

***Recent Changes in
Federal Tax Laws
Affecting Individuals,
Businesses, and Estates***

**Part 2
Changes Affecting Individuals**

Changes Affecting Individuals

Many of the provisions of federal tax laws enacted in the early 2000s were set to expire in 2011. As a result, tax rates would have reverted to pre-2001 levels, and several tax deductions and credits were to be discontinued. As a result, most taxpayers were anticipating tax increases for 2011 and later years. The general effect of the 2010 TRA is to continue the provisions of the earlier tax laws, some through 2011 and others through 2012. One change, in particular, resulting from the 2010 TRA affecting all taxpayers is the extension of 2010 federal income tax rates that would have otherwise reverted to pre-2001 levels.

Individual Income Tax Rates. The federal income-tax rates were scheduled to increase in 2011 and after, compared to the 2010 rates. Effective January 1, 2011, the individual income tax rates would have reverted to the higher levels in effect before the passage of EGTRRA in 2001. The 2010 TRA extends the 2010 ordinary income tax rates for two years, through December 31, 2012. Table 1 compares the tax rates that would have been in effect in 2011-2012 to those in effect with the 2010 TRA.

Table 1. Individual Tax Rates for Married Taxpayers, Filing Jointly

2010 Taxable Income Brackets*	2010 Tax Rates	Scheduled Tax Rates for 2011-2012 Before 2010 TRA	Tax Rates for 2011-2012 After 2010 TRA
\$0 to 16,750	10%	15%	10%
\$16,750 to 68,000	15%	15%	15%
\$68,000 to 137,300	25%	28%	25%
\$137,300 to 209,250	28%	31%	28%
\$209,250 to 373,650	33%	36%	33%
Over \$373,650	35%	39.6%	35%

*These taxable income brackets for married taxpayers filing jointly are used as a point of reference. The brackets will be adjusted for inflation in 2011 and 2012.

What does this mean for taxpayers? What will be the difference in taxes paid compared to what they would have paid without the passage of the 2010 Tax Relief Act? The tax calculations in Table 2 are based on a married couple filing jointly with two dependents.⁴

Although the differences in the dollar amounts of taxes due are greater for the higher income levels, the percentage reductions are highest at the lower income levels.

⁴ Calculated using the Tax Foundation's federal income calculator at <http://www.mytaxburden.org/>.

Table 2. Differences in Income Taxes Due for a Married Couple Filing Jointly*

Adjusted Gross Income	2011 Taxes Before TRA	2011 Taxes After TRA	Difference in Taxes Due	Percent Reduction
\$30,000	\$833	\$360	\$473	57%
\$50,000	\$3,833	\$2,690	\$1,143	30%
\$80,000	\$8,333	\$7,190	\$1,143	14%
\$120,000	\$19,260	\$15,650	\$3,610	19%
\$170,000	\$33,446	\$28,278	\$5,168	15%

*Income taxes due before credits

Capital Gains and Qualified Dividends. Net capital gain income is net long-term gains (assets held longer than one year) minus net short-term losses.⁵ The tax rates on net capital gains have been 0% for individual taxpayers below the 25% income bracket and 15% for individuals in the 25% bracket and above. In 2011, however, these rates would have reverted to 10% and 20% of the net capital gain. With the 2010 TRA, these rates of 0% and 15% are temporarily extended through 2012. Whether the tax rates on capital gains revert to higher levels in 2013 will depend on what Congress does or does not do adding uncertainty to decisions about when to sell appreciated assets.

Qualified dividends (those received from domestic corporations and certain foreign corporations) will continue to be taxed at 0% and 15% rates, the same as net capital gains in 2011 and 2012. Without the enactment of the 2010 TRA, these dividends would have been subject to ordinary income rates.

Marriage Penalty Relief. The provision to reduce the tax penalty for married taxpayers compared to single taxpayers was due to expire at the end of 2010. These provisions included adjusting the lower income tax brackets and the standard deduction. Under the 2010 TRA, the marriage penalty relief is extended through 2012.

Social Security Taxes. For 2011 only, the 2010 TRA reduces the Social Security (FICA-OASDI) tax rate paid by employees on wages earned up to \$106,800 by 2% from 6.2% to 4.2%. This benefit, amounting to as much as \$2,136 per worker, showed up as reduced withholding rates in January 2011 paychecks (Table 3). The employers' contributions to Social Security taxes are not affected. For self-employed individuals, the Social Security tax rate is reduced from 12.4% to 10.4% for the 2011 tax year.

Table 3. Social Security Tax Rate Reduction per Employee, 2011

Total Wage or Salary	Reduction in Tax Due
\$30,000	\$600
\$50,000	\$1,000
\$70,000	\$1,400
\$106,800	\$2,136
\$120,000	\$2,136

⁵ For more information on how to calculate net capital gain, see IRS Publication 550, *Investment Income and Expenses (Including Capital Gains and Losses)*, for use in preparing 2010 Returns.

Alternative Minimum Tax (AMT). The AMT was created to ensure that high-income individuals pay at least a minimum amount of income tax. Taxpayers calculate their tax liability using both the regular 1040 income tax form and the AMT worksheet, and then pay the higher of the two amounts. To calculate the AMT, the taxpayer starts with the regular taxable income and then adds the applicable adjustments and preference items.⁶ A special AMT exemption is subtracted from this recalculated income, and the difference is subject to tax rates of 26 percent for incomes below \$175,000, and 28 percent for incomes above. The problem is that this AMT exemption is not indexed for inflation. As a result, more taxpayers, particularly those with certain significant deductions and credits are paying the higher AMT.

This provision of the 2010 TRA to increase the AMT exemptions is retroactive to 2010 and extends through 2011. The increased exemption amounts for 2010 and 2011 are compared to the 2009 levels in Table 4.

Table 4. Alternative Minimum Tax (AMT) Exemptions

	2009	2010	2011
Married joint filers and surviving spouses	\$70,950	\$72,450	\$74,450
Unmarried individuals	\$46,700	\$47,450	\$48,450
Married individuals who file separate	\$35,475	\$36,225	\$37,225

Personal Exemptions and Itemized Deductions. Personal exemptions allow a deduction from taxable income for each taxpayer and dependent.⁷ Prior to 2010, however, the total exemption that could be claimed was reduced or phased out for taxpayers with adjusted gross income (AGI) above certain levels. This reduction was eliminated in 2010, but the phase out was scheduled to come back in 2011. Now the 2010 TRA continues this elimination of the personal exemption phase out for 2011 and 2012. This means that all taxpayers will get the full benefit of their personal exemptions regardless of their income levels.

Also prior to 2010, taxpayers, who itemized deductions when the total deductions are more than the standard deduction amount, were subject to a limitation or reduction of their allowable itemized deductions for the year if their AGI exceeded certain amounts. Again, this reduction was eliminated in 2010, but was scheduled to come back in 2011 until the new tax law extended the elimination through 2011 and 2012.

⁶ The calculation of income for the AMT disallows many of the deductions and tax preferences allowed by the regular income tax, including personal exemptions, standard deduction, state and local tax deductions, interest on second mortgages, net operating losses, certain medical expenses, accelerated depreciation, various tax credits, and other items. See <http://www.irs.ustreas.gov/pub/irs-pdf/i6251.pdf>.

⁷ For 2010, the amount for each personal exemption is \$3,650; for 2011, the personal exemption increases to \$3,700.

Itemized Deduction for Sales Tax. The tax laws allowing an itemized deduction to be claimed for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes has been an important advantage for Texas taxpayers who itemize rather than take the Standard Deduction. The temporary provision for the sales tax deduction election expired after 2009, but the 2010 TRA retroactively extends this option for two years, 2010 and 2011.

Deductions for Non-Itemizers. Some benefits for individual taxpayers who do not itemize were allowed to expire. For example, in 2008 and 2009, taxpayers who did not itemize could write off up to \$500 or \$1,000 of state and local real property taxes by claiming an increased standard deduction. This benefit was not restored by the 2010 TRA. Another provision not extended for non-itemizers is the 2009 deduction for state sales tax or other fees paid on the purchase of new cars that was enacted by the American Recovery and Reinvestment Act of 2009.

IRA Distributions for Charitable Purposes. Under prior law, taxpayers, who are age 70½ or over, could exclude from gross income IRA distributions, which would otherwise be taxable, when made to qualified charities. The exclusion could not exceed \$100,000 per taxable year and was available through 2009. The 2010 TRA extends the exclusion for 2010 and 2011.

Provisions for Families and Children. Several provisions of the 2010 Tax Relief Act are important for families.

- **Child Tax Credit.** Taxpayers with income below certain threshold amounts may claim the Child Tax Credit to reduce regular income tax and AMT for each qualifying child under the age of 17. For 2010, the maximum amount of the child tax credit was \$1,000 per child and was scheduled to revert to \$500 in 2011. Taxpayers are eligible for an additional refundable Child Tax Credit equal to 15% of earned income in excess of a threshold amount. This threshold was reduced from \$10,000 to \$3,000 for both 2009 and 2010 by the American Recovery and Reinvestment Act of 2009 (ARRA). The 2010 TRA extends the 2010 provisions through 2012, including the individual child credit of \$1,000 and the lower \$3,000 threshold for the refundable credit.
- **A Dependent Care Credit** may be claimed for an applicable percentage of qualifying care expenses paid for children under 13 and disabled dependents in order for the taxpayer to work. The 2010 TDA extends through 2012 the amounts of eligible expenses of \$3,000 for one child and \$6,000 for two or more children at the applicable percentage of 20-35 percent depending upon adjusted gross income..
- **Earned Income Tax Credit.** This credit is available to certain low-income taxpayers, who qualify based on their earned income, adjusted gross income, number of children, and filing status. For 2009 and 2010, the ARRA increased the credit to 45% of the first \$12,590 of earnings for taxpayers with three or more qualifying children. The credit is phased out at higher earnings levels. The 2010 TRA extends the refundable Earned Income Tax Credit of 45% and the higher phase-out threshold for married taxpayers filing jointly through 2012.
- **Energy Credits.** The American Recovery and Reinvestment Act of 2009 (the Stimulus Act – ARRA) provided a non-refundable tax credit for specified energy-efficient improvements

installed in the taxpayer's principal residence in 2009 and 2010. The new law extends the credit to include nonbusiness energy property placed in service on or before December 31, 2011, then credit rates, dollar limits, and lifetime limits revert back to the less-favorable levels in effect prior to 2009.

- **Adoption Credit.** Individuals who adopt an eligible child are entitled to claim an income-tax credit for qualified adoption expenses, up to \$13,170 per child for 2010 and \$13,360 for 2011. The credit phases out for higher income taxpayers. These higher credit limits were established by the Patient Protection and Affordable Care Act of 2010. The 2010 TRA extends the credit through 2012, but at the lower levels in place before 2010. The corresponding benefit allowing the exclusion from income of adoption expenses paid by an employer was also extended through 2012.

Education Incentives. The new law extends several education-related tax benefits. In some cases, they are retroactive.

- The **American Opportunity Tax Credit (AOTC)**, which replaced the Hope Scholarship credit, was scheduled to expire at the end of 2010. The AOTC allows a credit for each eligible student of up to \$2,500 per year for up to four years of undergraduate education, but is subject to phase out for higher income taxpayers. The 2010 TRA extends the AOTC for the 2011 and 2012 tax years.
- **Coverdell Education Savings Accounts (ESAs)** are tax-exempt savings accounts used to pay the higher education expenses of a designated beneficiary. The ESA per beneficiary contribution limit of \$2,000 and other enhancements, which were scheduled to end after 2010, have been extended to the end of 2012.
- **Qualified Tuition Deduction.** The deduction from gross income of up to \$4,000 for individual taxpayers whose adjusted gross income is \$65,000 or below (up to \$2,000 for AGI between \$65,000 and \$80,000 certain higher income taxpayers) for qualified post-secondary education tuition and related expenses expired at the end of 2009. The new law reinstates and extends the deduction for 2010 and 2011.
- **Student Loan Interest Deduction.** Certain favorable features of this allowable deduction from gross income for higher-education student loan interest of up to \$2,500 a year, including higher income limits before the deduction is phased out, were to end after 2010. The 2010 TRA temporarily extends the expanded student loan interest deduction through 2012.
- **Employer Education Assistance.** The 2010 TRA temporarily extends the provision allowing an employee to exclude from gross income up to \$5,250 per year of employer-provided undergraduate and graduate education assistance through 2012.
- **Income Exclusion for Qualified Scholarships.** Previous legislation allowed certain scholarships for tuition and related expenses to be excluded from income for income tax purposes. The 2010 TRA extends these provisions for 2011 and 2012.