome or seem particularly unfair?” Suggestions may be submitted at [www.TaxpayerAdvocate.irs.gov](http://www.TaxpayerAdvocate.irs.gov). The TAS will track suggestions and post results periodically.



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