President Obama Signs Bill on Tax Cut Extensions

12.17.2010 | Private Client Alert

President Obama has signed into law a $858 billion tax cut package that will extend for two years the tax cuts enacted under President Bush in 2001 and 2003. The bill passed in the Senate on Wednesday and was approved by the House late Thursday by a vote of 277 to 148.

Background

Known as the "Bush tax cuts," the tax cuts enacted by Congress in 2001 and 2003 lowered taxes comprehensively for earned income, long-term capital gains and dividends. Specifically, the tax cuts slashed rates to reflect the following schedule:

- Six tax rate brackets: 10%, 15%, 25%, 28%, 33% and 35%, based on income levels
- Maximum long-term capital gains: 15%
- Qualified dividends: 15%

However, in order to enable passage without a supermajority vote, Congress embedded "sunset provisions" within the laws, thereby allowing most of the tax cuts to expire at the end of 2010. If Congress had been unable to reach an agreement this year on extending the cuts, tax rates would have increased to pre-Bush levels at each income bracket.

Compromise Bill

President Obama and Congressional Republicans negotiated the terms of a compromise bill last weekend. After the bill passed in the Senate on Wednesday, the House of Representatives on Thursday passed the compromise measure that will extend the Bush-era tax cuts for two years at all income levels – including the wealthiest Americans. This measure is part of a larger package that also extended the period for which long-term unemployment benefits are available and reduced payroll taxes. The package also includes imposition of the estate tax at a flat rate of 35 percent and with an exemption of $5 million per person ($10 million for married couples) for the next two years. Having lapsed this year, the estate tax was set to return on January 1, 2011, with a maximum rate of 55 percent and an exemption of $1 million per person. The estates of 2010 decedents are allowed to accept a $5 million exemption and stepped-up basis at death, or elect instead to be exempt from estate tax and accept a modified carryover basis regime.

The gift tax will remain in effect for all years. The current (2010) rate of 35 percent will continue in 2011 and 2012. In addition, effective in 2011, the gift exemption will be "re-unified" with the estate tax exemption, and the full $5 million of exemption can be used for gifts. This unified exemption will be indexed for inflation beginning in 2012. The gift tax exemption for 2010 will remain at $1 million.

The generation-skipping transfer (GST) tax will be reinstated for 2010, but assigned a rate of 0 percent. This means that "direct skips" to grandchildren (in trust or outright) will be free of GST for all of 2010, as will "taxable distributions" and "taxable terminations" made in 2010 from non-exempt trusts. The new GST exemption will be $5 million and that exemption will be available for use in 2010 as well as 2011 and 2012. The relief provisions for errors made in GST exemption allocation will be extended through 2012 (they otherwise would have expired on December 31, 2010).

The entire bill will expire on December 31, 2012. If the law is allowed to terminate, both income tax and estate and gift tax rates will return to 2001 law (a 55% maximum estate and gift tax rate and a $1 million exemption).

Please let us know if we can be of any assistance with this development. To discuss such issues, you may contact any of our attorneys listed below.

Beth Shapiro Kaufman at 202-862-5062 or bkaufman@capdale.com
Michael G. Pfeifer

Caplin & Drysdale
Washington, D.C. Office: One Thomas Circle N.W., Suite 1100, Washington, D.C., USA 20005
PH: +1 202-862-5000 FX: +1 202-429-3301

New York Office: 375 Park Avenue, 35th Floor, New York, New York, USA 10152
PH: +1 212-319-7125 FX: +1 212-644-6755
www.caplindrysdale.com

Caplin & Drysdale provides a full range of tax and legal services to companies, organizations, and individuals throughout the United States and around the world. The firm also offers private client counseling, exempt organizations counseling, employee benefits counseling, corporate law counseling, political activity law counseling, white collar defense, and complex civil litigation services.

Attorneys

Beth Shapiro Kaufman
(202) 862-5062
bkaufman@capdale.com

Related Practices/Industries

Business, Investment & Transactional Tax

Private Client