# Updates to the U.S. Master Tax Guide 2011

## Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312)

*Overview*

### ¶1. Tax Legislation.

**2010 Tax Legislation**. *Extension of individual/business incentives.* Before the scheduled sunset of numerous individual and business incentives, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). The legislation extends the lower marginal individual income tax rates, marriage penalty relief, lower capital gains tax rates, as well as other tax benefits put into place pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (P.L. 107-16). It also provides for an alternative minimum tax (AMT) "patch", a one-year payroll tax cut, 100 percent bonus depreciation through 2011, and extends through 2011 a number of expiring tax provisions. President Obama signed the bill into law on December 17, 2010.

The following provisions in the Tax Relief Act are highlighted below:

- The lower income tax rates applicable to individuals, estates and trusts are extended to apply to tax years beginning in 2011 and 2012. Thus, the tax rates will be 10, 15, 25, 28, 33 and 35 percent (see ¶128).
- The 15-percent tax bracket for married taxpayers filing joint returns (and surviving spouses) remains twice the corresponding rate bracket for single taxpayers for tax years 2011 and 2012 (see ¶128).
- The standard deduction amounts for married taxpayers filing joint returns (and surviving spouses) remains twice the amount allowed for single taxpayers and married taxpayers filing separate returns for tax years 2011 and 2012 (see ¶126).
- The repeal of the limitation on the amount of allowable itemized deductions for higher-income individuals is extended for two years. As a result, the itemized deduction phaseout for taxpayers with adjusted gross income in excess of the applicable thresholds will not apply to tax years beginning in 2011 and 2012 (see ¶1014).
- The repeal of the phaseout of personal exemptions for higher-income taxpayers is extended through December 31, 2012 (see ¶133).
- The election to claim an itemized deduction for State and local general sales taxes in lieu of State and local income taxes is extended and may be claimed for tax years beginning in 2010 and 2011 (see ¶1021).
- The child tax credit is $1,000 per qualifying child for 2011 and 2012 (see ¶1305).

- The above-the-line deduction for eligible educator expenses has been extended two years and is available for tax year beginning in 2010 and 2011 (see ¶1084).
- An employee's annual exclusion of up to $5,250 in employer-provided educational assistance is extended through December 31, 2012 (see ¶2192D).
- The modifications to the earned income credit are extended for two years through December 31, 2012. The phaseout rule is applied by multiplying the phaseout percentage by a taxpayer's adjusted gross income and the earned income credit will not be reduced by the taxpayer's alternative minimum tax liability (see ¶1322).
- The above-the-line deduction for qualified tuition and related expenses is extended through December 31, 2011 (see ¶1082).
- The alternative minimum tax (AMT) exemption amount for individuals have been increased for tax years beginning in 2010 and 2011. For 2010, the amounts are: $72,450 for married individuals filing a joint return and surviving spouses; $47,450 for unmarried individuals; and $36,225 for married individuals filing separate returns (see ¶1405).
- The reduced capital gains rates for noncorporate taxpayers have been extended for two years and will apply to the 2011 and 2012 tax years. The maximum rate will be 15 percent (zero percent for taxpayers in the 10-percent or 15-percent income tax bracket) (see ¶1736).
- The taxation of qualified dividends received by individuals, trusts and estates at capital gains rates is extended for two years through December 31, 2012 (see ¶733).
- The federal estate and generation-skipping transfer taxes are reinstated and will apply to estates of decedents dying and generation-skipping transfers made after December 31, 2009, and before January 1, 2013. The estate tax applicable exclusion and GST exemption amount is $5 million for 2010 through 2012 (see ¶2901).

*Tax Rates*

## ¶11. Single Individuals

| | ***2011*** | |
|---|---|---|
| $0 - $8,500 | $0 + 10% | $0 |
| 8,500 – 34,500 | 850.00 + 15% | 8,500 |
| 34,500 – 83,600 | 4,750.00 + 25% | 34,500 |
| 83,600 – 174,400 | 17,025.00 + 28% | 83,600 |
| 174,400 – 379,150 | 42,449.00 + 33% | 174,400 |
| 379,150 - | 110,016.50 + 35% | 379,150 |

## ¶13. Married Filing Jointly and Surviving Spouses

*2011*

| | | |
|---|---|---|
| $0 - $17,000 | $0 + 10% | $0 |
| 17,000 – 69,000 | 1,700.00 + 15% | 17,000 |
| 69,000 – 139,350 | 9,500.00 + 25% | 69,000 |
| 139,350 – 212,300 | 27,087.50 + 28% | 139,350 |
| 212,300 – 379,150 | 47,513.50 + 33% | 212,300 |
| 379,150 - | 102,574.00 + 35% | 379,150 |

## ¶15. Married Individuals Filing Separately

*2011*

| | | |
|---|---|---|
| $0 - $8,500 | $0 + 10% | $0 |
| 8,500 – 34,500 | 850.00 + 15% | 8,500 |
| 34,500 – 69,675 | 4,750.00 + 25% | 34,500 |
| 69,675 – 106,150 | 13,543.75 + 28% | 69,675 |
| 106,150 – 189,575 | 23,756.75 + 33% | 106,150 |
| 189,575 - | 51,287.00 + 35% | 189,575 |

## ¶17. Head of Households

*2011*

| | | |
|---|---|---|
| $0 – $12,150 | $0 + 10% | $0 |
| 12,150 – 46,250 | 1,215.00 + 15% | 12,150 |
| 46,250 – 119,400 | 6,330.00 + 25% | 46,250 |
| 119,400 – 193,350 | 24,617.50 + 28% | 119,400 |
| 193,350 – 379,150 | 45,323.50 + 33% | 193,350 |
| 379,150 - | 106,637.50 + 35% | 379,150 |

## ¶19. Estates and Nongrantor Trusts

*2011*

| | | |
|---|---|---|
| $0 - $2,300 | $0 + 15% | $0 |
| 2,300 – 5,450 | 345.00 + 25% | 2,300 |
| 5,450 – 8,300 | 1,132.50 + 28% | 5,450 |
| 8,300 – 11,350 | 1,930.50 + 33% | 8,300 |
| 11,350 - | 2,937.00 + 35% | 11,350 |

## *Chapter 1: Individuals*

### ¶47. Self Employment Taxes.

For calendar year 2010, a tax of 15.3% is imposed on net earnings from self-employment. The rate consists of a 12.4% component for old-age, survivors, and disability insurance (OASDI) and a 2.9% component for hospital insurance (HI or Medicare). For calendar year 2011, a tax of 13.3% is imposed on net earnings from self-employment (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The rate consists of a 10.4% component for OASDI and a 2.9% component for Medicare. For both calendar years, the OASDI rate applies only to net earnings from self-employment up to the OASDI wage base, which is $106,800 in 2010 and 2011. All net earnings from self-employment are subject to the Medicare rate in both years.

### ¶49. Social Security Taxes.

*Social Security, Hospital Insurance.* For calendar year 2010, a tax rate of 7.65% (6.2% for OASDI and 1.45% for Medicare) is imposed on both employer and employee. For calendar year 2011, a tax rate of 5.65% (4.2% for OASDI and 1.45% for Medicare) is imposed on an employee (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). For calendar year 2011, a tax rate 7.65% (6.2% for OASDI and 1.45% for Medicare) is imposed on an employer. For both calendar years, the OASDI rate applies only to wages paid up to the OASDI wage base, which is $106,800 in 2010 and 2011. All wages are subject to the Medicare rate in both years.

*Railroad Retirement Tax.* For calendar year 2010, a tier I tax rate of 7.65% (6.2% for OASDI and 1.45% for Medicare) is imposed on both employer and employee. For calendar year 2011, a tier I tax rate of 5.65% (4.2% for OASDI and 1.45% for Medicare) is imposed on an employee (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). For calendar year 2011, a tier I tax rate 7.65% (6.2% for OASDI and 1.45% for Medicare) is imposed on an employer. For both calendar years, the OASDI rate applies only to wages paid up to the OASDI wage base, which is $106,800 in 2010 and 2011. All wages are subject to the Medicare rate in both years. For calendar years 2010 and 2011, a tier II tax rate of 12.1% for employers and 3.9% for employees is imposed on annual compensation within a compensation base $79,200.

### ¶53. Excise Taxes.

The excise taxes on aviation gasoline, domestic passenger tickets, Alaska and Hawaii tickets, international passenger tickets and air freight waybills have been extended to March 31, 2011.

## *Chapter 1: Individuals*

### ¶126. Standard Deduction.

***Comment:*** The standard deduction amount for married taxpayers filing jointly (and surviving spouses) will be twice the amount (200 percent) of the inflation-adjusted standard deduction amount of a single filer for the 2011 and 2012 tax years. Similarly, the standard deduction amount for a married taxpayer filing separately will be equal to the standard deduction amount for single taxpayers in 2011 and 2012 (Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶128. Tax Rates and Tables for Individuals.

***Comment:*** For 2011 and 2012, the six tax rates applicable to individuals are 10, 15, 25, 28, 33 and 35 percent. The upper limit of the 15-percent tax bracket for joint filers will remain at 200 percent of the upper limit of the 15-percent tax bracket for single filers. Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).

### ¶133. Exemption Amount.

***Comment:*** The elimination of the phaseout of personal exemptions for high-income taxpayers, originally slated to end after 2010, has been extended through 2012 (Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). Thus, the personal exemption deduction for high-income taxpayers will be reduced or even eliminated for certain high income taxpayers beginning in 2013.

### ¶156. Joint v. Separate Return.

***Comment:*** For 2011 and 2012, the upper limit of the 15-percent tax bracket for joint filers will be 200 percent of the upper limit of the 15-percent tax bracket for single filers. Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).

***Comment:*** The standard deduction amount for married taxpayers filing jointly (and surviving spouses) will be twice the amount (200 percent) of the inflation-adjusted standard deduction amount of a single filer for the 2011 and 2012 tax years. Similarly, the standard deduction amount for a married taxpayer filing separately will be equal to the standard deduction amount for single taxpayers in 2011 and 2012. Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## *Chapter 2: Corporations*

### ¶251. Rate and Nature of Tax.

***Comment:*** The 15-percent accumulated earnings tax rate is extended for two years and applies to tax years beginning on or before December 31, 2012 (Act Secs. 101(a) and 102(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶275. Tax on Personal Holding Companies.

***Comment:*** The 15-percent rate on personal holding companies is extended for two years and applies to tax years beginning on or before December 31, 2012 (Act Secs. 101(a) and 102(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## *Chapter 3: S Corporations*

### ¶317. Adjustment to Shareholder's Stock Basis.

*Charitable deductions.* For tax years beginning in 2006 through 2011, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property ( Code Sec. 1367(a)(2), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## *Chapter 5. Trusts — Estates*

### ¶505. Trustees in Bankruptcy of Individual Debtors.

Delete **Comment** at the end of the section.

### ¶510. Return of Estate or Trust by Fiduciary.

Delete **Comment** and replace with the following:

*Special Information Return for Certain Estates of 2010 Decedents.* The executor of the estate of a decedent who died in 2010 can elect to apply the Internal Revenue Code as if the federal estate tax had not been reinstated for 2010 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). *If the executor makes this election,* the estate tax does not apply to that decedent's estate, and modified carryover basis rules apply to assets transferred by the estate to heirs (see ¶2901 and ¶2946). Accordingly, the executor making such election must file an information return with the IRS, generally due with the decedent's last income tax return (see ¶180), for transfers involving (1) property acquired from a decedent with a fair market value over $1.3 million; or (2) appreciated property acquired from a decedent that the decedent had acquired for less than adequate consideration within the three years ending on the date of death and for which a gift tax return was required to be filed. The executor must also provide property recipients with similar statements regarding the transferred property (Code Sec. 6018(b), (c) and (e); Code Sec. 6075(a); Act Sec. 301 of P.L. 111-312).

### ¶524. Sale of Property by Estate or Trust.

Delete **Comment** and replace with the following:

For estates of decedents dying in 2010, if the executor elects *not* to have the federal estate tax apply to the estate (see ¶2901), then the decedent's estate, a qualified revocable trust (¶516), or an heir may be able to exclude from gross income the gain on the sale of the decedent's personal residence (Code Sec. 121(d)(11); Act Sec. 301 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). See ¶1705 for general discussion of the personal residence gain exclusion. This exclusion is not available for estates of decedents dying in 2010 where the executor does not make the special election, or for estates of decedents dying after December 31, 2010.

### ¶526. Gain on Transfer to Beneficiary.

Delete **Comment** and replace the first text paragraph with the following:

Generally, gain or loss is realized by an estate or trust, or by the other beneficiaries, by reason of a distribution of property in kind if the distribution satisfies a beneficiary's right to receive a specific dollar amount, specific property other than that which is distributed, or other income if the income is required to be distributed currently (Reg. §1.661(a)-2(f)). A special rule generally limits gain on transfers to qualified heirs of property for which a special use valuation election under Code Sec. 2032A was made (see ¶2922). However, for estates of decedents dying in 2010 for which the executor elects *not* to have the federal estate tax apply to the estate (see ¶2901), this rule limits gain on exchanges that satisfy pecuniary bequests with appreciated property (Code Sec. 1040; Act Sec. 301 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶529. Expenses.

Delete **Comment** at the end of the section.

### ¶533. Interest.

Delete **Comment** at the end of the section.

### ¶534. Exemption.

Delete **Comment** and replace the first text paragraph with the following:

An estate can claim a personal exemption of $600. A "simple" trust ( ¶542)—one that is required to distribute all of its income currently—is allowed an exemption of $300. All other trusts ("complex" trusts) are entitled to a $100 exemption (Code Sec. 642(b); Reg. §1.642(b)-1). A "qualified disability trust," whether taxed as a simple or complex trust, can claim an exemption in the amount that a single individual taxpayer can claim ($3,650 for 2010; $3,700 for 2011) (Code Sec. 642(b)(2)(C)). The exemption amount is generally subject to phase-out, but *not* in 2010, 2011 or 2012 (see ¶133). If a final distribution of assets has been made during the year, all income of the estate or trust must be reported as distributed to the beneficiaries, without reduction for the amount claimed for the exemption (see ¶543).

## *Chapter 6: Exempt Organization*

### ¶673. Dividends, Interest, Annuities and Royalties (Investment Income).

The application of special rules that permit the exclusion of certain qualifying payments by a controlled entity to a tax-exempt organization from that tax-exempt organization's unrelated business income is extended through December 31, 2011 (Code Sec. 512(b)(13)(E)(iv), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## *Chapter 7: Income*

### ¶706. Unearned Income of Minor Child.

Net unearned income of a child is the portion of adjusted gross income for the year that is not attributable to earned income, reduced by $950 in 2010 and 2011, and by either (1) the standard deduction amount, which is $950 for 2010 and 2011, or (2) the child's itemized deductions relating to the production of the unearned income (Rev. Proc. 2009-50; Rev. Proc. 2010-40; Rev. Proc. 2011-12).

In 2010 and 2011, the combination of the $950 standard deduction for a child without earned income and the $950 used to calculate the net unearned income reported on the kiddie tax return usually shields $1,900 of a child's unearned income from taxation at the parents' rate. These amounts are adjusted annually for inflation.

The marginal tax rate of the parent with the greater amount of taxable income applies in the case of married individuals filing separately. In the case of divorced parents, the custodial parent's taxable income is taken into account in determining the child's tax liability.

The parent of a child with unearned income subject to the kiddie tax may elect to include the interest and dividend income in excess of $1,900 in his or her gross income for the 2010 or 2011 tax year by filing Form 8814. See ¶103 for the filing requirements of Form 8814.

## ¶729. Private Activity Bonds.

Specific tax-exempt private activity bonds, called Gulf Opportunity Zone bonds or GO Zone bonds, may be authorized through 2011 for the purpose of financing construction or repair of real estate and infrastructure in the Gulf Opportunity Zone (Code Sec. 1400N(a), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The amount of GO Zone bonds that can be issued is in addition to the amount of qualified private activity bonds that are otherwise authorized under the volume cap of the relevant state. These bonds can be issued by Alabama, Louisiana, Mississippi, or any political subdivision of those states, and must meet the relevant state law bond issue requirements. GO Zone bonds can be issued after December 21, 2005 and prior to January 1, 2012. GO Zone bonds can be treated as exempt facility bonds or as qualified mortgage bonds. A GO Zone repair or reconstruction loan will be treated as a qualified rehabilitation loan for purposes of the qualified mortgage bond rules (Code Sec. 1400N(a)(7)). Moreover, bonds of this type may be issued for any Midwestern disaster area, meaning parts of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota,

Missouri, Nebraska, and Wisconsin in which storms, tornadoes, or flooding resulted in a federal declaration of major disaster (Heartland Disaster Tax Relief Act of 2008 (P.L 110-343), §702, Division C). These bonds are known as qualified Midwestern disaster area bonds, and may be issued prior to January 1, 2013.

## ¶733. Dividends.

Generally, dividends are taxed as ordinary income. However, qualified dividend income received by an individual between January 1, 2003, and December 31, 2012, is taxed at rates lower than those applicable to ordinary income (Code Sec. 1(h)(11), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). "Qualified dividend income" is defined as dividends received during the tax year from (1) a domestic corporation or (2) a qualified foreign corporation (Code Sec. 1(h)(11)(B)).

Qualified dividends paid to shareholders by a domestic corporation or a qualified foreign corporation between January 1, 2003, and December 31, 2012, are taxed at capital gains rates (Code Sec. 1(h)(11), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). From 2003 through 2007, capital gains rates were 5 percent for taxpayers in the 10- or 15-percent brackets and 15 percent for those in the higher tax brackets. For 2008 through 2012, capital gains rates are zero percent for taxpayers in the 10- or 15-percent brackets and 15 percent for those in the higher tax brackets. See ¶1736 for discussion of capital gains rates.

### ¶745. Redemption of Stock to Pay Estate Taxes and Expenses.

***Comment:*** The federal estate tax has been reinstated for decedents dying after December 31, 2009, and before January 1, 2013, but with a higher estate tax applicable exclusion amount of $5 million and lower tax rate of 35 percent (Act Sec. 301 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). However, the executor of an estate of a decedent dying in 2010 may elect to not have the federal estate tax apply, but instead have the modified carryover basis rules apply. For discussion of the estate tax, see ¶2901 and following sections.

### ¶799. Tax Treatment of Recoveries.

For situations in which a high-income individual's itemized deductions are reduced by the smaller of three percent of AGI in excess of the threshold phaseout amount or 80 percent of allowable deductions (no phaseout applies in 2010, 2011 or 2012; see ¶1014), and, later, all or a portion of the previously deducted amount is recovered, the amount includible in income in the year of receipt is the difference between (1) the amount of the prior year's itemized deductions (after reduction) and (2) the deductions that would have been claimed (the greater of (a) itemized deductions (after reduction) or (b) the standard deduction) had the individual paid the proper amount in the prior year and not received a recovery or refund in a subsequent year (Rev. Rul. 93-75).

Delete both **Comments** in ¶799.

## *Chapter 8: Exclusions from Income*

### ¶898. Coverdell Education Savings Accounts.

***Comment:*** The maximum contribution limit of $2,000 for Coverdell education savings accounts has been extended to tax years beginning in 2011 and 2012 (Act Secs. 101(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). In addition, qualified education expenses will continue to include expenses incurred while the beneficiary is in attendance or enrolled at an elementary or secondary school (i.e., kindergarten through grade 12, as defined by state law) for tax years beginning in 2011 and 2012.

***Comment:*** The federal estate and generation-skipping transfer taxes have been reinstated for decedents dying after December 31, 2009, and before January 1, 2013, but with a higher applicable exclusion amount of $5 million and lower tax rate of 35 percent (Act Sec. 301 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). However, the executor of an estate of a decedent dying in 2010 may elect to not have the federal estate tax apply, but instead have the modified carryover basis rules apply. The gift tax will continue to apply in 2010 with a maximum tax rate of 35 percent, but with an applicable exclusion amount of $5 million for gifts made in 2011 and 2012. See ¶2901 for a discussion of the estate, gift, and generation-skipping transfer taxes.

### ¶899. Qualified Tuition Programs.

***Comment:*** The federal estate and generation-skipping transfer taxes have been reinstated for decedents dying after December 31, 2009, and before January 1, 2013, but with a higher applicable exclusion amount of $5 million and lower tax rate of 35 percent (Act Sec. 301 of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). However, the executor of an estate of a decedent dying in 2010 may elect to not have the federal estate tax apply, but instead have the modified carryover basis rules apply. The gift tax will continue to apply in 2010 with a maximum tax rate of 35 percent, but with an applicable exclusion amount of $5 million for gifts made in 2011 and 2012. See ¶2901 for a discussion of the estate, gift, and generation-skipping transfer taxes.

## *Chapter 9: Business Expenses*

### ¶923. Five-Year Carryover for Corporations.

***Comment:*** For 2011, the rate of the old age, survivors and disability insurance (OASDI) tax on self-employment income is reduced by two percent, to 10.4 percent. See ¶47. This rate reduction is not taken into account in computing the self-employment income deduction. Thus, the deduction for 2011 remains at 7.65 percent of self-employment income. For any tax year that begins in 2011, the self-employment tax liability deduction under Code Sec. 164(f) equals the sum of 59.6 percent of the applicable OASDI taxes, plus 50 percent of the applicable Medicare taxes (Act Sec. 601(b)(2) of Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶927 Corporate Limits

*Conservation contribution.* Individuals can take an immediate deduction for the donation of conservation property up to 50 percent of their "contribution base." Corporate donors that qualified as farmers or ranchers were permitted to deduct up to 100 percent of their contribution base (adjusted gross income computed without regard to any net operating loss carryback) for qualified conservation contributions of capital gain real estate made in 2006, 2007, 2008, 2009, 2010 and 2011 (Code Sec. 170(b)(2)(B), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶930. Contributions of Inventory or Scientific Property.

Inventory-Type Property. C corporations can claim an enhanced deduction for donations of book inventories to public schools made through December 31, 2011 (Code Sec. 170(e)(3)(D), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). This provision essentially takes the present-law enhanced deduction for donations of inventory to a qualified charity or private operating foundation and extends it to qualified donations of book inventory to public schools. The enhanced deduction generally increases the deductible amount from the donated inventory item's basis to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation or (2) two times the donated inventory item's basis.

*Computer Equipment.* A C corporation is entitled to an enhanced deduction for a charitable contribution of computer technology or equipment to an elementary or secondary school or public library. The amount of the deduction is equal to the taxpayer's basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. The deduction can not exceed twice the taxpayer's basis in the donated property. The contribution must be made within three years of the property's acquisition or substantial completion of its construction or assembly, and the original use of the property must have been by the donor or the donee (Code Sec. 170(e)(6). The enhanced charitable deduction for contributions of computer technology and/or equipment to schools or public libraries does not apply to contributions made during any tax year beginning after December 31, 2011 (Code Sec. 170(e)(6)(G) as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶930A. Contributions of Food.

Corporate, as well as noncorporate, taxpayers are entitled to an enhanced deduction for charitable donations of food inventory through December 31, 2011 (Code Sec. 170(e)(3)(C)(iv), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The food inventory has to consist of items fit for human consumption and has to be contributed to a qualified charity or private operating foundation for use in the care of the ill, the needy or infants. The enhanced deduction is not available after December 31, 2011, and charitable donations of food after that date are subject to the 10 percent of taxable income limitation (¶927).

### ¶941C. School Teachers.

Generally, a taxpayer may deduct ordinary and necessary business expenses paid during the tax year. However, unreimbursed employee business expenses of an individual are only deductible as miscellaneous itemized deductions to the extent they exceed two percent of the taxpayer's adjusted gross income (AGI). For tax years beginning in 2002 through 2011, eligible educators are allowed to deduct up to $250 for qualified expenses paid or incurred during the year, rather than as a miscellaneous itemized deduction (Code Sec. 62(a)(2)(D)). See ¶1084.

### ¶977. Environmental Clean-Up Costs.

Prior to January 1, 2012, taxpayers could elect to currently deduct certain environmental cleanup costs in the year in which they occurred, rather than to treat them as capital expenditures (Code Sec. 198, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). This deduction only pertained to the cleanup of hazardous substances located on sites within areas that met specific requirements (Code Sec 198(c)(2)(A)). The expenses must have been paid or incurred before January 1, 2012 (Code Sec. 198(h), as amended by P.L.111-312). The IRS has provided guidance for taxpayers who want to make this election (Rev. Proc. 98-47).

### ¶977B. Domestic Film and Television Productions Deduction.

Film and television producers are required to capitalize the cost of a production that commences after December 31, 2009. For productions that were commenced after October 22, 2004, and before January 1, 2012, they could elect to immediately deduct the cost of the production if the cost did not exceed $15 million ($20 million, if the costs were significantly incurred in a low-income community or distressed area). At least 75 percent of the compensation paid in the production must be for services performed in the United States by actors, production personnel, directors and producers (Code Sec. 181, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). See ¶1229 for general discussion of the amortization of film and television production costs.

### ¶980D. Domestic Production Gross Receipts.

The allowance of the Code Sec. 199 deduction for production activities in Puerto Rico has been extended so it is available in the taxpayer's first six tax years beginning after December 31, 2005, and before January 1, 2012.

### ¶989A. Advanced Mine Safety Equipment Expensing.

A taxpayer may make an election to expense 50 percent of the cost of advanced mine safety equipment paid or incurred after December 20, 2006 (Code Sec. 179E, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). However, the election is available only with respect to the cost of new advanced mine safety equipment placed in service after December 20, 2006, and before January 1, 2012. The cost of any eligible equipment that is expensed under Code Sec. 179 cannot be taken into account in calculating this special deduction for mine safety equipment. The deduction is subject to recapture as ordinary income under the Code Sec. 1245 depreciation recapture rules.

### ¶999A. Empowerment Zones, Renewal Communities, and District of Columbia Tax Incenctives.

Status as an empowerment zone (¶999B), generally terminates after December 31, 2011 (Code Sec. 1391(d), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). Designation as a renewal community (¶999C) generally remains in effect until December 31, 2009 (Code Sec. 1400E). The status of the District of Columbia Enterprise Community Zone (¶999D), as an empowerment zone terminates after December 31, 2011.

### ¶999B. Empowerment Zones.

Status as an empowerment zone (¶999B), generally terminates after December 31, 2011 (Code Sec. 1391(d), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The work opportunity credit and the 60 percent gain exclusion for small business stock are also extended through December 31, 2011.

*60-Percent Gain Exclusion for Small Business Stock.* Taxpayers other than corporations may exclude 50 percent of the gain on the sale or exchange of qualified small business stock (¶2396) (Code Sec. 1202(a)(1)). For gain attributable to periods before January 1, 2017, the amount that can be excluded is increased to 60 percent if the small business stock is stock in a corporation that qualifies as an empowerment zone business that was acquired after December 21, 2001 (Code Sec. 1202(a)(2)(C), the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). In general, the corporation must qualify as an enterprise zone during substantially all of the time the stock is held (Code Sec. 1202(a)(2)(A)). In applying this rule, the end of the empowerment zone designation on December 31, 2011, is ignored in determining whether the corporation qualified as an enterprise zone during substantially all of the time the stock was held.

### ¶999D. District of Columbia.

Prior to January 1, 2012, the District of Columbia Enterprise Zone (DC Zone) is treated as an empowerment zone and qualifying taxpayers are entitled to the same wage credit, work opportunity credit, and increased expense allowance (¶999B) applicable to other empowerment zones (Code Sec. 1400, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). In addition, the capital gain exclusion described below is available. The $5,000 credit that is available to certain first-time homebuyers within the District of Columbia will no longer be available after December 31, 2011 (¶1308).

*Capital Gain Exclusion for DC Zone Assets.* Gross income does not include qualified capital gain from the sale or exchange of any DC Zone asset held for more than five years (Code Sec. 1400B(a)). In general, a DC Zone asset includes only (Code Sec. 1400B(b)):

1. DC Zone business stock – stock acquired for cash at original issue after 1997 and before 2016 from a domestic corporation that is a DC Zone business;
2. a DC Zone partnership interest – a capital or profits interest in a domestic partnership interest originally issued after 1997 and acquired before 2016 for cash from a partnership that is a DC Zone business; and

3. DC Zone business property – tangible property acquired by purchase (as defined in Code Sec. 179(d)(2)) after December 31, 1997 and before January 1, 2017, the original use of which commences with the taxpayer in the taxpayer's DC Zone business. The property may not be acquired from a related person or another member of a controlled group.

### ¶999E New York Liberty Zone

Several tax incentives that were made available in the New York Liberty Zone (NYLZ), the portion of Manhattan directly affected by the September 11, 2001, terrorist attack, are no longer available including: (1) New York Zone business employee credit (¶1365G); (2) the 30-percent first-year bonus depreciation allowance (¶1237); and (3) the increased Code Sec. 179 deduction (¶1208). The NYLZ is the area on or south of Canal Street, East Broadway (east of its intersection with Canal Street), or Grand Street (east of its intersection with East Broadway) (Code Sec. 1400L(h)).

*Tax-Exempt Bonds.* An aggregate of $8 billion in additional tax-exempt private activity bonds, called New York Liberty bonds, are authorized during calendar years 2002 through 2011 to finance the construction and repair of real estate and infrastructure in the NYLZ ( Code Sec. 1400L(d), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). In addition, advance refunding may be available with respect to certain tax-exempt bonds issued for facilities located in New York City ( Code Sec. 1400L(e)(1)).

*Depreciation of Leasehold Improvements*. Qualified NYLZ leasehold improvements placed in service after September 10, 2001, and before January 1, 2007, are depreciated as five-year MACRS property using the straight-line method (Code Sec. 1400L(c)).

*Rollover Period for Involuntary Conversions Extended to Five Years.* The Code Sec. 1033 replacement period (¶1713 and following) for property that was compulsorily or involuntarily converted in the NYLZ as a result of the September 11, 2001, attack is five years, provided that substantially all of the use of the replacement property is in New York City (Code Sec. 1400L(g)).

### ¶999F. Hurricane-Related GO Zones.

The Gulf Opportunity Zone Act of 2005 and the Katrina Emergency Tax Relief Act of 2005 amended the Code to provide special tax benefits to assist taxpayers affected by Hurricanes Katrina, Rita, and Wilma (Code Sec. 1400M). The IRS has also provided relief for certain taxpayers affected by the storms under its own authority. Benefits for victims of Gulf Storms are extended through December 31, 2011 (The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). For each storm there is, from largest to smallest, a disaster area, a covered disaster area, and a Gulf Opportunity Zone. A variety of benefits and relief are available depending on the geographic area involved including: casualty and theft losses (¶1131); involuntary conversions (¶1715); net operating losses; extended carrybacks of net operating losses to the extent they are applicable to certain

GO Zone expenses (¶1141); early distributions from retirement plans without penalty (¶2124); special rules for calculating the earned income and additional child tax credits (¶1305); increased Hope and lifetime learning credits for students attending a school located in the GO Zone (¶1303); Code Sec. 179 expense (¶1208); expanded definition of "targeted employee" for purposes of Work Opportunity Credit (¶1365G); increased deduction for reforestation costs (¶1287); deduction of demolition and cleanup costs (¶1112); rehabilitation tax credit (¶1365B) and the issuance of GO Zone Bonds (¶729).

## *Chapter 10: Nonbusiness Expenses*

### ¶1002. Standard Deduction.

Add at end of first sentence:

… (see ¶126).

### ¶1005. Deductions Allowed.

Delete **Comments** under List Items (17) and (18).

### ¶1014. When AGI Exceeds Inflation-Adjusted Dollar Amount.

***Comment:*** Congress has extended the repeal of the limitation on the amount of allowable itemized deductions for higher-income individuals for 2011 and 2012 (Act Sec. 101(a)(1) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). Thus, the limitation will not apply for those tax years. Absent further legislation, the limitation will return for 2013 and later tax years. If this occurs, allowable itemized deductions must be reduced by the lesser of (1) three percent of the excess of AGI over $100,000 ($50,000 for married individuals filing separately), adjusted for inflation, or (2) 80 percent of allowable itemized deductions.

### ¶1021. Deductible Taxes.

Delete **Comment** under List Item (5).

Delete **Comment** under second text paragraph and replace with the following:

In 2010 and 2011, taxpayers may elect to deduct either state and local income tax paid or general state and local sales taxes paid, on line 5 of Schedule A, Form 1040. If they elect to deduct the general state and local sales taxes paid, they may claim either the total amount paid by substantiation with receipts, or the amount from IRS tables plus the amounts of general state and local sales taxes paid on the purchase a motor vehicle, boat or other items to be determined by the IRS (Notice 2005-31). A taxpayer who elects to deduct state and local sales taxes (including motor vehicle taxes) on line 5 cannot also take a duplicate deduction for 2009 qualified motor vehicle taxes on line 7 of Schedule A, Form 1040 (see ¶1022A). Absent further legislation, the election will not apply to tax years after 2011 Code Sec. 164(b)(5), as amended by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, §722(a) (P.L. 111-312)).

## ¶1047A. Mortgage Insurance Premiums.

Certain premiums paid from 2007 through 2011 for qualified mortgage insurance in connection with acquisition indebtedness are deductible as qualified residence interest (Code Sec. 163(h)(3)(E), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

However, for every $1,000 by which the taxpayer's adjusted gross income (AGI) exceeds $100,000, the amount of premiums treated as interest is reduced by 10 percent; for married taxpayers filing separately, the 10-percent phase-out applies to every $500 that AGI exceeds $50,000. The deduction does not apply to mortgage insurance contracts issued prior to January 1, 2007, or to premiums paid, accrued, or properly allocable to any period after December 31, 2011. Qualified mortgage insurance is that provided by the Veterans Administration (VA), the Federal Housing Administration (FHA), the Rural Housing Administration (RHA) and private mortgage insurance.

## ¶1058. Contributions by Individuals.

*IRA Distributions.* Individuals age 70 1/2 or older can continue to distribute up to $100,000 tax-free in 2010 and 2011 from their individual retirement account (IRA) to certain charitable organizations without including the distribution in gross income (Code Sec. 408(d)(8), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). To qualify, the distribution must be made directly by the trustee to a 50-percent organization (¶1059), but not to a supporting organization or a donor advised fund (¶1061), and the entire distribution must otherwise be deductible under Code Sec. 170 (disregarding the percentage limitations) even though the individual was not allowed to claim a charitable deduction for the donation. The distribution could be delivered to the charity by the IRA owner provided that the check from the IRA is payable to the charity. See 2153G for a special rule that permits a qualified charitable distribution made in January 2011 to be treated as having been made on December 31, 2010.

## ¶1059. Limits on Individuals' Contributions.

*Qualified Conservation Contributions.* Prior to January 1, 2006, and after December 31, 2011, individual donors who make a qualified conservation contribution (QCC) of real property (¶1063) are limited to a charitable deduction of up to 20- or 30-percent of their contribution base for a donation of capital gain appreciated property, and any excess over the contribution base can be carried forward for five years (¶1060).

In 2006 through 2011, individual donors who make a QCC are allowed a 50-percent contribution base, and any excess over this base amount can be carried forward for 15 years. These rules are applied separately from the rules that apply to other donations (Code Sec. 170(b)(1)(E), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

*Special Rules for Qualified Farmers and Ranchers.* For qualified farmers and ranchers (i.e., individual taxpayers with more than 50 percent of gross income from farming), the QCC deduction limit is 100 percent of the contribution base. For contributions made after August 17, 2006, and before January 1, 2012, the 100-percent limit applies only if the contribution includes a restriction that the property must remain generally available for agriculture or livestock production (Code Sec. 170(b)(2)(B), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). Donations of food inventories (¶1062) by qualified farmers and ranchers on or after October 3, 2008, but before January 1, 2009, were treated as QCCs (Code Sec. 170(b)(3).

## ¶1060. Individuals' Five-Year Carryover.

If the value of a taxpayer's qualified conservation contribution made in a tax year from 2006 through 2011 (¶1059) exceeds the special 50-percent contribution base for such a donation, the excess can be carried forward for 15 years (Code Sec. 170).

## ¶1062. Gifts of Appreciated Property.

*Food Inventories.* In 2010 and 2011 (as in 2008 and 2009), noncorporate and corporate taxpayers can claim an enhanced deduction for certain donations of food inventories (¶930A). For a taxpayer other than a C corporation, the total deduction for food inventory donations during the tax year is limited to a maximum of 10 percent of the taxpayer's net income from those trades or businesses making such donations (Code Sec. 170(e)(3)(C), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The 10-percent limitation was suspended for contributions made by qualified farmers and ranchers on or after October 3, 2008, but before January 1, 2009 (¶1059).

## ¶1082. Education and Related Expenses.

*Higher Education Deduction.* An "above-the-line" deduction is allowed for qualifying tuition and related expenses paid in 2010 (and 2011) for enrollment or attendance by the taxpayer or the taxpayer's spouse or dependent at any accredited post-secondary institution. The deductible amount is based on the taxpayer's adjusted gross income (AGI). The maximum deductible amount for tax years 2004 through 2011 is $4,000 for taxpayers with AGI at or below $65,000 ($130,000 for joint filers); for taxpayers with AGI above $65,000 but less than or equal to $80,000 ($130,000 and $160,000, respectively, for joint filers), the maximum deductible amount is $2,000. No deduction is available to taxpayers with AGI above $80,000 ($160,000 for joint filers). Absent further legislation, this deduction will not apply to tax years beginning after 2011 (Code Sec. 222, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶1084. Teachers' Classroom Expenses.

For tax years beginning in 2002 through 2011, eligible educators are allowed an "above-the-line" deduction of up to $250 for unreimbursed expenses incurred in connection with books, supplies (other than nonathletic supplies for courses in health or physical education), computer equipment and supplementary materials used in the classroom Code Sec. 62(a)(2)(D), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

An eligible educator is an individual who, for at least 900 hours during a school year, is a kindergarten through grade 12 teacher, instructor, counselor, principal or aide in a school that provided elementary or secondary education as determined under state law  Code Sec. 62(d)(1)).

### ¶1094. Limitation on Deduction of Investment Interest.

Delete **Comment.**

## *Chapter 12: Depreciation, Amortization and Depletion*

### ¶1201. Property Subject to Depreciation.

**Comment:** The rule allowing off-the-shelf computer software to be expensed has been extended for one year to apply to software placed in service in tax years beginning before 2013 (Code Sec. 179(d)(1), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶1208. Election to Expense Certain Depreciable Business Assets.

An expense deduction is provided for taxpayers (other than estates, trusts or certain noncorporate lessors) who elect to treat the cost of qualifying property, called section 179 property, as an expense rather than a capital expenditure (Code Sec. 179). The election, which is made on Form 4562, is generally attached to the taxpayer's original return (including a late-filed original return). However, for tax years beginning in 2003 through 2012, a taxpayer may make, revoke, or change an election without IRS consent on an amended return filed during the period prescribed for filing an amended return (i.e., generally, three years from the filing of the original return) (Code Sec. 179(c)(2), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312); Reg. §1.179-5).

*Dollar Limitation.* The maximum Code Sec. 179 deduction is $250,000 for tax years beginning in 2008 and 2009. For tax years beginning in 2010 and 2011, the limitation is increased to $500,000. For tax years beginning in 2012 the maximum deduction is $125,000 and for tax years beginning in 2013 and thereafter is $25,000 (Code Sec. 179(b)(1), as amended by P.L. 111-312).

*Investment Limitation.* The maximum Code Sec. 179 dollar limitation is reduced dollar for dollar by the cost of qualified property placed in service during the tax over an investment limitation. The investment limitation is $800,000 for tax years beginning in 2008 and 2009, and $2,000,000 for tax years beginning in 2010 and 2011. For tax years beginning in 2012 the investment limitation is $500,000 per year and for tax years beginning in 2013 and thereafter is $200,000 (Code Sec. 179(b)(2), as amended by P.L. 111-312).

*Qualified Section 179 Property.* Depreciable off-the-shelf computer software placed in service in tax years beginning in 2003 through 2012 may be expensed under Code Sec. 179 (Code Sec. 179(d)(1)(A), as amended by P.L. 111-312). This is software described in Code Sec. 197(e)(3)(A)(i) (i.e., software that is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified) which is depreciable over three years under Code Sec. 167(f)(1)(A).

## ¶1229. Income Forecast Model.

***Comment:*** The election to deduct the costs of a qualifying film or television production productions has been extended to productions that commence before January 1, 2012 (Code Sec. 181, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## ¶1234. Lessee/Lessor Improvements, Lease Acquisition Costs.

*15-Year Qualified Leasehold Improvement Property.* Qualified leasehold improvement property placed in service after October 22, 2004, and before January 1, 2012, is depreciated under MACRS over 15 years (39-years if ADS applies) using the straight-line method and the half-year or mid-quarter convention, as applicable (Code Sec. 168(e)(3)(E)(iv), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), Code Secs. 168(b)(3)(G) and (g)(3)(B)). Qualified leasehold improvement property is defined the same way as the term is defined in Code Sec. 168(k)(3) for purposes of the bonus depreciation deduction (see *Qualified Leasehold Improvement Property* at ¶1237) subject to an exception that generally prohibits an individual who acquires qualified leasehold improvement property from a lessor from treating the property as qualified leasehold improvement property (Code Sec. 168(e)(6)). Thus, the improvements must be made to the interior portion of nonresidential real property that is more than three years old by the lessor or lessee under or pursuant to the terms of a lease. Elevators and escalators, internal structural framework of the building, structural components that benefit a common area, and improvements relating to the enlargement of a building do not qualify (Code Sec. 168(k)(3)).

**¶1237. MACRS Bonus Depreciation.**

A bonus depreciation deduction is allowed for qualifying MACRS property acquired after December 31, 2007 and placed in service on or before December 31, 2012 (Code Sec. 168(k), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

The placed-in-service-deadline is extended one year (December 31, 2013) for "long production property" which otherwise qualifies for bonus depreciation. Long production property is defined as property that (a) is subject to the Code Sec. 263A uniform capitalization rules, (b) has a production period greater than one year and a cost exceeding $1 million, and (c) has an MACRS recovery period of at least 10 years or is used in the trade or business of transporting persons or property for hire, such as commercial aircraft (Code Sec. 168(k)(2)(B), as amended by P.L. 111-312). However, only pre-January 1, 2011 progress expenditures are taken into account if the extended placed-in-service deadline applies. The extended December 31, 2013 placed-in-service deadline also applies to certain noncommercial aircraft acquired by purchase. In contrast, 2012 progress expenditures on noncommercial aircraft placed in service on or before December 31, 2012 are eligible for bonus depreciation (Code Sec. 168(k)(2)(C)).

The bonus depreciation rate is generally 50 percent. However, for qualifying MACRS property acquired after September 8, 2010 and placed in service before January 1, 2012, the rate is increased to 100 percent. In the case of long production property and certain noncommercial aircraft, the 100 percent rate will apply if the long production property or noncommercial aircraft is placed in service before January 1, 2013. The entire basis of the property is eligible for the 100 percent rate if this deadline is met.

Property purchased by a taxpayer in a sale-leaseback transaction within three months after the original purchaser placed the property in service may qualify for the allowance if the original purchaser placed the property in service after December 31, 2007. The last purchaser in a syndicated leasing transaction may also qualify if certain requirements are satisfied.

Property acquired after December 31, 2007 pursuant to a written binding contract entered into before January 1, 2008, by the taxpayer or a related party does not qualify for bonus depreciation at either the 50 percent or 100 percent rate. The 100 percent bonus rate does not apply to property if a written binding contract was in effect before September 9, 2010.

Bonus depreciation is treated as depreciation for recapture purposes upon the sale of the property. Unlike the Code Sec. 179 expensing allowance (¶1208), there is no taxable income or investment limitation on the bonus allowance. There is no limit on the overall amount of bonus depreciation that may be claimed on qualifying property. The length of the tax year or date during the tax year that the qualifying property was placed in service does not affect the amount of the bonus deduction, except that a 100 percent rate applies to property acquired after September 8, 2010 and placed in service before January 1, 2012.

*Election by Corporation to Forgo Bonus Depreciation and Claim Accelerated Research and/or AMT Credit Carryforward from Tax Years Beginning Before 2006.* Effective for property placed in service after December 31, 2010, eligible qualified property is property that is acquired after March 31, 2008, and before January 1, 2013, and placed in service before January 1, 2013 (before January 1, 2014 for longer-period production property and certain noncommercial aircraft) and that is eligible for the bonus depreciation deduction. No binding written purchase contract may be in effect before April 1, 2008 (Code Sec. 168(k)(2)(A) and (4)(D), as amended by P.L. 111-312).

Effective for property placed in service before January 1, 2011, eligible qualified property is property that is acquired after March 31, 2008, and before January 1, 2010, and placed in service before January 1, 2010 (before January 1, 2011 for longer-period production property and certain noncommercial aircraft) and that is eligible for the bonus depreciation deduction. No binding written purchase contract may be in effect before April 1, 2008 (Code Sec. 168(k)(2)(A) and (4)(D), prior to amendment by P.L. 111-312).

The Small Business Jobs Act of 2010 (P.L. 111-240) extended bonus depreciation an additional year to include qualifying assets acquired after December 31, 2007 and before January 1, 2011 and placed in service after December 31, 2009 and before January 1, 2011 (before January 1, 2012 for property with a long production period and certain noncommercial aircraft). Property that qualifies for bonus depreciation only on account of this one-year extension is not treated as eligible qualified property (Code Sec. 168(k)(4)(D)(iv) and (v), prior to being stricken by P.L. 111-312)).

If a corporation previously made an election to forgo bonus depreciation for its first tax year beginning after March 31, 2008, or made an election to forgo bonus depreciation with respect to extension property for its first tax year ending after December 31, 2008, the election to forgo bonus depreciation will apply to "round 2 extension property," unless the corporation makes an election not to forgo bonus depreciation on round 2 extension property (Code Sec. 168(k)(4)(I)(ii), as added by P.L. 111-312).

If a corporation did not previously make an election to forgo bonus depreciation in its first tax year beginning after March 31, 2008, and did not make an election to forgo bonus depreciation with respect to extension property for its first tax year ending after December 31, 2008, the corporation may make an election to forgo bonus depreciation in its first tax year ending after December 31, 2010, and each subsequent tax year. However, if the election is made, it only applies to round 2 extension property (Code Sec. 168(k)(4)(I)(iii), as added by P.L. 111-312).

Round 2 extension property is property which is eligible qualified property (as defined above in Code Sec. 168(k)(4)(D), as amended by the P.L. 111- 312) solely by reason of the two-year extension of the bonus depreciation allowance by P.L. 111-312 to property acquired after December 31, 2007, and placed in service in 2011 or 2012, and, in the case of longer-period production property and certain noncommercial aircraft, to property placed in service in 2013 (Code Sec. 168(k)(4)(I)(iv), as added by P.L. 111-312).

A separate bonus depreciation amount, maximum amount, and maximum increase amount are computed and applied to eligible qualified property which is extension property, eligible qualified property which is round 2 extension property, and eligible qualified property which is not extension property or round 2 extension property (Code Sec. 168(k)(4)(H)(i)(II), as added by P.L. 111-5; Code Sec. 168(k)(4)(l)(ii) and (iii), as added by P.L. 111-312; Rev. Proc. 2009-33, Section 5.02)). This separate computation means that a corporation may claim a maximum $30 million of credits with respect to property that is not extension property or round 2 extension property, a maximum $30 million of credits with respect to property that is extension property, and a maximum $30 million of credits with respect to property that is round 2 extension property.

The placed-in-service deadline for nonresidential and residential property is December 31, 2008. The deadline is extended to December 31, 2012, if the building is located in the Louisiana parishes of Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany, or Washington or the Mississippi counties of Hancock, Harrison, Jackson, Pearl River, or Stone. Bonus depreciation may be claimed on portions of buildings (e.g., floors of multi-story buildings) that are placed in service by the December 31, 2012 deadline. MACRS recovery property with a depreciation period of 20 years or less, such as furniture or personal property identified in a cost segregation study, which is placed in service in a building that meets the December 31, 2012, placed-in-service deadline will qualify for bonus depreciation under this GO Zone provision if it is placed in service not later than 90 days after the building is placed in service. However, such property when placed in service before 2013 will be treated as if it qualified for bonus depreciation under the general rules of Code Sec. 168(k), as described above (Code Sec. 1400N(d)(6); Notice 2007-36).

*50 Percent Bonus Allowance for Mine Safety Equipment.* A taxpayer may elect to deduct 50 percent of the cost of qualified advanced mine safety equipment paid or incurred after December 20, 2006, if the equipment is placed in service before January 1, 2012 (Code Sec. 179E, as amended by P.L. 111-312)

## ¶1240. MACRS Depreciation Periods.

*15-Year Restaurant Improvements and Buildings*. Qualified restaurant property placed in service after October 22, 2004 and before January 1, 2012 is 15-year MACRS property, depreciable using the straight-line method using the half-year or mid-quarter convention, as applicable. The ADS recovery period is 39 years. Qualified restaurant property is section 1250 property which is an improvement to a building if the improvement is placed in service more than three years after the date the building was first placed in service. More than 50 percent of the building's square footage must be devoted to preparation of and seating for on-premises consumption of prepared meals. For improvements placed in service in 2009, it is not necessary that the restaurant building be more than three years old (Code Sec. 168(e)(3)(E)(v) and (e)(7), as amended by P.L. 111-312).

A restaurant building placed in service after December 31, 2008, and before January 1, 2012, is also included in the definition of qualified restaurant property and is depreciated as 15-year property using the straight-line method and half-year or mid-quarter convention if more than 50 percent of the building's square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals. A 39-year ADS recovery period applies (Code Sec. 168(e)(7)(A), as amended by P.L. 111-312; Code Sec. 168(b)(3)(l)).

*15-Year Qualified Retail Improvement Property.* Qualified retail improvement property placed in service after December 31, 2008 and before January 1, 2012 is depreciated under MACRS using a 15-year recovery period, the straight-line method, and the half-year or mid-quarter convention. The ADS recovery period is 39 years. Qualified retail improvement property is an improvement to the interior portion of a building that

is nonresidential real property. The improvement must be placed in service more than three years after the building was first placed in service. The improved interior portion must be open to the general public and used in the retail trade or business of selling tangible personal property to the general public. Elevators and escalators, internal structural framework of the building, structural components that benefit a common area, and improvements relating to the enlargement of a building do not qualify. Qualified retail improvement property is ineligible for bonus depreciation under Code Sec. 168(e)(8), as amended by P.L. 111-312).

*Indian Reservation Property.* For qualified Indian reservation property that is placed in service after 1993 and before January 1, 2012, special MACRS recovery periods are provided for both regular tax and alternative minimum tax purposes that permit faster write-offs (Code Sec. 168(j), as amended by P.L. 111-312).

### ¶1294. Oil and Gas Production.

For tax years (1) beginning after December 31, 1997, and before January 1, 2008 or (2) beginning after December 31, 2008, and before January 1, 2012, the 100-percent taxable income limit on percentage depletion deductions for oil and gas properties is suspended for marginal properties (Code Sec. 613A(c)(6)(H), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[135] Thus, the limitation is not suspended for tax years beginning in 2008 but is suspended for tax years beginning in 2009, 2010, and 2011.

## *Chapter 13: Tax Credits*

### ¶1301. Child and Dependent Care Credit.

*Amount of Credit.* The maximum amount of employment-related expenses to which the credit may be applied is $3,000 if one qualifying individual is involved or $6,000 if two or more qualifying individuals are involved (less excludable employer dependent care assistance program payments) (Code Sec. 21(c)). The credit amount is equal to the applicable percentage, as determined by the taxpayer's adjusted gross income (AGI), times the qualified employment expenses paid. Taxpayers with an AGI of $15,000 or less use the highest applicable percentage of 35 percent. For taxpayers with an AGI over $15,000, the credit is reduced by one percentage point for each $2,000 of AGI (or fraction thereof) over $15,000 (Code Sec. 21(a)(2)). The minimum applicable percentage of 20 percent is used by taxpayers with an AGI greater than $43,000. Thus, the maximum dependent care credit amount for one qualifying dependent is $1,050 and $2,100 for two or more qualifying dependents.

**Comment:** The increased amounts and higher limits provided for the child and dependent care expense credit by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (P.L. 107-16) are extended for two years or until January 1, 2012 (Code Sec. 21, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶1303. Credits for Higher Education.

***Comment:*** The American Opportunity credit (modified Hope scholarship credit) has been extended to apply to tax years 2011 and 2012, including the $2,500 maximum credit per eligible student, the higher income phaseout ranges of $80,000 - $90,000 for single filers ($160,000 - $180,000 for joint filers), the eligibility extension to the first four years of post-secondary education, the inclusion of text books and course materials as eligible expenses, and the 40 percent refundable credit component. The Hope scholarship credit will apply for tax years other than 2009, 2010, 2011, and 2012.

### ¶1305. Child Tax Credit.

Taxpayers who have one or more qualifying children that they may claim as dependents under Code Sec. 151 may be entitled to a child tax credit of $1,000 per child through 2012 (Code Sec. 24(a), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)). However, beginning in 2013, the credit decreases to $500 per qualifying child. The credit is allowed only for tax years consisting of 12 months (Code Sec. 24(f)). The credit is calculated using a worksheet in the Form 1040 Instructions.

*Tax Liability Limitation.* For tax years 2000 through 2011, the aggregate amount of nonrefundable personal credits, including the nonrefundable portion of the child tax credit that may be claimed cannot exceed his or her regular income tax liability reduced by the foreign tax credit plus alternative minimum tax (AMT) liability (Code Sec. 26(a)(2), as amended by the Tax Relief Act of 2010). Beginning in 2012, the nonrefundable portion of the child tax credit that may be claimed by the taxpayer cannot exceed the excess of the regular income tax liability as defined in Code Sec. 26(b) plus the AMT liability over the sum of all the nonrefundable personal credits other than the child tax credit, the American opportunity (modified Hope) credit, the retirement savings contributions credit, the residential energy efficient property credit, the certain plug-in electric drive motor vehicle credit, the alternative motor vehicle credit, the new qualified plug-in electric drive motor vehicle credit, and the foreign tax credit Code Sec. 24(b)(3) as amended by the Patient Protection and Affordable Care Act (P.L. 111-148), and further amended by the Tax Relief Act of 2010). No carryover of the credit is allowed if the credit exceeds these limits (¶1315).

**Comment:** The increased child tax credit amount and refundable credit amount have been extended for two additional years or until 2013 (Code Sec. 24, as amended by the Tax Relief Act of 2010). Beginning in 2013 and thereafter, the credit amount per qualifying child is scheduled to decrease to $500; the increased earned income refundable component is scheduled to expire; the repeal of the AMT offset against the additional child credit for families with three or more children is scheduled to expire; and the offset of the nonrefundable component against regular tax and AMT liability is scheduled to expire.

## ¶1307. Adoption Credit.

For 2009, taxpayers may claim a nonrefundable credit on Form 8839, Qualified Adoption Expenses, of up to $12,150 for qualified adoption expenses for each eligible child (Former Code Sec. 23; Rev. Proc. 2008-66).[11] The credit is phased out ratably for taxpayers with a modified adjusted gross income (AGI) over $182,520 and no credit is allowed to taxpayers with a modified AGI of $222,520 or more (Rev. Proc. 2009-50).

***Comment:*** For tax years beginning in 2010 through 2012, the credit amount is increased, and the credit is refundable. See ¶1326A for further discussion.

***Comment:*** The increased adoption credit amount and refundability have been extended one additional year or until January 1, 2013 (Code Sec. 36C, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)). Beginning in 2013 and thereafter, the adoption credit will become nonrefundable and the maximum credit amount will revert back to $5,000, or $6,000 in the case of a special needs child. The phaseout range will be $75,000 to $115,000.

## ¶1308. Credit for First-Time Homebuyer in the District of Columbia.

First-time homebuyers who purchase a principal residence in the District of Columbia from an unrelated person, can claim a nonrefundable personal credit of up to $5,000 of the purchase price ($2,500 in the case of a married person filing separately) (for two or more unrelated individual, the credit will be allocated per regulations but the total amount of credit for all individuals could not exceed $5,000) (Code Sec. 1400C). The credit is claimed on Form 8859, District of Columbia First-Time Homebuyer Credit. To qualify, the taxpayer (and, if married, his or her spouse) cannot have a present ownership interest in a principal residence in the District of Columbia during the one-year period ending on the date of purchase. The credit can only be claimed once. The credit is phased out ratably between modified adjusted gross income (MAGI) of $70,000 to $90,000 ($110,000 to $130,000 for married individuals filing jointly). MAGI is the adjusted gross income increased by the exclusions for foreign or U.S. possessions earned income and foreign housing expenses ( Code Sec. 1400C(b)). The basis of the residence is reduced by the amount of the credit (including any carryforward portion) (Code Sec. 1400C(h)). The purchase had to be before January 1, 2012 (Code Sec. 1400C(i), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## ¶1315. Limitation on Nonrefundable Credits.

For tax years beginning before 2012, all nonrefundable personal tax credits available to an individual may be claimed to the extent of the full amount of the taxpayer's combined regular tax and alternative minimum tax liability (AMT) liability (Code Sec. 26(a)(2), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The taxpayer's regular tax liability, however, must first be reduced by the amount of any applicable foreign or U.S. possession tax credit. For this purpose, the nonrefundable personal tax credits include: the dependent care credit (¶1301), the credit for the elderly and disabled (¶1302), the adoption credit (in tax years before 2010) (¶1307), the child tax credit (¶1305), the credit for interest on certain home mortgages (¶1306), the Hope Scholarship and Lifetime Learning credits (including the American Opportunity tax credit) (¶1303), the retirement savings contributions credit (¶1304), the credit for certain nonbusiness energy property (¶1341), the credit for residential energy efficient property (¶1342), the small plug-in electric vehicle credit (Code Sec. 30) (see ¶1354), the alternative motor vehicle credit (¶1349), the new qualified plug-in electric drive motor vehicle credit (¶1351), and the District of Columbia first-time homebuyer credit (¶1308).

For tax years beginning in 2012, only specified nonrefundable personal credits are fully allowed against the taxpayer's combined regular tax and AMT liability (Code Sec. 26(a)(1), as amended by P.L. 111-312). These credits include the child tax credit, the American Opportunity tax credit, the retirement savings contributions credit, the credit for residential energy efficient property, the credit for small plug-in electric vehicles, the alternative motor vehicle credit, and the credit for new plug-in electric drive motor vehicles. However, special limitation rules apply to the credits listed above that operate in addition to the Code Sec. 26(a)(1) limitation. All other nonrefundable personal credits are allowed only to the extent the taxpayer's regular tax liability exceeds the taxpayer's tentative minimum tax (determined without regard to the AMT foreign tax credit). These would include the dependent care credit, the credit for the elderly and disabled, the credit for interest on certain home mortgages, the Lifetime Learning credit, the credit for certain nonbusiness energy property, and the District of Columbia first-time homebuyer credit.

***Comment:*** The adoption credit as noted in ¶1307 is a refundable credit for 2010, 2011, and 2012. Thus, the limitation on nonrefundable credit will no longer be limited by the adoption credit.

### ¶1321. Earned Income Credit.

A refundable earned income credit (EIC) is available to certain low-income individuals (Code Sec. 32).[19] To be eligible to claim the credit, a taxpayer must have earned income with an adjusted gross income (AGI) below a certain level, a valid Social Security number, use a filing status other than married filing separately, must be a U.S. citizen or resident alien, have no foreign income, and investment income less than a certain amount. The amount of credit varies depending on the number of the taxpayer's qualifying children and their adjusted gross income level.

***Comment:*** The increased earned income credit amount and phase out threshold has been extended for two additional years or until January 1, 2013 (Code Sec. 32, as amended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312)).

### ¶1326A. Refundable Adoption Credit.

Taxpayers may claim a refundable credit for qualified adoption expenses for each eligible child beginning in tax years after December 31, 2009, but before January 1, 2013 (Code Sec. 36C, as redesignated and amended by the Patient Protection and Affordable Care Act (P.L. 111-148), and as further amended by the Tax Relief, Unemployment Insurance Reauthorization Act of 2010 (P.L. 111-312)). The maximum credit amount for the 2010 tax year is $13,170. The credit is phased out ratably for taxpayers with a modified adjusted gross income (AGI) over $182,520 and no credit is allowed to taxpayers with a modified AGI of $222,520 or more (Rev. Proc. 2009-50). Modified AGI is defined as the taxpayer's AGI plus any amounts excluded by reasons of the foreign housing, foreign earned income, or U.S. possession income exclusions. The credit amount and the phase out range are adjusted annually for inflation.

**Comment:** Beginning in 2013 and thereafter, the amount of the credit reverts back to $5,000, or $6,000 in the case of a special needs child, which amount will be adjusted for inflation. The credit also becomes nonrefundable (¶1307).

### ¶1341. Nonbusiness Energy Property Credit.

A tax credit is available to individuals for the installation of nonbusiness energy property, such as residential exterior doors and windows, insulation, heat pumps, furnaces, central air conditioners and water heaters (Code Sec. 25C, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[28] The credit applies to qualified energy efficiency improvements and qualified energy property installed before January 1, 2008, or after December 31, 2008, but before January 1, 2012. The property must be installed in, or on, a dwelling unit in the United States that is owned and used by the taxpayer as the taxpayer's principal residence. Original use of the property must commence with the taxpayer. The credit is claimed on Form 5695, Residential Energy Credits.

*Credit amounts for 2011.* Effective for property placed in service after December 31, 2010, but before January 1, 2012, an individual is entitled to a credit against tax in an amount equal to:

- 10 percent of the amount paid or incurred for qualified energy efficiency improvements (building envelope components) installed during the tax year, and
- the amount of residential energy property expenditures paid or incurred during the tax year (Code Sec. 25C(a), as amended by P.L. 111-312).

The maximum credit allowable is $500 over the lifetime of the taxpayer. The $500 amount must be reduced by the aggregate amount of previously allowed credits the taxpayer received in 2006, 2007, 2009 and 2010 (Code Sec. 25C(b)(1), as amended by P.L. 111-312). The maximum amount of the residential energy property credit that may be allocated to exterior windows and skylights is $200. With regard to residential energy property expenditures, the following credit dollar limitations apply to property placed in service in 2011; $50 for any advanced main air circulating fan, $150 for any qualified natural gas, propane, or oil furnace or hot water boiler, and $300 for any item of energy-efficient building property (Code Sec. 25C(b)(3), as amended by P.L. 1110312)). Energy efficient property must meet the criteria for such materials and systems as established by the 2009 International Energy Conservation Code (IECC) in effect on February 17, 2009 (Code Sec. 25C(c)(1) and (c)(2)(A), as amended by P.L. 111-312)). Any expenditures made with funds obtained from subsidized energy financing are ineligible for the credit (Code Sec. 25C(e)(3), as added by P.L. 111-312)).

## ¶1355. Alternative Fuel Vehicle Refueling Property Credit.

Taxpayers are permitted a credit for the installation of qualified alternative fuel refueling property placed in service before 2012 (before 2015 for refueling property related to hydrogen) (Code Sec. 30C, as amended by the Tax Relief, Unemployment Insurance Reauthorization Act of 2010 (P.L. 111-312)). The credit is claimed on Form 8911, Alternative Fuel Vehicle Refueling Property Credit, regardless of whether the property is personal or used in a trade or business. Taxpayers may elect not to have the credit to apply to otherwise qualifying property (Code Sec. 30C(e)(5)).

*Credit Amount and Limitations.* The credit is equal to 50 percent of the cost for non-hydrogen-related property and 30 percent of the cost of hydrogen-related property placed into service by the taxpayer during the tax year . For property of a character that is subject to depreciation (such as a commercial or retail refueling stations), the credit cannot exceed $50,000 for non-hydrogen-related property for 2009 through 2011 ($200,000 for hydrogen-related property). For all other instances (such as residential), the credit cannot exceed $2,000 for non-hydrogen-related property for 2009 through 2011 ($1,000 for hydrogen-related property). If the credit is attributable to property that is subject to the rules of depreciation, then it will be considered to be part of the general business credit under Code Sec. 38 (¶1365). The amount of the credit that is not attributable to depreciable property (such as in the case of a residence) cannot exceed the excess of the taxpayer's regular income tax liability (as defined in Code Sec. 26(b)) reduced by the sum of nonrefundable personal credits and the foreign tax credit over the taxpayer's tentative minimum tax (Code Sec.30C(d)). Credits for property sold to a tax-exempt entity may be claimed by the seller but only if they disclose in a written document the amount of credit allowable. For purposes of claiming this credit for property sold to a tax-exempt entity, the property is to be treated as if it is depreciable property, and thus is subject to the business tax credit limitation rule. Qualifying property used outside the United States cannot be used to claim this credit. The qualifying property's basis must be reduced by the amount of the credit claimed. However, should the property cease to be qualifying property, the Secretary of the Treasury is authorized to issue regulation outlining the procedure for recapture of credit amounts claimed. Taxpayers also have the option to elect not to claim this credit (Code Sec. 30(e)).

## ¶1362. Puerto Rico Economic Activity Credit.

The Puerto Rico and possession tax credit under Code Secs. 30A and 936 has terminated for taxpayers conducting a trade or business in Puerto Rico for tax years after 1995. However, in the case of existing claimants, the possessions tax credit continued to apply to Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands with out change for tax years beginning after 1995 and ending for tax years after 2006. However, a modified version of the credit for certain existing claimants continued to apply to the American Samoa for tax years beginning after 2006 and ending before 2012. This credit extension itself is not in the Code but adopts all the meanings and definition as if a part of Code Secs. 30A and 936 (Act Sec. 756(a), of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), amending Division C, Act Sec. 309(a) of the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), amending Act Sec. 119 of the Tax Relief and Health Care Act of 2006 (P.L. 109-432)). The amount of the credit equals the sum of:

- 60 percent of the qualified American Samoa wages and allocable
- employee fringe benefit expenses, plus
- the sum of the following depreciation allowances:
    - 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property,
    - 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, and

- 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

Finally, the rule that denies a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the Code Sec. 936 credit amount does not apply.

### ¶1365C. Energy Credit.

*Coordination With Grants Authorized for 2009, 2010 or 2011.* The Secretary of Treasury is authorized to provide a grant to each person who places into service specified energy property that is either:

1. an electricity production facility otherwise eligible for the renewable electricity production credit under Code Sec. 45, or
2. qualifying property otherwise eligible for the energy investment credit under Code Sec. 48 (Act Sec. 1603(a) of the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

In order to be eligible for the grant, the specified energy property must be:

- placed in service during 2009, 2010 or 2011, or
- placed in service after 2011 and before the credit termination date for such property, if construction of the property began during 2009, 2010 or 2011.

However, no energy credit (Code Sec. 48) or electricity from renewable resources credit (Code Sec. 45) shall be allowed for the year of the grant or any subsequent year (Code Sec. 48(d)(1)). In the event that a credit amount was claimed for the facility prior to the grant being made, the credit amount will be recaptured by adding the prior claimed credit amounts to the tax liability of the grant year. The taxpayer will also need to adjust any carryovers of general business credits to reflect the amount of the recaptured credit (Code Sec. 48(d)(2)).

### ¶1365G. Work Opportunity Tax Credit.

A credit is available for wages paid by employers who hire individuals from certain targeted groups of hard-to-employee individuals—the work opportunity credit (Code Sec. 51).56 Generally, the credit is 40 percent of the first $6,000 of qualified wages ($3,000 for qualified summer youth employees) paid to each member of a targeted group during the first year of employment and 25 percent in the case of wages attributable to individuals meeting only minimum employment levels. The credit is taken for first-year wages paid to eligible individuals who begin work before January 1, 2012 (Code Sec. 51(c)(4), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)) unless an election is made to not claim the credit. Two exceptions to the general rule are (1) individuals who are qualifying veterans, and (2) long-term family assistance recipients (see *Target Groups*, following). Any business deduction for such wages must be reduced by the amount of the credit, as computed on Form 5884, Work Opportunity Credit.

*Small Ethanol Producer Credit.* An eligible small ethanol producer (a producer with a production capacity of up to 60 million gallons of alcohol per year) may claim the small ethanol producer credit of 10 cents per gallon on production of up to 15 million gallons per year of ethanol sold or used for purposes of fuel or added to a fuel mixture in the user’s trade or business in the United States prior to January 1, 2012. For fuels produced after December 31, 2007, the 15 million annual limitation of the production of ethanol shall be determined without regard to any qualified cellulosic biofuel production (see following) (Code Sec. 40(b)(4)(C), as amended by the Tax Relief, Unemployment Insurance Reauthorization Act, and Job Creation Act of 2010 (P.L. 111-312)). The small ethanol producer credit is recaptured through a tax of 10 cents per gallon that is imposed if a producer fails to use the ethanol or ethanol mixture as fuel (Code Sec. 40(d)(3)(C)).

Taxpayers also have the option of electing to not claim the alcohol fuels credit. Any excise tax exemption claimed with respect to alcohol produced for alcohol fuels reduces the amount of the income tax credit. The carryforward period for the alcohol fuels credit is limited to three tax years after the termination year which is currently 2012. An alcohol fuels credit carryforward that is unused at the end of the carryforward period would be deductible in the following tax year under Code Sec. 196. An earlier termination of the carryforward period may occur if the tax rates on fuels under Code Sec. 4081(a)(2)(A) are 4.3 cents per gallon (Code Sec. 40(e)(1)(B)). The tax rates for gasoline (other than aviation gasoline) and diesel fuel or kerosene will be reduced to 4.3 cents per gallon effective after September 30, 2011 (Code Sec. 4081(d)). The tax rate for aviation gasoline will be reduced to 4.3 cents per gallon effective after June 30, 2008. This date will trigger the earlier termination of the alcohol credit under Code Sec. 40(e). Special rules apply for S corporations, partnerships, and other pass-thru entities which include allocation to patrons of farm cooperatives.

## ¶1365J. Credit for Increased Research Expenditures.

A credit for incremental research expenses (computed on Form 6765, Credit for Increasing Research Activities) is claimed as one of the components of the general business credit (¶1365) (Code Sec. 41).[59] The credit is available for amounts paid or incurred through December 31, 2011 (Code Sec. 41(h)(1)(B), as amended by the Tax Relief, Unemployment Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)).

## ¶1365N. Credit for Electricity Produced from Renewable Sources.

A credit is available for the domestic production of electricity from qualified energy resources at a qualified facility place in service before January 1, 2014, if the electricity is sold to an unrelated third party (Code Sec. 45, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L.

111-312)).[64] In addition, the credit is also allowed for the sale of certain refined coal produced within the United States at a qualified refined coal production facility placed into service before January 1, 2012, and for coal produced on an Indian reservation (Indian coal) at a qualified facility placed into service before January 1, 2009, but only if sold to an unrelated person. The credit for refined coal production, however, may not be claimed if production from the facility was eligible for the nonconventional fuel source credit for any tax year (¶1365BB).

### ¶1365Q. Indian Employment Credit.

A nonrefundable credit is available to employers for certain wages and health insurance costs paid or incurred in a tax year that begins before 2011 for qualified full- or part-time employees who are enrolled members of an Indian tribe or their spouses (Code Sec. 45A, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)).[68] The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs paid or incurred during a tax year over the amount of these costs paid or incurred during 1993. However, the credit is available only for the first $20,000 of qualified wages and health insurance costs paid for each qualified employee. Also, no wage deduction is allowed for the portion of wages equal to the amount of the credit. Qualified wages are wages paid or incurred by an employer for services performed by a qualified employee excluding wages for which a work opportunity credit (¶1365G) is allowed. Qualified health insurance costs are costs paid or incurred by an employer for a qualified employee, except for costs paid under a salary reduction agreement.

### ¶1365T. New Markets Tax Credit.

The new markets tax credit was created to increase investments in low-income communities. The credit is equal to five percent of the investment in a qualified community development entity (CDE) for the first three allowance dates and six percent of the investment for the next four allowance dates (Code Sec. 45D(a)).[71] The total credit available is equal to 39 percent of the investment over seven years. Active involvement of the low-income communities is required with strict penalties if the investment is terminated before seven years. There are national limitations on the amount of investments which can be used to claim the new markets tax credit for investments made after December 31, 2000, as well as allocation and carryover rules (Code Sec. 45D(f)). The new markets credit availability has been extended through 2011 and the national limitations is $3.5 billion for calendar years 2006 through 2007, and 2010 and 2011 (Code Sec. 45D(f), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)). The maximum amount of qualified equity investments that can be made is increased by $1.5 billion (for a total of $5 billion) for 2008 and 2009 (Code Sec. 45D(f)(1)(E) and (F)). The additional amount for 2008 must be allocated in accordance with Code Sec. 45D(f)(2) to qualified community development entities (CDEs) that submitted an allocation application for calendar year 2008 and either (1) did not receive an allocation for that year, or (2) received an allocation for that year in an amount less than the amount requested in the application.

### ¶1365V. Employer-Provided Child Care Credit.

Businesses may claim a tax credit for qualified expenses related to either an employer-provided child care center or a service related to locating qualified child care for tax years beginning after December 31, 200, and before January 1, 2013 (Code Sec. 45F, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[73] The amount of the credit for a given tax year is the sum of 25 percent of the qualified child care expenditures and 10 percent of the qualified resource and referral expenditures. The maximum amount of credit allowed in any given year is $150,000. Form 8882, Credit for Employer-Provided Child Care Facilities and Services, is to be used to calculate and claim the credit. The credit is part of and subject to the tax liability limitation and carryover rules of the general business credit under Code Secs. 38 and 39 (¶1365). No double benefit is allowed for expenditures used to claim the employer-provided child care credit and the basis of the qualified child care facility must be reduced by the amount of the credit taken. In addition, there is no deduction allowed in the year following the final year of any carryforward of unused employer-provided child care credit. If a qualified childcare facility ceases to operate as a qualified childcare facility (or there is a change in ownership), the business may have to recapture part or all of the credit claimed. In the event of recapture, the tax liability of that tax year must be increased by an amount equal to the applicable percentage times the aggregate decrease in the general business credit as if all previously allowed employer-provided child care credits with respect to the employer's child care facility had been zero (Code Sec. 45F(d)(2)(A)). Any carryforward or carryback amounts of the employer-provided child care credit must also be adjusted.

### ¶1354W. Railroad Track Maintenance Credit.

An income tax credit was available to small-and mid-sized railroad companies for qualified railroad track maintenance expenses (Code Sec. 45G, as amended by the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[74] The credit was equal to 50 percent of the qualified expenses paid or incurred by an eligible taxpayer after December 31, 2004, and before January 1, 2012. The credit could not exceed $3,500 multiplied by the number of miles of railroad track owned or leased by the eligible taxpayer as of the close of the tax year. Eligible taxpayers were Class II and Class III railroad companies and persons who operate over their rail lines or provided related rail services. The credit was a part of the general business credit but, for credit amounts determined after 2007, was not subject to the tax liability limitation rule. The railroad track maintenance credit was allowed against the sum of the regular income tax and alternative minimum tax liabilities (Code Sec. 38(c)). However, the credit was subject to the carryover rules under Code Sec. 39 (¶1365). The credit was claimed on Form 8900, Qualified Railroad Track Maintenance Credit. No provision was made for deduction of unused credits at the end of the carryforward period or if the taxpayer ceases to exist.

### ¶1365X. Biodiesel Fuels Credit.

Biodiesel fuels are defined as monoalkyl esters of long chain fatty acids derived from plant or animal matter that meet the requirements for fuels or fuel additives imposed by the Environmental Protection Agency. Biodiesel fuel mixture is defined as biodiesel mixed with diesel fuel, determined without regard to any use of kerosene. Agri-biodiesel is biodiesel derived solely from virgin oils, including esters derived from virgin vegetable oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, and mustard seeds, camelina, and animal fats. Tax penalties are imposed if the credit for biodiesel mixture is claimed and the fuels are later separated. The credit is part of the general business credit and is subject to the tax liability limitation and carryover rules under Code Secs. 38 and 39 (¶1365). Any unused credit at the end of the carryforward period, or if the taxpayer ceases to exist, may be claimed as deduction under Code Sec. 196. The credit may be claimed on Form 8864, Biodiesel and Renewable Diesel Fuels Credit, for the fuels produced and sold in the United States before January 1, 2012 (Code Sec. 40A(g), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).

### ¶1365CC. Energy Efficient Home Credit.

Eligible contractors who build an energy-efficient home acquired by a person for use as a residence before 2012 could claim an income tax credit of up to $2,000 (Code Sec. 45L, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[80] Eligible contractors also included manufacturers of energy-efficient manufactured homes. A residence qualified as an energy-efficient home if it was: (1) located in the United States, (2) substantially completed after August 8, 2005, and (3) certified to have an annual heating and/or cooling saving at least 50-percent less than a comparable house and that at least 10 percent of the 50 percent saving must come from the building envelope. This credit was a component of and subject to the tax liability limitation and carryover rules of the general business credit under Code

Secs. 38 and 39 (¶1365). The credit was claimed on Form 8908, Energy Efficient Home Credit.

### ¶1365DD. Energy Efficient Appliance Credit.

An income tax credit is available to manufacturers of energy-efficient home appliances for tax years after 2005 and before 2012 (Code Sec. 45M, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).[81] The total amount of credit available for a tax year is equal to the sum of the credit amount separately calculated for each type of qualified energy-efficient appliance (dishwashers, clothes washers and refrigerators) produced by the taxpayer during the calendar year ending with or within that tax year. The credit amount for each type of qualified appliance is determined by multiplying the eligible production for that type of appliance by the type's applicable amount. The maximum credit amount is reduced each subsequent year by the amount of credit, if any, claimed in the prior year. In addition, there are sublimits for each type of home appliance. This credit is a component of and subject to the tax liability limitation and carryover rules of the general business credit under Code Secs. 38 and 39 (¶1365).

### ¶1365GG. Mine Rescue Team Training Credit.

Eligible employers were entitled to a credit for mine rescue team training expenses incurred in tax years beginning after December 21, 2005, but before January 1, 2012. The credit amount was equal to the lesser of: (1) 20 percent of the training program costs paid or incurred during the tax year for each qualified mine rescue team employee, including wages paid while attending the training program, or (2) $10,000 (Code Sec. 45N, as amended by the Tax Relief, Unemployment Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)).[84] An eligible employer was any taxpayer that employs individuals as miners in underground mines located in the United States. A qualified mine rescue team employee was a full-time miner employee who was eligible for more than six months of the tax year to serve as a mine rescue team member because he or she has met certain training requirements. To prevent any double benefits that may arise from the claiming of this credit, eligible mine employers could not claim as a wage deduction the amount of any mine rescue team training credit determined for the tax year (Code Sec. 280C). The mine rescue team training credit was claimed on Form 8923, Mine Rescue Team Training Credit, and was a component of and subject to the tax liability limitation and carryover rules of the general business credit under Code Secs. 38 and 39 (¶1365).

### ¶1365II. Employer Credit for Differential Wage Payments to Military Personnel.

Eligible employers making differential wage payments after June 17, 2008, but before January 1, 2012, could claim a credit equal to 20 percent of such eligible payments for each employee (Code Sec. 45P, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312)).[86] An eligible differential wage payment was a payment that: (1) must be made by an employer to an individual with respect to any period during which the individual is performing services in the uniformed armed forces on active duty for a period of more than 30 days, and (2) must represent all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer (Code Sec. 3401) (¶895 and ¶2609). The differential wage payment was limited to $20,000 per employee paid during the tax year. A qualified employee was an individual who has been employed by the employer for a period of 91 days immediately preceding the period for which any differential wage payments were made. A qualified employer was a small business employer that: (1) employs an average of fewer than 50 individuals on any day during the tax year, and (2) provides differential wage payments to every qualified employee under a written plan. The deduction for wages was reduced by the amount of differential wage payment credit claimed as well as reducing any other credit related to compensation paid to eligible employees. The differential wage payment credit was a component of and subject to the tax liability limitation and carryover rules of the general business credit under Code Secs. 38 and 39 (¶1365).

### ¶1376. Qualified Zone Academy Bond Credit.

State and local governments are authorized to issue qualified zone academy bonds (QZAB) through 2011 to be used to improve certain eligible public schools (Code Sec. 1397E and Code Sec. 54E, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). QZABs issued after October 3, 2008, will be subject to the requirements for qualified tax credit bonds (¶1385). Up to $400 million bonds may be issued for this purpose. QZABs issued prior to October 3, 2008, are still subject to the provisions under Code Sec. 1397E. Up to $400 million of QZABs may be issued each year. For 2009 and 2010, the credit amount has been increased to $1.4 billion over the two year period. The credit amount is calculated on Form 8860, Qualified Zone Academy Bond Credit. Allocation and carryover rules also apply

The refundable credit for QZABs is repealed for obligations issued under the 2011 limitation or any carryforward of such an allocation (Code Sec. 6431(f)(3)(A)(iii), as amended by the Tax Relief Act of 2010). The provision has no effect on bonds issued with the limitation carried forward from 2009 or 2010.

### ¶1377. Qualified School Construction Tax Credit Bonds.

Tax credit bonds known as "qualified school construction bonds" may be issued through December 31, 2010 (Code Sec. 54F). These bonds must satisfy the requirements relating to expenditures, reporting, arbitrage, maturity and conflicts of interest under Code Sec. 54A (Code Sec. 54A(d)(1)(E)). The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirement remain at $10 million through December 31, 2012 (Code Sec. 148(f)(4)(D)(vii), as amended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312)). In 2013, the arbitrage rebate requirement will decrease from $10 million to $5 million.

## *Chapter 14: Minimum Tax*

### ¶1401. The Minimum Tax Equation.

[Change the eighth text paragraph to read:]

From 2003 through 2012, qualified dividends are taxed at the net capital gains rates (Code Sec. 55(b)(3)(C). The current sunset provisions, which were extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), provide that the reduced net capital gains rates and the special treatment of qualified dividend income will expire at the end of 2012 and the previous net capital gains rates will again apply for regular tax and AMT purposes. The special qualified five-year gain rates will be reinstated after 2012.

### ¶1405. Amount Excluded from Minimum Taxation.

For the 2010 tax year, the AMT exemption amount is $72,450 for married individuals filing a joint return and surviving spouses; $47,450 for a single individual who is not a surviving spouse; and $36,225 for a married individual filing a separate return (Act Sec. 201 of the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312). The AMT exemption amount for 2011 is set to increase to $74, 450 for married individuals filing a joint return and surviving spouses; $48,450 for a single individual who is not a surviving spouse; and $37,225 for a married individual filing a separate return (Act Sec. 201 of the Tax Relief, Unemployment Insurance Reauthorization, and Jobs Creation Act of 2010 (P.L. 111-312). The AMT exemption amount of an estate or trust (other than electing small business trusts) remains $22,500 (Code Sec. 55(d)(1)).

Since the AMT exemption amount for individuals has increased in the 2010 tax year, while the phaseout triggers have remained the same, the maximum amount of AMTI that an individual taxpayer may have before the exemption amount is fully phased out has also increased. For married taxpayers filing joint returns and surviving spouses, the decreased AMT exemption amount of $72,450 is completely phased out when AMTI reaches $433,800, up from $429,800 in 2010. For single taxpayers, the exemption amount of $47,450 is completely phased out when AMTI reaches $302,300, up from $299,300 in 2010. Similarly, for married taxpayers filing a separate return, the exemption amount of $36,225 is completely phased out when AMTI reaches $219,900, up from $216,900. For married individuals filing a separate return, the maximum exemption phaseout amount is, in effect, the same as the maximum exemption phaseout amount for married individuals filing jointly. This is accomplished by phasing out the otherwise applicable $36,225 exemption, and by increasing the AMTI of the married individual filing a separate return by the lesser of (1) the $36,225 married filing separately AMT exemption or (2) 25 percent of the excess of AMTI (as determined before this adjustment) over the $219,900 phaseout ceiling. Thus, the ceiling on the amount of AMTI that would subject a married filing separate taxpayer to the full $36,225 add-back and $36,225 exemption phaseout is $364,800, up from $358,800.

*Special Exemption Amounts for Certain Minor Children.* The AMTI exemption amount of a child to whom the "kiddie tax" applies (¶706; ¶1401) is equal to the sum of the child's earned income plus $6,700 in 2010 ($6,800 in 2011) (Code Sec. 59(j); Rev. Proc. 2009-50; Rev. Proc. 2010-40).

### ¶1415. Other Credits.

These include the dependent care credit (Code Sec. 21) (see ¶1301), the credit for the elderly and disabled (Code Sec. 22) (see ¶1302), the adoption credit (in tax years before 2010) (former Code Sec. 23) (see ¶1307), child tax credit (Code Sec. 24) (see ¶1305), the mortgage interest credit for low-income homeowners (Code Sec. 25) (see ¶1306), the Hope Scholarship and Lifetime Learning credits (including the American Opportunity tax credit) (Code Sec. 25A) (see ¶1303), the retirement savings contributions credit (the savers credit) (Code Sec. 25B) (see ¶1304), the credit for certain nonbusiness energy property (Code Sec. 25C) (¶1341), the residential energy efficient property credit (Code Sec. 25D) (see ¶1342), the small plug-in electric vehicle credit (Code Sec. 30) (see ¶1354), the alternative motor vehicle credit (Code Sec. 30B) (see ¶1345), the new qualified plug-in electric drive motor vehicle credit (Code Sec. 30D) (¶1351), and the District of Columbia first-time homebuyer credit (Code Sec. 1400C) (see ¶1308). See ¶1315 for discussion of the nonrefundable personal tax credits.

Additionally, several other specified credits are allowed to the full extent of the taxpayer's regular tax and AMT liability (Code Sec. 38(c)(4)). These credits are listed in the general business credit statute (Code Sec. 38), and may be subject to particular limitations specific to the individual credit. These credits include the alcohol fuels credit (Code Sec. 40) (see ¶1365I), the low-income housing credit (Code Sec. 42) (see ¶1365K), the renewable electricity production credit (Code Sec. 45) (see ¶1365N), the FICA employer tip credit (Code Sec. 45B) (see ¶1365R), the railroad track maintenance credit (Code Sec. 45G) (see ¶1365W), the rehabilitation credit (Code Sec. 47) (see ¶1365B), the business energy credit (Code Sec. 48) (see ¶1365C), and the work opportunity credit (Code Sec. 51) (see ¶1365G).

### ¶1435. Adjustments Affecting Noncorporate Taxpayers.

*State Taxes.* In computing the AMT, no deduction is allowed for state or local property or income taxes (Code Sec. 56(b)(1)(A)(ii)). However, state and local property and income taxes are taken into account in computing adjusted gross income (AGI) if the taxes arose from the operation of a business (Code Sec. 56(b)(1)(A) (see ¶235 and ¶1005)). This exception for use in computing the AGI does not apply to state or local sales taxes, which are deductible as an itemized deduction in the computation of the regular tax for tax years beginning after 2003 and before 2012 (see ¶1021) (Code Sec. 164(b)(5)). Therefore, an individual who elected to deduct state sales taxes rather than state income taxes when computing AMT might not achieve the lowest total tax liability, if the income taxes paid were allowable in the computation of the taxpayer's adjusted gross income.

## *Chapter 15: Tax Accounting*

### ¶1501. Tax Year.

*Qualifying Electric Transmission Transaction.* Special rules are provided for determining the tax year of inclusion of certain income arising from a qualifying electric transmission transaction. A taxpayer may elect to defer the gain from such a transaction if the taxpayer purchases replacement utility property within four years of the date of the sale (Code Sec. 451(i)).[15] A “qualifying electric transmission transaction” is a sale or other disposition to an independent transmission company, before January 1, 2008, or before January 1, 2012, in the case of a qualified electric utility, of property used in the trade or business of providing electric transmission services or any stock or partnership interest in an entity whose principal trade or business consists of providing those services (Code Sec. 451(i)(3), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

## *Chapter 17: Sales and Exchanges: Capital Gains*

### ¶1701. Gain or Loss From Sale or Exchange of Property.

*Exclusion of Gain on Sale of Small Business Stock*. A noncorporate taxpayer may exclude up to 100 percent of the gain from the sale of qualified small business stock acquired after September 27, 2010, but before January 1, 2012, and held for more than five years (Code Sec. 1202(a), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). None of the excluded gain on such stock will be subject to any alternative minimum tax adjustment. See ¶2396. For stock acquired after February 17, 2009, but before September 28, 2010, and held for more than five years, a noncorporate taxpayer may exclude up to 75 percent of the gain from the sale. Qualified business stock acquired after August 10, 1993, but before February 18, 2009, which is held for more than five years, will qualify for up to a 50-percent exclusion of gain upon its sale. In addition, a noncorporate taxpayer may elect to roll over the realized gain from the sale of qualified small business stock held for more than six months if other small business stock is purchased during the 60-day period beginning on the date of sale (Code Sec. 1045). See ¶2397.

### ¶1735. Characterization of Gain or Loss.

***Comment:*** Capital gains rates (¶1736) will increase to 10 percent for noncorporate taxpayers in the 15-percent income tax bracket and to 20 percent for all other noncorporate taxpayers beginning in 2013. A special reduced rate of 8 percent for noncorporate taxpayers in the 15-percent income tax bracket and 18 percent for all other noncorporate taxpayers on the gains from the sale of property held for more than five years also will become effective beginning in 2013.

### ¶1736. Tax on Capital Gains – Individual, Estate, Trust.

***Comment:*** The capital gains rates for noncorporate taxpayers will be 10 percent for taxpayers in the 15-percent income tax bracket (the 10-percent income tax bracket will be eliminated) and 20 percent for all other taxpayers for tax years beginning in 2013. The rates on unrecaptured Section 1250 gain and collectibles will remain unchanged.

***Comment:*** Qualified dividend treatment will terminate on December 31, 2012.

***Comment:*** Capital gains rates will increase beginning in 2013, however, a new reduced rate of 8 percent for taxpayers in the 15-percent income tax bracket and 18 percent for all other noncorporate taxpayers will apply to the gain on the sale of property held for more than five years.

***Comment:*** Lower capital gains rates will apply to the gain on the sale of exchange of property held for more than five years after December 31, 2012. Capital gains rates will be 10 percent on gains from the sale or exchange of long-term assets for noncorporate taxpayers in the 15-percent tax bracket and 20 percent for gains from the sale or exchange of long-term assets of all other noncorporate taxpayers. An 8-percent rate, however, will apply to the gains from the sale or exchange of property held for more than five years for noncorporate taxpayers in the 15-percent tax bracket. For noncorporate taxpayers in higher tax brackets, an 18-percent rate will apply to gains for property acquired after December 31, 2000, and held for more than five years.

*Small Business Stock*. When a taxpayer sells or exchanges certain small business stock (i.e., Sec. 1202 stock) acquired after September 27, 2010, but before January 1, 2012, that the taxpayer has held for more than five years, 100 percent of the gain may be excluded from the taxpayer's gross income (Code Sec. 1202(a)(4), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). None of the excluded gain on such stock will be subject to any alternative minimum tax adjustment (Code Sec. 1202(a)(4)(C), For qualified stock acquired after February 17, 2009, but before September 28, 2010, and held for more than five years, the amount of gain from the sale or exchange of such stock that may be excluded is equal to 75 percent (Code Sec. 1202(a)(3)). Gain from the sale or exchange of qualified small business stock acquired after August 10, 1993, but before February 18, 2009, and held for more than five years, is excludable up to 50 percent (Code Sec. 1202(a)(1)). If the small business stock qualifies for this exclusion, any recognized gain from the sale or exchange of the stock is subject to a maximum capital gains rate of 28 percent (Code Sec. 1(h)(4)(A)(ii)). See ¶2396 for more information concerning small business stock. Generally, the exclusion of gain from the sale or exchange of qualified small business stock is increased to 60 percent in the case of the sale or exchange of stock of an enterprise zone business (as defined Code Sec. 1397C(a)) that operates within an empowerment zone and that was acquired after December 21, 2000 (Code Sec. 1202(a)(2)). The exclusion percentage for gain from the sale or exchange of qualified small business stock for an enterprise zone business located in an empowerment zone, held for more than five years, has been increased to match the exclusion percentage of any qualified small business stock. Thus, for stock acquired after September 27, 2010, but before January 1, 2011, the exclusion percentage will be 100 percent; for stock acquired after February 17, 2009, but before September 28, 2010, the exclusion percentage will be 75 percent; and for stock acquired after December 21, 2000, but before February 18, 2009, the exclusion percentage will be 60 percent. See ¶999B for more information concerning empowerment zones and enterprise zone businesses.

## *Chapter 21: Retirement and Benefits*

### ¶2153G. Distributions – Taxation.

*Charitable Distributions*. An individual can continue to have up to $100,000 of their IRA balance distributed in 2010 and 2011 to a charitable organization without recognizing income on the distribution (Code Sec. 408(d)(8), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The exclusion from income only applies to a distribution that is otherwise includible in income and is made directly to a charitable organization on or after the date the account owner reached age 70 1/2. The account owner is not allowed a deduction for the contribution (¶1058).

A special rule permits a taxpayer to elect to have a qualified charitable distribution made in January 2011 treated as having been made on December 31, 2010 (Act Sec. 725(b)(2) of the Tax Relief Act of 2010). If a taxpayer makes the election as prescribed by the IRS, then the distribution made in January 2011 counts toward: (1) the taxpayer's $100,000 exclusion limitation for the 2010 calendar year; *and* (2) the taxpayer's required minimum distribution (RMD) for the 2010 calendar year.

### ¶2192A. Adoption Assistance Program.

The exclusion is limited and subject to phase out for higher income taxpayers the same as for the adoption credit (¶ 1326A). For 2010, the maximum exclusion amount is $13,170 and the phaseout range for upper income taxpayers is $182,520 to $222,520 (Rev. Proc. 2009-50). For tax years beginning after 2010, the maximum exclusion amount is indexed for inflation (Code Sec. 137(b)(1), as amended by the Patient Protection and Affordable Care Act (P.L. 111-148), and as further amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). The maximum credit for 2011 will be $13,360 and the phaseout range will be $185,210 to $225,210. For a child who is a U.S. citizen or resident, the exclusion is taken in the year the payments were made regardless if the adoption became final. However, for the adoption of a foreign child, a taxpayer cannot exclude the payments until the adoption becomes final. Although the excluded amount under an adoption assistance program is not subject to income tax withholding, the payment remains subject to Social Security, Medicare and federal unemployment taxes. Other requirements and the definition of qualifying adoption expenses are the same as found under the adoption credit (¶1326A).

## *Chapter 23: Special Corporate Status*

### ¶2303. Taxation of Mutual Funds.

A mutual fund (regulated investment company) is subject to taxation at regular corporate income tax rates on its "investment company taxable income" (Code Sec. 852(b); Reg. §1.852-3). Investment company taxable income is computed on Form

1120-RIC in the same manner as the taxable income of an ordinary corporation with the following adjustments:

- gross income is the fund's ordinary income (net capital gains are not included);
- a deduction is allowed for any ordinary dividends paid (however, no deduction is allowed for dividends of capital gains or tax-exempt interest);
- no deduction is allowed for dividends received;
- no deduction is allowed for net operating losses (NOLs);
- taxable income of a short tax year is not annualized; and
- if the fund so elects, taxable income is computed by disregarding the short-term discount obligation rules of Code Sec. 454(b).

For purposes of the dividends-paid deduction, dividends declared and payable by a mutual fund in October, November or December in a calendar year will be treated as paid on December 31 of that year even if they are actually paid in January of the following calendar year (Code Sec. 852(b)(7)). In addition, a mutual fund may declare and pay "spillover dividends" after the close of a tax year that are considered made out of a mutual fund's earnings and profits for that year. Spillover dividends are also included in the calculation of mutual fund taxable income for that year and are considered in determining whether the mutual fund met its distribution requirements for the year. Spillover dividends in tax years beginning on or before December 22, 2010, must be declared no later than the due date for filing the mutual fund's tax return for the year to which the spillover dividend relates. Spillover dividends for such years must be paid no later than the date of the first regular dividend payment after the declaration and, in any event, no later than twelve months after the close of the tax year to which the spillover dividend relates (Code Sec. 855(a), prior to amendment by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). Spillover dividends in tax years beginning after December 22, 2010, must be declared no later than the fifteen day of the ninth month following the close of the tax year to which the dividend relates, or the extended due date for the mutual fund's return for the tax year, whichever comes later. The dividend must be paid no later than the date of the first dividend payment of the same type of dividend (e.g., capital gains or ordinary) after the declaration, but no later than twelve months after the close of the tax year to which the dividend relates (Code Sec. 855(a), as amended by P.L. 111-325).

On the other hand, a mutual fund, other than a publicly traded mutual fund, may generally not claim a deduction for dividend distributions if it singles out one class of shareholders, or one or more members of a class of shareholders, for special dividend treatment unless such treatment was originally intended when the dividend rights were created (Code Sec. 562(c); Rev. Rul. 89-81). The IRS has issued guidance describing the conditions under which distributions to mutual fund shareholders may vary and nevertheless be deductible, including the treatment of distributions to shareholders that differ as a result of the allocation and payment of fees and expenses (Rev. Proc. 99-40). For distributions in tax years beginning after December 22, 2010, the rule has been repealed for publicly offered mutual funds, as defined in Code Sec. 67(c)(2)(B)

(Code Sec. 562(c), as amended by P.L. 111-325).

*Excise Taxes.* A nondeductible excise tax is generally imposed on a mutual fund that does not satisfy minimum distribution requirements. The tax is four percent of the excess of any "required distribution" for the calendar year over the amount actually distributed for the calendar year. For this purpose, the required distribution is the sum of 98.2 percent of the fund's ordinary income for the year, plus 98.2 percent of its net capital gain income for the one-year period ending October 31 of the calendar year. (For calendar years before 2011, the amounts were 98 percent.) Special rules apply in how a mutual fund treats post-October 31 capital gains and foreign currency losses (Code Sec. 4982, as amended by P.L. 111-325).

### ¶2305. Capital Gains of Mutual Funds.

A mutual fund (regulated investment company) may avoid corporate level tax on its net capital gains by distributing such gains to shareholders. However, if it elects to retain some of its net capital gains, then it will be subject to tax at regular capital gains rates on the excess of its net capital gains for the tax year over the amount of any capital gains dividends paid during the year (Code Sec. 852(b)(3)). Form 2438</xref> is used to figure and report the fund's capital gains. Although the fund is taxed on its undistributed net capital gains, it may elect to pass through the net capital gains and tax paid to shareholders. Form 2439 is used to notify each shareholder of his or her portion of the undistributed capital gains and tax paid for the year (¶2309 and ¶2311).

*Capital Loss Carryovers.* For tax years beginning on or before December 22, 2010, a mutual fund can carry over a net capital loss to each of the eight tax years following the loss year as a short-term capital loss (Code Sec. 1212(a)(1)(C)(i), prior to amendment by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). The entire amount of a net capital loss is carried over to the first tax year succeeding the loss year and the portion of the loss that may be carried to each of the next seven years is the excess of the net capital loss over the capital gain net income (determined without regard to any net capital loss for the loss year or tax year thereafter) for each of the prior tax years to which the loss may be carried.

For tax years beginning after December 22, 2010, net capital loss carryover rules similar to those applicable to individual taxpayers also apply to mutual funds. If a mutual fund has a net capital loss for a tax year, any excess of the net short-term capital loss over the net long-term capital gain is treated as a short-term capital loss arising on the first day of the next tax year, and any excess of the net long-term capital loss over the net short-term capital gain is treated as a long-term capital loss arising on the first day of the next tax year (Code Sec. 1212(a)(3)(A), as added by P.L. 111-325). There is no limit to the number of tax years that a net capital loss of a mutual fund may be carried over. Capital gain net income is the excess of gains from the sale or exchange of capital assets over losses from such sales or exchanges (Code Sec. 1222(9)).

Special rules coordinate the treatment of net capital loss carryovers under the pre-enactment law with the mutual fund's post-enactment tax years. These rules apply to capital loss carryovers from tax years beginning on or before the date of enactment of the carryover provision, and to capital loss carryovers from other tax years before the corporation became a mutual fund. Under these rules, amounts treated as a long-term or short-term capital loss arising on the first day of the next tax year under the new rules are determined without regard to amounts treated as a short-term capital loss under the pre-enactment carryover rule. In determining the reduction of a present-law carryover by capital gain net income for a prior tax year, any capital loss treated as arising on the first day of the prior tax year under the new rules is taken into account in determining capital gain net income for the prior year (Code Sec. 1212(a)(3)(B), as added by P.L. 111-325).

**¶2307. Tax-Exempt Interest of Mutual Funds.**

A mutual fund (regulated investment company) may pass on tax-exempt interest earned on state or local bonds to its shareholders in the form of exempt-interest dividends, but only if the bonds represent at least 50 percent of the value of the fund's assets at the close of each quarter of its tax year (Code Sec. 852(b)(5)). Form 1099-INT is used to inform shareholders of dividends identified as tax-exempt interest dividends (¶2309 and ¶2311).

An upper-tier mutual fund that is a qualified fund of funds may pass through exempt-interest dividends and foreign tax credits to its shareholders, without having to meet the 50-percent asset requirement (Code Sec.852(g), as added by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). A qualified fund of funds is a RIC if, at the close of each quarter of the tax year, at least 50 percent of the value of its total assets is represented by interests in other RICs (Code Sec. 852(g)(2)</xref>, as added by P.L. 111-325).

Generally, if a mutual fund shareholder receives an exempt-interest dividend with respect to any share held for six months or less, then any loss on the sale or exchange of such share is disallowed to the extent of the amount of the exempt-interest dividend (Code Sec. 852(b)(4)(B)). However, for losses incurred on shares of stock for which the taxpayer's holding period begins after December 22, 2010, the disallowance of a loss on the sale or exchange of mutual fund shares, on which exempt-interest dividends have been paid, does not apply, except as otherwise provided by regulations, to a regular dividend paid by a RIC which declares exempt-interest dividends on a daily basis in an amount not less than 90 percent of its net tax-exempt interest and distributes such dividends on a monthly or more frequent basis (Code Sec. 852(b)(4)(E)(i), as added by P.L. 111-325).

**¶2309. Designation of Mutual Fund Distributions.**

The requirement that shareholders be notified of the designation of mutual fund distributions is now a reporting requirement.

### ¶2311. Taxation of Mutual Fund Distributions.

The requirement that shareholders be notified of the designation of mutual fund distributions is now a reporting requirement.

### ¶2313. Earnings and Profits of Mutual Funds.:

Dividends from a mutual fund (regulated investment company), just like dividends from most other corporations, must be paid out of earnings and profits (Code Secs. 301, 312, 316, 561, 562(a) and 852(a)(1)) (see ¶747--¶757). Thus, a mutual fund must be careful to maintain sufficient current or accumulated earnings and profits to satisfy annual dividend distribution requirements. There should also be enough earnings and profits to avoid the excise tax on the undistributed income of a mutual fund (Code Sec. 4982).

A mutual fund's earnings and profits are generally computed under the rules applicable to ordinary corporations. However, for tax years beginning on or before December 22, 2010, a mutual fund's earnings and profits for any tax year are not reduced by any amount that is not allowable as a deduction in computing its taxable income for the tax year. Such amounts apply to reduce the mutual fund's accumulated earnings and profits (Code Sec. 852(c)(1), prior to amendment by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). For tax years beginning after December 22, 2010, mutual funds do not reduce their current earnings and profits by any amount they are unable to claim as a deduction from taxable income in that year. However, capital loss carryovers are applied to reduce accumulated earnings and profits for the first year of carryover (Code Sec. 852(c)(1)(A), as added by P.L. 111-325). For tax years beginning on or before December 22, 2010, deductions disallowed for expenses, interest and amortizable bond premium pertaining to tax-exempt interest are not taken into account in computing current earnings and profits (Code Sec. 852(c)(1), prior to amendment by P.L. 111-325). For tax years beginning after December 22, 2010, deductions disallowed in computing mutual fund taxable income with respect to tax-exempt interest are allowed in calculating a mutual fund's current earnings and profits (but not accumulated earnings and profits) (Code Sec. 852(c)(1)(B), as added by P.L. 111-325).

Where a mutual fund that is not a calendar-year taxpayer makes distributions to its shareholders with respect to any class of stock of the company in excess of the sum of its current and accumulated earnings and profits (i.e., where a portion of the distribution constitutes return of capital or capital gain), its current earnings and profits are allocated first to distributions during the mutual fund's tax year that are made before January 1 (Code Sec. 316(b)(4), as added by P.L. 111-325). Where a mutual fund has more than one class of stock, the provision will apply separately to each class of stock, so that distributions made during the corporation's tax year will be considered made to the shares with higher priority before they are made to shares with lower priority (Rev. Rul. 69-440, 1969-2 CB 46).

## ¶2315. Redemption of Mutual Fund Shares.

Generally, a redemption of stock by a corporation (including a mutual fund (regulated investment company)) is treated as an exchange of stock if the redemption falls within one of four categories of transactions (Code Sec. 302(a)): (i) a redemption that is not essentially equivalent to a dividend; (ii) a substantially disproportionate redemption; (iii) a redemption that terminates the shareholder's interest in the corporation; and (iv) a partial liquidation, in the case of a noncorporate shareholder (Code Sec. 302(b)). Redemptions of corporate stock are discussed in ¶742--¶745. Because transactions that fall within one of thse four categories are treated as exchanges of stock, they normally result in capital gain treatment to the redeemed shareholder. If the redemption does not fall within any of these categories, it is treated as a Code Sec. 301 distribution of property that generally results in dividend treatment (Code Sec. 302(d)).

For distributions after December 22, 2010, and except to the extent provided in regulations, two new rules apply. First, a distribution in redemption of stock of a publicly offered mutual fund will be treated as an exchange for stock if (i) the redemption is upon the demand by the stockholder, and (ii) the mutual fund issues only stock that is redeemable upon the demand of the stockholder (Code Sec. 302(b)(5), as added by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). A publicly offered RIC is a RIC whose shares are (i) continuously offered pursuant to a public offering, (ii) regularly traded on an established securities market, or (iii) held by or for no fewer than 500 persons at all times during the tax year (Code Sec. 67(c)(2)(B)). Second, the Code Sec. 267 loss disallowance and loss deferral rules will not apply to any redemption of stock of a fund-of-funds mutual fund if the mutual fund issues only stock that is redeemable upon the demand of the stockholder and the redemption is upon the demand of another mutual fund (Code Sec. 267(f)(3)(D), as added by P.L. 111-325).

## ¶2318. Basis in Mutual Fund Shares.

For charges incurred in tax years beginning after December 22, 2010, if the mutual fund stock is disposed of within 90 days after the date it was originally acquired, the taxpayer must acquire stock in the same RIC or another RIC during the period beginning on the date of the disposition of the original stock, and ending on January 31 of the calendar year following the calendar year that includes the date of such disposition for this rule to apply (Code Sec. 852(f)(1)(C), as amended by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-325)). If the later-acquired stock is acquired during this more limited period, and the otherwise applicable load charge on the later-acquired stock is reduced by a reinvestment right that the taxpayer received from making the original stock acquisition or incurring a load charge on that original acquisition, then the load charge incurred in the original acquisition (to the extent it does not exceed the load charge reduction due to the reinvestment right) is not taken into account for purposes of determining the amount of gain or loss on the disposition of the original stock.

### ¶2320. Tax Credit Elections.

Effective for tax years beginning after December 22, 2010, an upper-tier mutual fund that is a qualified fund of funds may pass through foreign tax credits to its shareholders, without having to meet the 50-percent asset requirement (Code Sec. 852(g)(1)(B), as added by the Regulated Investment Company Modernization Act of 2010 (P.L. 111-25)). A "qualified fund of funds" is a mutual fund at least 50 percent of the total value of whose assets (as measured at the close of each quarter of its tax year) is represented by interests in other mutual funds (Code Sec. 852(g)(2), as added by P.L. 111-325).

### ¶2323. Mutual Fund Distributions After Tax Year Ends.

Delete paragraph.

### ¶2396. Exclusion of Capital Gain from Small Business Stock.

A noncorporate taxpayer can exclude from gross income 50 percent of any gain from the sale or exchange of qualified small business stock held for more than five years (Code Sec. 1202(a)). The exclusion is 60 percent if the qualified small business stock issued by a corporation in an empowerment zone. The exclusion is 75 percent for stock acquired after February 17, 2009, and before September 28, 2010, and 100 percent for stock acquired after September 27, 2010, and before January 1, 2012 (Code Sec. 1202(a), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). Eligible gain from any single issuer is subject to a cumulative limit for any given tax year to the greater of: (1) $10 million reduced by the aggregate amount of eligible gain taken in prior years ($5 million for married taxpayers filing separately), or (2) 10 times the taxpayer's adjusted basis of all qualified stock of the issuer disposed of during the tax year. For alternative minimum tax purposes, seven percent of the excluded gain is a preference item (¶1425) (Code Sec. 57(a)(7)).

## *Chapter 24: Foreign Income and Transactions*

### ¶2431. Fixed or Determinable Periodic Income.

*U.S. Possession Corporation*

Nonresident aliens and foreign corporations are not subject to U.S. taxes on interest from bank deposits that are not effectively connected with a U.S. trade or business. Additional exceptions to the tax on FDAP income apply to interest received by a nonresident alien or foreign corporation from bank deposits that are not effectively connected with a U.S. trade or business, as well as the types of interest received by a foreign corporation that will not be considered portfolio interest, including interest received by a foreign corporation that is a bank or a controlled foreign corporation (CFC) (¶2487). "Interest-related" dividends and short-term capital gains dividends received by a nonresident alien or foreign corporation from a mutual fund (regulated investment company) are also exempt from U.S. taxation under certain circumstances if paid with respect to a tax year beginning before January 1, 2012 (Code Secs. 871(k), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶2442. Disposition of U.S. Real Property Interest.

The term "qualified investment entity," as used in Code Sec. 897, continues to include regulated investment companies (RICs) (mutual funds) that are U.S. real property holding companies (USRPHCs) through December 31, 2011, for all situations in which the inclusion would otherwise expire at the end of 2009 (Code Sec. 897(h)(4)(A)(ii), as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶2487. Controlled Foreign Corporation.

Three provisions have been extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) for two years, through 2011. The exceptions from subpart F income for so-called active financing income; the temporary exception from subpart F insurance income for "exempt insurance income" of a qualifying insurance company or a qualifying insurance company branch; and the look-through rule that applies to dividend, interest, rent and royalty payments received by a controlled foreign corporation from a related corporation are all extended.

## *Chapter 26: Withholding - Estimated Tax*

### ¶2648. FICA Taxes.

***Comment:*** For 2011, as part of a Congressionally imposed "payroll tax holiday," the OASDI tax imposed on employees and withheld by employers is reduced by two percent, to 4.2 percent (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)).

### ¶2664. Rate and Payment.

***Comment:*** For 2011, as part of a Congressionally imposed "payroll tax holiday," the rate of the OASDI tax on self-employment income is reduced by two percent, to 10.4 percent (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). See ¶47.

### ¶2768. Refunds Disregarded for Means-Tested Assistance Programs.

Effective for amounts received after December 31, 2009, any federal tax refund, or advance payment with respect to a refundable federal tax credit, made to any individual cannot be taken into account as income, or as resources for a period of 12 months from receipt, for purposes of determining the individual's eligibility (or that of any other individual) for benefits or assistance, or for the amount or extent of benefits or assistance, under (1) any federal program, or (2) any state or local program financed in whole or in part with federal funds (Code Sec. 6409, as added by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). This treatment will not apply to any amount received after December 31, 2012.

### ¶2670. Self-Employment Income.

***Comment:*** For 2011, as part of a Congressionally imposed "payroll tax holiday," the rate of the OASDI tax on self-employment income is reduced by two percent, to 10.4 percent (Act Sec. 601(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312)). See ¶47.

## *Chapter 29: Estate, Gift and Generation-Skipping Transfer Tax*

### ¶2901. Transfer Tax System.

The estate, gift, and generation-skipping transfer (GST) taxes were designed to form a unified transfer tax system on the transfer of property at death (estate tax), during life (gift tax), and on transfers that skip a generation (GST tax). In 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) (EGTRRA) prospectively repealed the estate and GST taxes for estates of decedents dying after December 31, 2009 (Code Sec. 2210(a), as amended by EGTRRA) while retaining the gift tax, although in a modified form. However, in 2010, the sunset of the transfer tax provisions of EGTRRA, which was scheduled to occur after December 31, 2010, were extended through December 31, 2012, by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) (Tax Relief Act of 2010). In addition, the Tax Relief Act of 2010 provides that federal estate and generation-skipping transfer (GST) taxes will apply to the estates of decedents dying and GSTs made after December 31, 2009, and before January 1, 2013, but with a higher estate tax applicable exclusion and GST exemption amount of $5 million and lower tax rates (35 percent maximum) than would have applied under the sunset provision. In addition, the modified adjusted carryover basis rules are repealed. The gift tax will continue to apply, as it did in 2010, with a maximum tax rate of 35 percent, but with an applicable exclusion amount of $5 million for gifts made in 2011 and 2012. Both the estate and gift tax applicable exclusion amounts will be subject to indexingfor inflation beginning in 2012. Finally, the Tax Relief Act of 2010 provides an election to allow the unused portion of the applicable exclusion amount of a predeceased spouse to be available to the estate of his or her surviving spouse.

The Tax Relief Act of 2010 also provides that, for certain estates, executors may elect to have the EGTRRA rules (no estate tax, but modified carryover basis) apply. The executor of the estate of a decedent who died after December 31, 2009, and before

January 1, 2011 (i.e., a decedent who died in 2010), may elect to apply the Internal Revenue Code as if the reinstatement of the estate tax by the Tax Relief Act of 2010 had not occurred. Thus, if made, this election would mean that the estate tax would not apply to that decedent's estate, but that the carryover basis rules would apply to assets transferred by the estate to heirs. This election is not available with respect to the GST tax, because for 2010 the GST tax rate is zero. A decedent's classification as a "transferor" under Code Sec. 2652(a)(1) for purposes of the GST tax will not be affected by an executor's decision to elect that the estate tax not apply to the estate of a decedent dying in 2010. Thus, the $5 million GST tax exemption is available in 2010 regardless of whether the executor of a decedent who dies in 2010 makes the election (Joint Committee on Taxation, Technical Explanation of the Revenue Provisions Contained in the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (JCX-55-10), December 10, 2010).

Absent the subsequent amendment of EGTRRA by the Tax Relief Act of 2010, the estate and GST taxes for estates of decedents dying after December 31, 2009 (Code Sec. 2210(a), as amended by EGTRRA) were repealed. The gift tax was retained, although in a modified form Also under EGTRRA, prior to amendment in 2010, the stepped-up basis at death rules were repealed (Code Sec. 1014) and replaced with the modified carryover basis at death rules (Code Sec. 1022). Effective for property acquired from a decedent dying after December 31, 2009, the income tax basis of property acquired from a decedent was generally to be carried over from the decedent (Code Sec. 1022). More specifically, the recipient of property would receive a basis equal to the lesser of the adjusted basis of the property in the hands of the decedent, or the fair market value of the property on the date of the decedent's death. Under these carryover basis at death rules, executors could elect to increase the basis of estate property by up to $1.3 million, and possibly an additional $3 million, in the case of property passing to a surviving spouse (Code Sec. 1022(b)). Although the Code had long provided that the recipient of a lifetime gift received the donor's basis in the transferred property, this carryover basis rule previously did not apply to property received from a decedent.

The unified transfer tax system was "de-unified" with different applicable credit amounts applying to estates and gifts beginning in 2004. In 2002, the gift tax applicable credit amount was raised to $345,800 (sheltering the first $1 million of a donor's lifetime gifts) in 2002 and remained at this amount through the estate tax repeal in 2010 without adjustment for inflation (Code Sec. 2505(a)(1)). In 2004, the estate tax applicable credit amount increased to $555,800 and sheltered the first $1.5 million of a decedent's estate (the applicable exclusion amount) (Code Sec. 2010(c)). The applicable credit amount increased again in 2006 to $780,800, sheltering $2 million and again in 2009 to $1,455,000, sheltering $3.5 million. Also, starting in 2004 and continuing through 2011, the lifetime GST tax exemption amount is the same as the estate tax applicable exclusion amount. For 2010 and 2011, both the estate tax applicable exclusion amount and the GST tax exemption are $5,000,000. For 2012, the GST exemption remains at $5,000,000 but the exclusion amount for estate taxes is subject to inflation indexing.

This increase in the amount of the exemptions for the estate and GST taxes was accompanied by a gradual decrease in the top marginal tax rate applicable to the estate, gift and GST taxes, as follows:

- 48%; in 2004;
- 47%; in 2005;
- 46%; in 2006;
- 45%; in 2007, 2008 and 2009;
- 35%; in 2010 (estate tax); 0%; in 2010 (GST); and
- 35%; in 2011 and 2012.

### ¶2933. Family-Owned Business Deduction.

*(Repealed from 2004 through 2012)*. Certain estates of decedents dying after December 31, 1997, and before January 1, 2004, could elect to deduct up to $675,000 of a qualified family-owned business interest (QFOBI) from the decedent's gross estate (Code Sec. 2057). A qualified family-owned business is any interest in a trade or business regardless of form with a principal place of business in the U.S., the ownership of which is held at least (1) 50 percent by one family, (2) 70 percent by two families, or (3) 90 percent by three families. If the interest is held by more than one family, the decedent's family must own at least 30 percent of the trade or business. One of the requirements for a decedent's interest to qualify as a QFOBI was that the decedent, or a member of the decedent's family, had to have owned and materially participated in the business for at least five of the eight years preceding the decedent's death. Further, a qualified heir will continue to be subject to a recapture tax after the decedent's death if the heir, or a member of the heir's family, does not materially participate in the business for at least five years of any eight-year period within 10 years following the decedent's death. The principal factors to be considered regarding "material participation" include physical work and participation in management decisions. To report a taxable event for recapture tax purposes, the heir must file Form 706-D, U.S. Additional Estate Tax Return Under Code Sec. 2057. Another requirement for the QFOBI deduction is that the decedent must have been a U.S. citizen or resident at the time of death. In addition, the aggregate value of the decedent's QFOBIs passing to qualified heirs must exceed 50 percent of the decedent's adjusted gross estate.

*Recapture Tax After Repeal.* Pursuant to EGTRRA, the QFOBI deduction is repealed for the estates of decedents dying after December 31, 2003 (Code Sec.2057(j)). However, under the sunset provision of EGTRRA, as amended by Tax Relief Act of 2010, the QFOBI deduction is available to the estates of decedents dying after December 31, 2012, if the estate meets the requirements of Code Sec. 2057 and makes the election on the federal estate tax return.

### ¶2934 Credits Against the Estate Tax

A number of credits are available to offset a decedent's federal estate tax liability. The most important credit is the applicable credit amount (formerly the unified credit).

In 2011, the applicable credit amount can be used to offset an estate tax liability on a taxable estate of $5 million.

*State Death Tax Credit (Repealed through 2012).* Prior to 2005, the estate tax was offset by state death taxes actually paid to a state or the District of Columbia. This credit for state death taxes was limited by a graduated rate table that used the adjusted taxable estate as a base (the taxable estate reduced by $60,000 (Code Sec. 2011)

Pursuant to EGTRRA, the state death tax credit was reduced annually in 25-percent increments, starting in 2002, until it was completely repealed in 2005. For estates of decedents dying in 2004, the state death tax credit was reduced by 75 percent (Code Sec. 2011(b), as amended by EGTRRA). In 2005, the credit was replaced by a "deduction" that will not longer be applicable when the state death tax credit is reinstated beginning in 2013. In addition, the state death tax deduction is subject to a limitations period, which generally requires the deduction to be claimed within four years after the estate tax return is filed.

Pursuant to the sunset provision in EGTRRA, the state death tax credit allowed for estate, inheritance, legacy, or succession taxes paid to any state or the District of Columbia (Code Sec. 2011) will be restored for the estates of decedents dying after December 31, 2012. Correspondingly, the state death tax deduction (Code Sec. 2058) will no longer be applicable

## ¶2938. Filing Estate Return and Liability for Payment.

Form 706, U.S. Estate (and Generation-Skipping Transfer) Tax Return, must be filed for every U.S. citizen or resident decedent whose gross estate exceeds $5 million in 2010 and $5 million in 2011. The estate tax table is at ¶42.

**Comment:** For certain estates, executors may elect to have the EGTRRA rules (no estate tax, but modified carryover basis) apply. The executor of the estate of a decedent who died after December 31, 2009, and before January 1, 2011 (i.e., a decedent who died in 2010), may elect to apply the Internal Revenue Code as if the reinstatement of the estate tax by the Tax Relief Act of 2010 had not occurred. Thus, if made, this election would mean that the estate tax would not apply to that decedent's estate, but that the carryover basis rules would apply to assets transferred by the estate to heirs.

## ¶2939. Election to Pay Estate Tax in Installments.

*Rates Scheduled to Sunset Under EGTRRA.* Pursuant to the sunset provision in EGTRRA, as amended by the by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), the rule under Code Sec. 6166(b)(1)(B)(ii); (b)(1)(C)(ii) and (b)(9)(B)(iii)(I) that provided that a decedent's estate cannot qualify for deferred payment of estate tax if the number of partners or shareholders in the decedent's closely held business exceeds 45 is scheduled to expire for the estates of decedents dying after December 31, 2012. As a result, the estate of a decedent who dies after December 31, 2012, will not be able to qualify for deferred payment of estate tax if the number of partners or shareholders in the decedent's closely held business exceeds 15. The rule permitting stock in qualifying lending and financing entities to be treated as stock in an active trade or business for purposes of the election to pay estate tax in installments is also scheduled to expire under the sunset provisions of EGTRRA. Therefore, if a decedent dies after December 31, 2012, owning stock in lending and financing entities, this stock will not be treated as stock in an active trade or business for purposes of the installment-payment election. Finally, the rule under Code Sec. 6166(b)(8)(B) providing that only the stock of holding companies must be non-readily tradable in order for an executor to elect to pay estate tax in installments is scheduled to expire for estates of decedents dying after December 31, 2012, under the sunset provision of EGTRRA. Consequently, in the case of a decedent who dies after December 31, 2012, the rule requiring that stock in a holding company must be non-readily tradable in order to qualify for purposes of the installment payment rules will be applied not just to the holding company, but to any operating subsidiary.

### ¶2942. Transfers Subject to Tax.

Every generation-skipping transfer (GST) is subject to the GST tax (Code Sec. 2601). The GST tax rate is 0 percent for 2010 and 35 percent for 2011.

### ¶2943. Lifetime Exemption.

Individual taxpayers are allocated a lifetime exemption that shields $5 million in 2010, 2011 and 2012 in GSTs from the tax (Code Sec. 2631). Married couples may treat transfers as if made one-half by each spouse under Code Sec. 2513.

### ¶2944. Filing the Return and Paying the GST Tax.

For decedents dying in 2010 and in 2011, executors must file the return (Form 706, Schedules R and R-1) and pay the tax for direct skips occurring at death.

**Comment:** A special election provision gives estate executors the power to elect application of the EGTRRA rules prior to amendment by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) (that is, no estate or GST taxes, and carryover basis), for estates of decedents dying after December 31, 2009 and before January 1, 2011 (Act Sec. 301(c) of the Tax Relief Act of 2010). This election must be made at the time and in the manner as provided by the IRS, and is revocable only with the consent of the IRS.

### ¶2945. Effects of EGTRRA Sunset on GST Tax.

Under the sunset provision of EGTRRA, as amended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), certain amendments made by the Act are set to expire. Unless Congress takes further action, these amendments will not apply to generation-skipping transfers after December 31, 2012. The deemed and retroactive GST allocation provisions (Code Sec. 2632(c)) which were added under EGTRRA, will not be operative beginning in 2011. The provision allowing for a qualified severance of a trust for purposes of the GST tax is scheduled to expire for generation-skipping transfers after December 31, 2012 (Code Sec. 2642(a)(3)). As a result, a taxpayer will no longer be able to make a qualified severance beginning in 2013. The clarification of the valuation rules with respect to the determination of the inclusion ratio for GST tax purposes is also scheduled to expire for transfers after December 31, 2010 (Code Sec. 2642(b)). Thus, beginning in 2013, these valuation rules will revert to their pre-EGTRRA form. The pre-EGTRRA version does not specifically address when the value of property is finally determined for estate or gift tax purposes. Finally, the provisions providing relief from late GST allocations and elections (Code Sec. 2642(g)(1)), as well as the provision pertaining to substantial compliance (Code Sec. 2642(g)(2)), will not be operative beginning in 2013.

### ¶2946. Modified Carryover Basis Regime.

In connection with the repeal for 2010 of the estate and GST taxes in, prior to amendment by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) (the Tax Relief Act of 2010), the long-standing stepped-up basis at death rules were to be replaced by a carryover basis regime. Prior to the amendment, effective for property acquired from a decedent dying after December 31, 2009, and before January 1, 2011, the income tax basis of property acquired from a decedent was generally to be carried over from the decedent. More specifically, the recipient of the property was to receive a basis equal to the lesser of the adjusted basis of the property in the hands of the decedent, or the fair market value of the property on the date of the decedent's death.

A special election provision (Act Sec. 301(c) of the Tax Relief Act of 2010) gives executors the power to elect application of the EGTRRA rules (that is, no estate or GST taxes, and carryover basis) for estates of decedents dying after December 31, 2009, and before January 1, 2011. This election must be made at the time and in the manner as provided by the IRS, and is revocable only with the consent of the IRS.

### ¶2948. Transfer Tax on Gifts and Bequests from Expatriates.

A U.S. citizen or resident who receives property, directly or indirectly, by gift, devise, bequest, or inheritance from a covered expatriate "covered gift or bequest" after the date of expatriation must pay a tax equal to the value of the covered gift or bequest multiplied by the highest rate in effect under Code Sec. 2001(c), as amended by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), (35 percent for 2010 and 2011) or, if greater, the highest rate in effect under Code Sec. 2502(a), as amended by Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), (35 percent for 2010 and 2011) (Code Sec. 2801(a)). This special transfer tax applies only to the extent that the value of the covered gifts and bequests received by any person during the calendar year exceeds the annual gift tax exclusion amount in effect under Code Sec. 2503(b) ($13,000 for 2010 and 2011) (Code Sec. 2801(c)). The tax is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest (Code Sec. 2801(d)). This rule applies to covered gifts and bequests received on or after June 17, 2008, from transferors (or the estates of transferors) whose expatriation date is on or after June 17, 2008. Covered gifts and bequests to a U.S. trust are subject to the tax. If covered gifts are made to a foreign trust, distributions from that trust to a U.S. citizen or resident are subject to the tax (Code Sec. 2801(e)(4)).