Tax Bill Summary

Real Estate Provisions in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

Congress has passed and President Obama has signed legislation (HR 4853) that extends the Bush-era tax rates and a host of other expired and expiring provisions. The legislation is not "paid for," so there are no revenue raisers taken from real estate or other industry groups. The package provides temporary extensions of its numerous provisions. Some are retroactive, as well, so that the rules that had been in place previously will operate as if they had never expired.

Only the provisions that affect real estate investment and operations are included in this summary. The bill itself is vast, even though there are few expansions or cutbacks of previous or current law.

Tax Rates: The Bush-era tax brackets will remain intact for the 2011 and 2012 tax years. Thus, there will be 6 brackets ranging from 10% to 35%. Also, the backdoor rate increases that affect upper income taxpayers are repealed in 2010, 2011 and 2012. These backdoor rate increases are known as the personal exemption phase-out and the limitation on itemized deductions.

Capital Gains: The tax rate will remain 15% for assets sold or disposed of during 2011 and 2012. Depreciation recapture tax rates remain 25%. No new limitations are created for Section 1031 like-kind exchanges. The 15% rate is retained for dividends received during those years. Small investors with incomes in either the 10% or 15% brackets will have a capital gains and dividend tax rate of 0%.

Payroll/Self-employment Taxes: For many years, the payroll tax rates have been 6.2% for employees and 12.4% for self-employed individuals. During 2011, employee payroll tax rates will be 4.2% and self-employed individuals will have a 10.4% rate. This holiday is available only for earnings during 2011. The earnings cap in 2011 is $106,800.

Estate Tax: During 2010, the estate tax was repealed, but heirs who received assets from an estate were required to use a so-called "carryover basis" in determining the value of the assets they receive. Carryover basis is the amount that the original owner of the asset paid for it. Prior to 2010, the heirs had always received the asset with a "stepped-up basis." Carryover basis requires heirs to know when the decedent acquired his/her assets and at what price. Stepped-up basis measures the value of the asset at its fair market value at the time of the

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death. Carryover basis is astonishingly burdensome. "Basis" is the value used to determine gain/loss when the heir sells an inherited asset.

In 2009, the estate tax was in place with an exclusion of $3.5 million and a maximum tax rate of 45%. In 2010, there was no estate tax. Without Congressional action, the estate tax would have been revived in 2011 with an exclusion of only $1 million and a maximum rate of 55%. This legislation revives the estate tax as of January 1, 2010, with an exclusion of $5 million ($10 million for a couple) and a maximum rate of 35%. The executors and heirs of those who died during 2010 may elect to pay no estate tax, but the assets will be subject to the more burdensome carryover basis rules. That election will not be available for those who die after 2010. The $5 million exclusion and 35% rate will be effective through December 31, 2012.

Alternative Minimum Tax (AMT): Without Congressional action, millions of middle- and upper-middle-income taxpayers would be forced to pay the AMT for the 2010 tax year, even though these individuals were never intended to be AMT taxpayers. The so-called "AMT patch" will limit the application of the AMT to these individuals and families. Thus, only upper-income individuals who also shelter their income will be subject to the AMT. An AMT patch for 2011 is also included in the legislation.

Leasehold Improvements: The legislation renews the 15-year cost recovery period for leasehold improvements made between January 1, 2010 and December 31, 2011.

Bonus Depreciation: Assets with a cost recovery period of 20 years or less are eligible for 100% depreciation (expensing) in the year the assets is placed in service. This rule applies to all assets placed in service on or after September 8, 2010 and before January 1, 2012. Eligible assets placed in service during 2010 will qualify for a 50% bonus depreciation allowance.

Energy-efficient New Homes Credit: A tax credit, based on numerous energy-efficiency milestones, has been available to some home construction activities since about 2008. That provision had expired, but is now renewed through 2011. The credit is available to builders/manufacturers of new homes that meet the various milestones.

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Energy-efficient Appliances: This tax credit is available to manufacturers of dishwashers, clothes washers and refrigerators – not to homeowners who purchase these appliances.

Energy-efficient Existing Homes: The tax credit for homeowners who make specified energy-related improvements to existing homes was scheduled to expire December 31, 2010. It has been extended through December 31, 2011. The qualified investments include replacement windows, doors, or skylights, some roofing materials and some heating and cooling equipment. The amounts of the credit vary depending on the asset and its energy rating as determined by the Energy Star program. The standards for qualified property are tougher than they were in 2010, so homeowners will need to exercise great care in their acquisitions. The credit is available *only* for improvements to a principal residence and only if the improvement is original to the property and only if the property will last for at least 5 years. The credit is not available if the improvement is financed using any form of subsidized energy program.

Energy-efficient Buildings: Owners of commercial buildings may qualify for tax credits for investments in designated insulation, windows and roofing improvements. Improvements to the heating/air conditioning systems, water heaters and air circulation fans may also be eligible for the credit. As with the home improvement credits, these credits require compliance with a variety of energy efficiency standards. Investors should exercise great care in determining what assets will satisfy the given criteria. The improvements must be in place on or before December 31, 2011.

Brownfields Clean-up: The provision that allows expensing (current deduction) for brownfield clean-up activities expired December 31, 2009. It is renewed effective January 1, 2010 and extended through December 31, 2011.

Mortgage Insurance Premiums: The provision that allows a deduction for individuals with less than $100,000 (with a phase-out up to $110,000) is extended through December 31, 2011.

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Other non-real estate provisions

The bill also covers an array of non-real estate provisions that affect individuals and families. These include:

- Education incentives
- Child credits (for each child)
- Child care credits
- Earned income credit
- Adoption assistance
- Region-specific relief provisions
  - Alaska Native settlements
  - GO Zone (Hurricane Katrina) credits, deductions, bonds
  - Puerto Rico manufacturing
  - Virgin Islands and Puerto Rico rum production
  - Indian reservations
  - American Samoa economic development
  - New York City Liberty Zone (9/11 area)
- Deduction for state and local sales taxes
- Empowerment Zones
- New Markets projects

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