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Highlights of Individual Tax Law Changes

Reduced capital gains and qualified dividends rate extended for two years.

Capital gain. For tax years beginning in 2010, for both regular tax and AMT purposes, the maximum rate of tax on the adjusted net capital gain of an individual is 15%. If the adjusted net capital gain would otherwise be taxed at a rate below 25% if it were ordinary income, it is taxed at a 0% rate. That part of net capital gain attributable to unrecaptured section 1250 gain (i.e., gain attributable to real estate depreciation) is taxed at a maximum rate of 25%. Net capital gain attributable to collectibles gain and section 1202 gain is taxed at a maximum rate of 28%.

Under pre-Act law, for tax years beginning after Dec. 31, 2010, the maximum rate of tax on an individual's adjusted net capital gain was to be 20%. Any adjusted net capital gain which otherwise would be taxed at the 15% rate was to be taxed at a 10% rate. In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10% capital gain rate would be taxed at an 8% rate. Any gain from the sale or exchange of property acquired after 2000 and held for more than five years, that would otherwise have been taxed at a 20% rate was to be taxed at an 18% rate. Net capital gain attributable to unrecaptured section 1250 gain was to continue to be taxed a maximum rate of 25%. Net capital gain attributable to collectibles gain and section 1202 gain was to continue to be taxed at a maximum rate of 28%.

Qualified dividend income. For tax years beginning in 2010, for both the regular tax and AMT purposes, an individual's qualified dividend income is taxed at the same rates that apply to net capital gain. Thus, an individual's qualified dividend income is taxed at a 15% and (for qualified dividend income which otherwise would be taxed at a 10% or 15% rate if the special rates did not apply) at a zero rate. The amount of a taxpayer's unrecaptured section 1250 gain taxed at a maximum 25% rate is limited to the taxpayer's net capital gain determined without regard to the taxpayer's qualified dividend income. (In addition, a taxpayer must hold stock for at least 61 days during the 121-day period beginning 60 days before the ex-dividend date in order for dividends on the stock to qualify as qualified dividend income.)

Under pre-Act law, for tax years beginning after Dec. 31, 2010, dividends received by an individual were to be taxed at ordinary income tax rates. The rules excluding qualified dividend income from net capital gain in computing unrecaptured section 1250 gain taxed at a 25% rate, and the holding period rule for determining when dividends on stock qualify as qualified dividend income were to expire for tax years beginning after Dec. 31, 2010.

New law. Under Sec. 102 of the 2010 Tax Relief Act, adjusted net capital gain will be taxed at a maximum rate of 0/15% for two additional years, through 2012. A qualified dividend paid to

individuals will be taxed at the same rates as adjusted net capital gain through 2012. In addition, the 2010 Tax Relief Act also extends for two years, through 2012, the rules excluding qualified dividend income from net capital gain in computing unrecaptured section 1250 gain taxed at a 25% rate; and the holding period rule for determining when dividends on stock qualify as qualified dividend income.

Temporary exclusion of 100% of gain on certain small business stock extended.

For 2010, a taxpayer may exclude all of the gain on the disposition of qualified small business stock acquired after Sep. 27, 2010 and before Jan. 1, 2011, and 75% of the gain from such stock acquired after Feb. 17, 2009 and before Sep. 28, 2010. Under pre-Act law, the exclusion was to be limited to 50% of gain for stock acquired after Dec. 31, 2010.

New law. The 2010 Tax Relief Act extends this provision for one year so that taxpayers may continue to exclude 100% of gain from the disposition of qualified small business stock acquired before Jan. 1, 2012.

Above-the-line deduction for higher education expenses reinstated and extended.

A taxpayer may claim an above-the-line deduction for qualified tuition and related expenses for higher education paid by that taxpayer during the tax year, subject to applicable adjusted gross income (AGI) and dollar limits. Under pre-Act law, this deduction wasn't available for tax years beginning after Dec. 31, 2009.

New law. The 2010 Tax Relief Act retroactively extends the qualified tuition deduction for two years so that it can be claimed for tax years beginning before Jan. 1, 2012.

Numerous education incentives extended two years.

American opportunity tax credit. For tax years beginning in 2010, individuals may claim an American opportunity tax credit (AOTC) under Code Sec. 25A equal to 100% of up to \$2,000 of qualified higher-education tuition and related expenses (including course materials), plus 25% of the next \$2,000 of expenses paid for education furnished to an eligible student in an academic period—i.e., a maximum credit of \$2,500 a year for each eligible student. For 2010, the availability of the credit phases out ratably for taxpayers with modified AGI of \$80,000 to \$90,000 (\$160,000 to \$180,000 for joint filers). The AOTC (which expanded the credit available under the Hope Scholarship Credit) is allowed for each of the first four years of the student's post-secondary education in a degree or certificate program. The credit can be claimed against AMT liability; and 40% of the otherwise allowable AOTC is refundable (unless the taxpayer claiming the credit is a child under age 18 or a child under age 24 who is a student providing less than one-half of his support, who has at least one living parent, and doesn't file a joint return).

Under pre-Act law, for tax years beginning after Dec. 31, 2010, instead of the AOTC an individual was to be able to claim a Hope credit equal to 100% of the first \$1,200 (as inflation adjusted) of qualified higher-education tuition and related expenses (not including course material), plus 50% of the next \$1,200 (as inflation-adjusted) of expenses paid for education furnished to an eligible student in an academic period—i.e., a total maximum Hope credit of \$1,800. For each eligible student, the Hope credit would be allowed only for expenses paid for the first two years of the post-secondary education, and it was to phase out ratably for taxpayers with lower specified (inflation adjusted) modified AGI.

Exclusion for scholarships. For 2010, a qualified individual can exclude from income a qualified scholarship or qualified tuition reductions under Code Sec. 117 . These exclusions generally do not apply to any amounts received by a student that are payment for teaching, research, or other services as a condition for receiving the scholarship or tuition reduction.

Under pre-Act law, for tax years beginning after Dec. 31, 2010, an exception to the no payment for teaching, research, or other services rule for the National Health Service Corps (NHSC) Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (Armed Forces Scholarship Program) was to no longer apply.

Employer-provided educational assistance. For 2010, an employee may exclude educational assistance provided under an employer's qualified educational assistance program, up to an annual maximum of \$5,250 under Code Sec. 127 . The education received need not be job-related.

Under pre-Act law, for tax years beginning after Dec. 31, 2010, the specific exclusion for employer-provided educational assistance was to no longer to apply, so that educational assistance would be excludable from gross income only if it qualifies as a working condition fringe benefit (i.e., the expenses would have been deductible as business expenses if paid by the employee; such expense must be related to the employee's current job).

Above-the-line student loan interest deduction. Individuals can deduct a maximum of \$2,500 annually for interest paid on qualified higher education loans under Code Sec. 221 . For 2010, the deduction phases out ratably for taxpayers with modified AGI between \$60,000 and \$75,000 (\$120,000 and \$150,000 for joint returns).

Under pre-Act law, for tax years beginning after Dec. 31, 2010, the phaseout ranges were to revert to a base level of \$40,000 to \$55,000 (\$60,000 to \$75,000 for joint returns), adjusted for inflation occurring since 2002. In addition, the interest was not to be deductible beyond the first 60 months that interest payments are required.

Coverdell education savings accounts. Taxpayers can contribute up to \$2,000 per year to Coverdell Education Savings Accounts (CESAs) for beneficiaries under age 18 (and, special needs beneficiaries of any age). The account is exempt from income tax, and distributions of earnings from CESAs are tax-free if used for qualified education expenses. The contribution limit is phased out for contributors with modified AGI between \$95,000 and \$110,000 (\$190,000 and \$220,000 for joint returns).

Under pre-Act law, for tax years beginning after Dec. 31, 2010, the following were to apply: a \$500 contribution limit; a phaseout range of \$150,000 - \$160,000 for joint returns; elementary and secondary education expenses excluded from qualified expenses; and no special age rules for special needs beneficiaries. In addition, provisions covering the following

were to expire: clarification that corporations and other entities were permitted to make contributions, regardless of the income of the corporation or entity during the year of the contribution; certain rules on when contributions were deemed made and extending the time during which excess contributions could be returned without additional tax; certain rules on coordination with the Hope and Lifetime Learning credits; and certain rules on coordination with qualified tuition programs.

New law. Under the 2010 Tax Relief Act, the AOTC, the NHSC Scholarship Program and the Armed Forces Scholarship Program exception, the exclusion for employer-provided educational assistance, the student loan interest deduction, and Coverdell education savings accounts rules are extended for two years, through 2012.

Above-the-line deduction for educator expenses reinstated and extended.

Eligible elementary and secondary school teachers may claim an above-the-line deduction for up to \$250 per year of expenses paid or incurred for books, certain supplies, computer and other equipment, and supplementary materials used in the classroom. Under pre-Act law, the educator expense deduction didn't apply for tax years beginning after 2009.

New law. The 2010 Tax Relief Act retroactively extends the educator expense deduction for two years so that it applies to expenses paid or incurred in tax years 2010 and 2011.

State and local sales tax deduction reinstated and extended.

Taxpayers may elect to deduct state and local general sales and use taxes instead of state and local income taxes. Under pre-Act law, this deduction was unavailable for tax years beginning after 2009.

New law. The 2010 Tax Relief Act retroactively extends this provision for two years so that taxpayers can elect to deduct state and local sales and use taxes for tax years beginning before Jan. 1, 2012.

Nontaxable IRA transfers to eligible charities reinstated and extended.

Taxpayers who are age 70½ or older can make tax-free distributions to a charity from an Individual Retirement Account (IRA) of up to \$100,000. These distributions aren't subject to the charitable contribution percentage limits since they are neither included in gross income nor claimed as a deduction on the taxpayer's return. Under pre-Act law, these rules didn't apply to tax years beginning after Dec. 31, 2009.

New law. The 2010 Tax Relief Act retroactively extends this provision for two years so that it's available for charitable IRA transfers made in tax years beginning before Jan. 1, 2012. In addition, a taxpayer can elect for such a distribution made in January of 2011 to be treated as if it were made on Dec. 31, 2010. (Act Sec. 725(b)) Thus, a qualified charitable distribution

made in Jan. 2011 is allowed to be (1) treated as made in the taxpayer's 2010 tax year and thus so allowed to count against the 2010 \$100,000 limitation on the exclusion, and (2) treated as made in the 2010 calendar year and so allowed to be used to satisfy the taxpayer's minimum distribution requirement for 2010.

New energy efficient home credit reinstated and extended two years.

An eligible contractor can claim a credit of \$2,000 or \$1,000 for each qualified new energy efficient home either constructed by the contractor or acquired by a person from the contractor for use as a residence during the tax year. Under pre-Act law, the new energy efficient home credit didn't apply to homes acquired after Dec. 31, 2009.

New law. The 2010 Tax Relief Act retroactively extends the new energy efficient home credit two years to homes acquired through Dec. 31, 2011.

Nonbusiness energy property credit extended for one year.

A taxpayer could claim a nonrefundable personal income tax credit, known as the nonbusiness energy property credit, for certain energy efficient property installed in a dwelling located in the U.S. and owned and used by the taxpayer as the taxpayer's principal residence.

Under changes made by the American Recovery and Reinvestment Act of 2009 (ARRA), for property placed in service in 2009 and 2010, the credit is equal to 30% of the sum of:

(1) the amount paid or incurred by the taxpayer during the tax year for qualified energy efficiency improvements (building envelope components meeting certain requirements) installed during the tax year, and

(2) the amount of residential energy property expenditures paid or incurred by the taxpayer during the tax year for the purchase of (a) advanced main air circulating fans, (b) qualified natural gas, propane, or oil furnace or hot water boilers, and (c) energy-efficient building property.

The aggregate credit is \$1,500 for both years together.

Under pre-Act law, the credit wasn't available for property placed in service after Dec. 31, 2010.

New law. The 2010 Tax Relief Act extends the nonbusiness energy property credit for one year, through Dec. 31, 2011, at pre-American Recovery and Reinvestment Act (ARRA) limitations, so that a taxpayer can claim a 10% credit for qualified energy property placed in service in 2011 up to a \$500 lifetime limit (with no more than \$200 from windows and skylights) over the aggregate of the credits allowed to the taxpayer for all earlier tax years ending after Dec. 31, 2005. The credit is equal to the sum of: (1) 10% of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during the tax

year, and (2) the amount of the residential energy property expenditures paid or incurred by the taxpayer during the tax year. (, as amended by Act Sec. 710) The credit for residential energy property expenditures can't exceed: (i) \$50 for an advanced main circulating fan; (ii) \$150 for any qualified natural gas, propane, or hot water boiler; and (iii) \$300 for any item of energy-efficient property.

Exterior windows, skylights, and exterior doors can qualify for the credit by meeting the Energy Star program requirements; are no longer required to meet the prescriptive criteria established by the IECC; and no longer required to have a U factor and SHGC of 0.30 or below. Efficiency standards for furnaces, boilers, and stoves are tightened.

The pre-Act rule that denies the credit for expenditures made from subsidized energy financing is reinstated.