



# Private Clients Alert<sup>®</sup>

Legal and financial developments  
affecting individuals and their families

A publication of Nixon Peabody LLP

June 2009

## **Recent (and Proposed) Tax Legislation Impacting Individuals**

### **Executive Summary**

Tax legislation enacted in late 2008 and early 2009 has again changed the tax landscape for individuals. On December 23, 2008, President Bush signed into law the Worker, Retiree and Employer Recovery Act, which includes, among a multitude of other retirement plan changes, a relaxation of the qualified plan and IRA required minimum distribution rules for 2009. The American Recovery and Reinvestment Act of 2009, a stimulus bill that includes \$300 billion in tax relief, was signed into law by President Obama on February 17, 2009. On February 26, 2009, the Obama administration released an overview of the fiscal year 2010 budget, outlining the major tax provisions they plan to ask Congress to address. Rest assured that additional tax legislation will be enacted soon, possibly before year-end. This *Alert* is designed to summarize tax legislation (both enacted and proposed) impacting individuals.

The following is a brief summary of the information contained in this *Alert*:

|   | <u>Page</u> |
|---|-------------|
| 1. <u>Income tax rates</u> - An overview of the tax rates for 2009.   | 3           |
| 2. <u>Relaxation of the required minimum distribution rules</u> - For 2009 only, individuals are <u>not</u> required to take their normal required minimum distributions (RMDs) from IRAs or qualified plans. | 4           |
| 3. <u>Reduced 2009 estimated tax requirements for small-business owners</u> - The law eases the estimated tax burden for 2009 only.   | 5           |
| 4. <u>Enhanced exclusion for qualified small-business stock</u> - For qualified small-business stock, the 50% gain exclusion is increased to 75%.   | 5           |
| 5. <u>Deduction for sales tax on car purchases</u> - A temporary deduction for 2009 is allowed for sales or excise taxes imposed on the purchase of a qualified motor vehicle.                                | 5           |

|   | <u>Page</u> |
|---|-------------|
| 6. <u>Increased AMT exemption amounts for 2009</u> - Alternative minimum tax (AMT) exemption amounts, scheduled to decrease in 2009, are increased above 2008 amounts.  | 6           |
| 7. <u>Personal nonrefundable credits are allowed to offset AMT for 2009</u> - Additional credits are allowed to offset the AMT liability.   | 6           |
| 8. <u>Private activity municipal bond interest not considered an AMT preference item</u> - For 2009 and 2010 newly issued private activity tax-exempt bonds, the municipal interest is not considered an AMT addition (preference).                       | 7           |
| 9. <u>Alternative motor vehicle credit</u> - The new law allows the alternative motor vehicle credit to offset the AMT.   | 7           |
| 10. <u>Making Work Pay Credit</u> - A new credit is allowed for certain individuals who report earned income.   | 7           |
| 11. <u>New American Opportunity Tax Credit</u> - A new education credit, enhancing the prior Hope credit, provides enhanced tax benefits for 2009 and 2010.   | 7           |
| 12. <u>Computer expenditures under 529 plans</u> - For 2009 and 2010 only, computer technology expenditures are considered qualified education expenses if the technology is used by the beneficiary enrolled in a qualified educational institution.     | 8           |
| 13. <u>Enhanced transit and van pool transportation fringe benefits</u> - For 2009 and 2010, the excludable amount for reimbursements of transit and van pool expenses is increased to equal the amount allowed for parking benefits.                     | 8           |
| 14. <u>First-time homebuyer credit enhanced</u> - For purchases before December 1, 2009, first-time homebuyers are allowed a permanent tax credit; prior law required this credit to be recaptured over time, which was in essence an interest-free loan. | 8           |
| 15. <u>Exclusion of unemployment compensation income</u> - For 2009, up to \$2,400 of unemployment compensation is excluded from gross income.  | 9           |
| 16. <u>Economic recovery payments</u> - The new law allows a one-time payment of \$250 to retirees, disabled individuals, SSI recipients and disabled veterans.   | 9           |
| 17. <u>Increase in the Earned Income Tax Credit (EITC)</u> - The new law increases the EITC percentage and increases the threshold phase out amounts, thus enhancing the opportunity for claiming a refundable tax credit.                                | 9           |

|  | <u>Page</u> |
|--|-------------|
| 18. <u>Nonbusiness homeowner's energy credit modified and extended</u> - The nonbusiness energy credit is extended through 2010, and other beneficial modifications were enacted.  | 10          |
| 19. <u>Credit caps on residential energy-efficient property credit are eliminated</u> - The law eliminates the credit caps for solar hot water, geothermal and wind property expenditures.   | 10          |
| 20. <u>Plug-in electric motor vehicle credit modified</u> - The credit allowed for electric motor vehicles is modified and two new credits are enacted.  | 10          |
| 21. <u>50% bonus depreciation</u> - is extended for 2009 expenditures.   | 11          |
| 22. <u>Small-business expensing rules</u> - extends the \$250,000 expensing limit to 2009, allowing for immediate tax benefits.  | 11          |
| 23. <u>Net operating loss carrybacks</u> - The law extends the loss carryback period to five years (instead of two) for small businesses.  | 11          |
| 24. <u>S corporation built-in gains tax</u> - The built-in gains tax, which previously applied for the first 10 years after making an S election, has been reduced to 7 years, for sales occurring in 2009 and 2010.   | 11          |
| 25. <u>Proposed legislation by President Obama's administration</u> - The President has proposed a number of individual tax provisions, including reinstatement of the 36% and 39.6% rates for high-income taxpayers; reinstatement of the personal exemption phaseout; reinstatement of the limitation on itemized deductions for high-income taxpayers; increasing the capital gain and dividend rates to 20% for high-income taxpayers; and limiting the value of itemized deductions to a 28% rate, among other items. | 11          |

## **Detailed Analysis**

1. Income Tax Rates - The top federal income tax rate for ordinary income and short-term capital gain is currently 35% and applies to taxable income over \$372,950 in 2009. Tax brackets of 10%, 15%, 25%, 28% and 33% apply to lower amounts. These rates are a product of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), as revised by 2003 and 2005 legislation, and, absent action by Congress, "sunset" (end) on December 31, 2010. In 2011, these rates will revert to pre-2001 tax rates of 15%, 28%, 31%, 36%, and 39.6%, again, unless Congress otherwise acts.

The federal tax rate for long-term capital gain for most capital assets (held over one year) is 15% for the majority of taxpayers (except as noted below). This favorable rate was extended though the

year 2010 by legislation enacted in 2006. In 2011, unless Congress acts, long-term capital gains will revert to the pre-2003 rate of 20%.

The tax rate for qualified dividends is 15%. The 2006 legislation extended this beneficial rate through 2010. Unless Congress acts, this low rate disappears in 2011, and dividends will again be taxed at the same marginal rate as other ordinary income.

The federal tax rate for long-term capital gain (and qualified dividends) for those in the lowest two (10% and 15%) tax brackets is 0% (zero) for 2009-2010. The lowest two brackets apply to taxable income of up to \$33,950 (single taxpayers) or \$67,900 (joint filers).

The maximum alternative minimum tax (AMT) rate is 28% for AMT income over \$175,000. A 26% rate applies to AMT income below that amount. Although these rates are nominally lower than the top regular tax rates, the AMT allows fewer deductions (much like a “flat tax”) and are void of lower brackets.

Tax legislation enacted in 2007 expanded the so-called “kiddie tax” rules, to 18-year-old children and to children over age 18 but under age 24 who are fulltime students (but only if their earned income doesn't exceed one-half of the amount of their support).

Under the kiddie tax rules, the unearned income (interest, dividends, capital gains) of specified children that exceeds an inflation-adjusted prescribed amount (\$1,900 for 2009) is taxed to the children, but at the tax rates that would apply if that income was included in their parents' return.

2. Relaxation of the RMD rules - Retirement plan accounts such as IRAs, 401(k)s and profit-sharing plans require their holders to take required minimum distributions upon reaching age 70½. Steep penalties are imposed for failure to take the minimum amount. RMDs are calculated based on the value of the account as of the end of the prior year and the age of the holder. With the economic problems and equity market downturn at the end of 2008, Congress enacted the Worker, Retiree, and Employee Recovery Act of 2008, waiving the requirement to withdraw RMDs for the 2009 tax year. Although this was somewhat welcome relief, it disappointed many who had waited to take their 2008 RMDs, hoping that 2008 RMDs would be eliminated. This 2009 waiver also extends to the beneficiaries of inherited plan accounts, who generally are also required to withdraw RMDs. In the case of plan balances in which a beneficiary was not designated, or in the case of a designation to one's estate or to certain nonqualifying trusts, plan balances must be paid out by the end of the fifth year following the year of death. In cases where the five-year rule applies, 2009 will not be counted as one of the five years (thereby turning the five-year rule into a six-year rule). The new law also has implications for

those who use a special rule in the year they turn age 70½. The special rule allows such individual to defer their initial RMD to the subsequent year (by April 1), meaning the individual must receive two RMDs in the year following attainment of age 70½. For example, if an individual turns 70½ in 2008, utilizing the special rule, the individual could withdraw the 2008 RMD by April 1, 2009, and withdraw the regular 2009 RMD by the end of the 2009 calendar year. Under the new law, the 2008 RMD still must have been claimed by April 1, 2009; only the regular 2009 RMD is waived. On the other hand, if an account owner turns 70½ in 2009, the historical rule would require a first RMD (for 2009) by April 1, 2010, and a second RMD (for 2010) by the end of the 2010 calendar year. The new law waives the first RMD for 2009 – payable by April 1, 2010; but does not waive the RMD required by the end of 2010.

3. Reduced 2009 estimated tax requirements for small-business owners - The new law eases 2009 estimated tax requirements for certain qualified small-business owners. For small-business owners who reported less than \$500,000 in adjusted gross income (AGI) for 2008, with at least half of their gross income derived from a business employing fewer than 500 employees, current year estimated payments may be based on the lesser of 90% of the 2008 tax liability (instead of the usual 110%), or 90% of the expected 2009 tax liability.

4. Enhanced exclusion for qualified small-business stock - Historically, the law allowed a 50% gain exclusion upon the sale of qualified small-business stock (QSBS). A QSBS must be an active trade or business operated as a C corporation with assets under \$50 million. For sales of QSBS acquired after February 17, 2009, and before January 1, 2011, that are held for more than five years, the gain exclusion is increased to 75%.

5. Deduction for sales tax on car purchases - In an effort to spur the economy, and help beleaguered car manufacturers, the new law allows an additional deduction to certain taxpayers for state or local sales taxes or excise taxes imposed on the purchase of a qualified motor vehicle, limited to the first \$49,500 of the purchase price. A qualified motor vehicle includes a passenger automobile, light truck (less than 8,500 pounds), motorcycle or motor home purchased between February 17, 2009 and December 31, 2009. The amount of sales or excise taxes that may be considered qualified motor vehicle tax is phased out ratably for a taxpayer with modified AGI between \$125,000 and \$135,000 (\$250,000 and \$260,000 for a joint return). This new change also applies to individuals who don't otherwise itemize deductions. However, this deduction is not allowed for a taxpayer who elects to deduct state and

local sales tax in lieu of income taxes as an itemized deduction. The deduction also is allowed in computing the AMT.

6. Increased AMT exemption amounts for 2009 - The AMT is calculated as the excess of the tentative minimum tax over the regular tax for the year. The tentative minimum tax is calculated on taxable income, modified by various adjustments and preferences, and reduced by an exemption amount (which is subject to a phaseout at higher-income levels). The result is alternative minimum taxable income, subject to a tax rate of 26% or 28%. Originally, the AMT was designed to tax wealthier taxpayers who took advantage of certain tax preferences and deductions. However, due to the reduction and compression in regular tax rates, the AMT now has an impact on many middle-income taxpayers, especially taxpayers living in states with high income and real property taxes (since state taxes are not deductible for AMT purposes). The AMT exemption amounts have not been indexed for inflation since inception of the law. For the past several years, Congress has enacted one year increases in the exemption amount, in an attempt to reduce the creep of the AMT into the middle class. For 2009, the AMT exemption amounts under the new law are \$70,950 for joint filers (up from \$ 69,950 for 2008 and \$45,000 under pre-Act law), \$46,700 for single taxpayers (up from \$ 46,200 for 2008 and \$33,750 under pre-Act law), and \$35,475 for married taxpayers filing separately (up from \$34,975 for 2008 and \$22,500 under pre-Act law). This one-year patch is estimated to protect 26 million taxpayers from being subject to the AMT. Notwithstanding these increases, the new law leaves in place the existing AMT exemption phaseout rules. The above exemptions phase out when AMT income (AMTI) exceeds certain thresholds. For joint filers, this occurs during the AMTI income range of \$150,000 through \$433,800; \$112,500 through \$299,300 for single taxpayers; and \$75,000 through \$216,900 for married taxpayers filing separately. Unless Congress acts again, the exemption amounts will again fall for the 2010 year, which will subject additional millions of taxpayers to the AMT. Clearly, this is a problem that begs for a more permanent solution.

7. Personal nonrefundable credits are allowed to offset AMT for 2009 - Under prior law, most nonrefundable personal credits could not offset the AMT, with a few exceptions (the adoption credit, child tax credit, low income savers credit, residential energy-efficient property credit, and nondepreciable property portion of the plug-in electric car credit). In addition, the prior law computation of the AMT also limited the taxpayer's nonrefundable personal tax credits in situations where the AMT did not ultimately apply. The new law changes the computation of the AMT, allowing otherwise allowable nonrefundable personal credits to offset AMT as well as the regular tax liability.

This law change will benefit middle-income individuals who have relatively low regular taxable income, are subject to the AMT because of certain itemized deductions or a large number of personal exemptions, and have significant nonrefundable personal tax credits.

8. Private activity municipal bond interest not considered an AMT preference item - Under prior law, tax-exempt interest on certain tax-exempt bonds issued for so called “private activities” was considered a preference item, and was included in alternative minimum taxable income. For bonds issued in 2009 and 2010, the new law provides that tax-exempt interest earned on private activity bonds is not considered an item of tax preference for purposes of the AMT.

9. Alternative motor vehicle credit - Under existing law, a taxpayer is allowed an alternative motor vehicle credit for certain qualified fuel cell vehicles, hybrid vehicles, advanced lean burn technology vehicles, and alternative fuel vehicles. Credit amounts vary based on certain conditions. The portion of the credit that is attributable to a vehicle that is depreciable is claimed as part of the general business credit. The remaining portion is considered a personal credit, which under prior law was allowed only against the regular tax, but not the AMT. The new law provides that the alternative motor vehicle credit is a personal credit allowed against the AMT.

10. Making Work Pay Credit - For 2009 and 2010, the new law provides a refundable credit based on the lesser of 6.2% of an eligible taxpayer's earned income, or \$400 (\$800 for joint filers). The credit is phased out at a rate of 2% of an eligible taxpayer's adjusted gross income above \$75,000 (\$150,000 for joint filers).

11. New American Opportunity Tax Credit - Under prior law, individuals were able to use the Hope Credit to claim a tax credit of up to \$1,800 per year per eligible student. The Hope credit was based on qualified tuition and fees paid during the first two years of college or other post-secondary institution for students enrolled at least half time in a degree or certificate program.

Under the new law, the Hope Credit has become the American Opportunity Tax Credit. With the new name (and new law) comes a tax credit increase from \$1,800 to \$2,500 per student per year for qualified tuition and fees, which now also includes books. Additionally, the credit is available for the first four years of post-secondary education instead of the two years in prior law.

The credit begins to phase out for single filers at \$80,000 (\$160,000 for joint filers) and is available for use against both regular income tax as well as alternative minimum tax.

Forty percent of the credit is refundable should it exceed a taxpayer's income tax liability. However, no portion is refundable if the taxpayer claiming the credit is a child subject to kiddie tax (tax on unearned income at his or her parent's tax rate).

The American Opportunity Tax Credit only applies to qualified payments actually made in 2009. For example, if the Spring 2009 semester was prepaid in December of 2008, the old Hope Credit rules apply.

Note also that the Lifetime Learning Credit is a companion credit available for up to \$2,000 of qualified education expenses. It differs from the Hope Credit (and American Opportunity Tax Credit) in that it does not have a degree or workload requirement and is available for graduate-level studies.

12. Computer expenditures considered education expenses under 529 plans - Making contributions to a Qualified Tuition Program (more commonly known as a 529 Plan) for a designated beneficiary is a great way to establish a savings vehicle from which to pay qualified higher education expenses. The 529 plan account earnings accumulate tax free and the distributions are not considered taxable income as long as they are used for qualified higher education expenses. Qualified expenses, under prior law, were defined as tuition, fees, books, supplies and eligible room and board.

The new law expands qualified expenses incurred in 2009 and 2010 to include computer technology and equipment as well as Internet access and related services. However, gaming and other hobby software do not qualify as qualified expenses unless the software is primarily educational.

13. Enhanced transit and van pool transportation fringe benefits - Employers may provide their employees with transportation fringe benefits that are tax free (excluded from wages) either through reimbursement or salary reduction. For example, an employer can provide employees with pre-tax parking benefits up to a predefined limit per month. In prior years, the tax free limit on transit passes and van pooling expenses was \$115/month while the parking limit was \$220/month.

Beginning March 1, 2009 the monthly exclusion increases to \$230 per month for transit passes and van pool expenses, as well as for parking. This Act brings parity to parking and transit/van pooling expenses, as well as an increase in qualified amounts.

14. First-time homebuyer credit enhanced - The new law makes significant improvements to the first-time homebuyer credit introduced last year (in 2008). Under the 2008 legislation, a qualified first-time homebuyer was allowed a refundable tax credit equal to the lesser of 10% of the purchase price of a new principal residence or \$7,500 (\$3,750 for married filing separately taxpayers). However,

the allowable credit was recaptured over a 15-year period, making this provision the equivalent of an interest-free loan (as opposed to a true credit against tax).

Under the new law, a qualified first-time homebuyer is now allowed a refundable credit equal to the lesser of 10% of the purchase price of a principal residence, or \$8,000. The credit phases out for single filers with an AGI between \$75,000 and \$95,000 and for joint filers between \$150,000 and \$170,000. A first-time homebuyer is defined as an individual who has not owned a principal residence within the last 3 years.

Although the credit is refundable should it exceed the taxpayer's regular income tax liability, it will not offset any alternative minimum tax. If a taxpayer disposes of the home, or the home ceases to be a principal residence of the taxpayer within three years of purchase, the 2008 rules for recapture of the credit will apply.

Taxpayers may make an election to treat a 2009 home purchase (made before November 30, 2009) as occurring on December 31, 2008, in order to obtain tax benefits on an accelerated basis (on a timely-filed or amended 2008 tax return).

The new law applies to home purchases before December 1, 2009. It also waives the recapture of credit under 2008 legislation for home purchases after December 31, 2008 (even if the taxpayer opts to treat a 2009 purchase as occurring on December 31, 2008, as noted above).

15. Exclusion of unemployment compensation income - In order to ease the burden of unemployed workers, the new law exempts the first \$2,400 of unemployment compensation received in 2009 from federal taxation.

16. Economic recovery payments - The new law provides for one-time payments of \$250 to certain participants, including retirees, disabled individuals, SSI recipients receiving benefits from the Social Security Administration, disabled veterans receiving benefits from the Department of Veteran Affairs and railroad retirement beneficiaries. This one-time payment is a reduction to any allowable Making Work Pay Credit. The law requires that these payments be made no later than June 17, 2009.

17. Increase in the Earned Income Tax Credit - The Earned Income Tax Credit (EITC) is a refundable credit allowed to low and moderate income workers. Its calculation is based on adjusted gross income, earned income, investment income, filing status and the number of qualifying children in a worker's family. The new law increases the earned income credit in 2009 and 2010 for working families with at least three children. The law increases the credit to 45% (up from 40%) of a family's

first \$12,570 of earned income, resulting in a maximum credit of approximately \$5,656. The new law also increases the threshold phaseout amounts for married couples filing joint returns. Under the law, the credit phases out for earnings above \$21,420 for joint filers (\$16,420 for single filers), and is completely phased out at \$40,463 of earnings (\$35,463 for single filers).

18. Nonbusiness homeowner's energy credit modified and extended - Prior law provided for an individual 10% tax credit for qualified energy-efficient improvements to existing homes and for qualified energy-efficient property through 2009. Qualified energy-efficient property includes furnaces and water heaters, heat pumps, air conditioners and ceiling fans. The maximum credit for all tax years was \$500, but no more than \$200 of the credit could be attributable to qualifying window expenditures. The new law increases the tax credit rate to 30% for improvements and new property and extends the credit through 2010. The new law also provides an aggregate tax credit cap of \$1,500 for qualifying property placed in service before 2011, regardless of amounts claimed in prior years.

19. Credit caps on residential energy-efficient property credit are eliminated - Under prior law, a cap applied to the 30% tax credit available for the purchase of residential energy-efficient property, such as qualified solar water heating property (\$2,000 maximum), small wind energy property (\$4,000 maximum), geothermal heat pump property (\$2,000 maximum), and qualified fuel cell property (\$500 per half kilowatt); there was no maximum credit for qualified solar energy property. The old law also required taxpayers to exclude expenditures that were financed pursuant to a subsidized federal, state or local energy conservation program. Under the new law, beginning in 2009, the credit caps are eliminated for solar hot water, wind and geothermal property, and the exclusion for subsidized energy financing is eliminated.

20. Plug-in electric motor vehicle credit modified - Legislation enacted in 2008 provides a tax credit to a taxpayer who places in service a qualified plug-in motor vehicle. The tax credit is equal to \$2,500, plus \$417 for each kilowatt hour of battery capacity in excess of a prescribed minimum. This legislation also provided for a phaseout beginning in the second calendar quarter after a manufacturer sells its 250,000th plug-in vehicle. The new law modifies this credit (increases the maximum to \$5,000, and reduces the vehicle limitation in the phaseout to 200,000 vehicles per manufacturer) and creates two new electric vehicle credits. For qualified motor vehicles purchased after February 17, 2009 and before 2012, a 10% nonrefundable personal credit (maxed out at \$2,500) is allowed for electric drive vehicles, motorcycles and three-wheeled vehicles. The law also creates a new 10% credit for the cost of

converting any motor vehicle into a qualified plug-in electric drive vehicle. The maximum amount of this conversion credit is \$4,000, and is added to the alternative motor vehicle credit.

21. 50% bonus depreciation extended - The stimulus legislation enacted in 2008 allowed businesses to take 50% bonus depreciation on qualifying assets. The bonus depreciation rules are now extended for depreciable personal property acquired and placed in service in 2009.

22. Small-business expensing rules - The 2008 stimulus legislation also provided enhanced abilities to expense business assets in the year they are placed in service. The new law extends the provisions to 2009, allowing small businesses to deduct currently up to \$250,000 of the cost of qualifying property. However, the amount of the deduction is reduced (dollar for dollar) to the extent the cost of the qualified property placed in service exceeds \$800,000 (up from \$500,000 under existing law).

23. Net operating loss carrybacks - Historically, unused net operating losses could be carried back to the two prior tax years. The Act allows certain small businesses (with gross receipts of \$15 million or less) to elect to carryback net operating losses for three, four or five years.

24. S corporation built-in gains tax - For regular (C) corporations, the sale of assets followed by a distribution to shareholders results in double taxation - at the corporation level and again at the shareholder level. To avoid double taxation, closely-held businesses are allowed to make a so-called "S" election, which eliminates the corporate level tax. However, for regular corporations that make an S election, any gain that would have been recognized had the corporation sold its assets at the time of the election (so-called "built-in gain"), remains taxable to the corporation for a 10-year period. The law reduces the built-in gain period from 10 years to 7 years, for 2009 and 2010 dispositions of assets.

25. Proposed legislation by President Obama's administration - President Obama's campaign articulated a plan to increase income tax rates for high income taxpayers, generally defined as individuals with income over \$250,000. At the time, expectations were that the increased tax rates would be made applicable to 2009. However, with the downturn in the economy, the tax rates were not changed, and as noted below, plans now call for increased tax rates starting in 2011.

In a February 2009 document titled "A New Era of Responsibility: Renewing America's Promise," the Obama administration outlined its tax and 2010 fiscal budget objectives. The Senate Budget Committee also released additional details on the President's tax proposals in a document titled

“Brief Analysis of President Obama's FY 2010 Budget.” In essence, the plan calls for higher taxes for higher-income individuals, tax reductions for other individuals, retention of President Bush’s tax cuts for lower-income taxpayers (specifically, the 10% bracket, marriage penalty relief, child tax credit, the 25% and 28% brackets, adoption tax credit, and dependent care tax credit), and several loophole closers designed to raise additional revenue.

Regarding 2011 tax rates on regular income, the current 33% and 35% tax brackets will rise to 36% and 39.6% respectively, according to the 2010 budget proposal. In general, the 36% bracket starts at approximately \$231,000 for married filers and approximately \$190,000 for single filers. The 39.6% bracket will likely start at approximately \$372,000, the same as the current top bracket threshold.

As part of this change, the current 28% tax bracket would be broadened, so that taxpayers in upper brackets would actually get some benefit due to the fact that part of their income now taxed at 33% would be in the broader 28% bracket.

Taxpayers with income taxed above the 28% bracket (specifically, the 36% and 39.6% brackets) will also experience higher tax burdens on long-term capital gains and dividends. The proposals call for an increase in the current 15% maximum rate to 20%, again effective in 2011.

A third element is the plan to reinstate phaseouts of personal exemptions and itemized deductions (so-called “Pease limitations”) for high income taxpayers. The phaseouts were expected to end after 2009. The proposal calls for personal exemption and itemized deduction phaseouts to apply to taxpayers in the two highest tax brackets, beginning in 2011.

Another proposal calls for a limitation on the value of itemized deductions for high income taxpayers. In essence, the proposal calls for a limit on the value of deductions to no more than 28% starting in 2011. This means that taxpayers in higher brackets, specifically the 36% and 39.6% brackets, would have their itemized deductions capped at a 28% tax rate. This would affect all itemized deductions, including mortgage interest and charitable contributions.

After factoring in the phaseouts, the top marginal tax rate will rise to approximately 40.8%, up from its current 35.4%, under the proposal.

Additional proposals call for making permanent the Making Work Pay tax credit (the payroll tax credit equal to 6.2% of earned income and capped at \$400 for single taxpayers and \$800 for joint taxpayers); expansion of the EITC; expansion of the refundable child tax credit; expansion of the saver's credit (including making it refundable); continuation of the American Opportunity Tax Credit (the enhanced credit for college expenses equaling \$2,500 per year for up to four years of college); and the

elimination of the advanced earned income credit. These proposals would result in tax savings for low- and middle-income taxpayers.

For investment fund managers who are currently taxed at long-term capital gain rates on so-called “carried interests,” the proposal calls for taxation of this particular income at regular income rates.

To raise additional revenue, the administration proposes additional changes related to businesses, including eliminating the use of the LIFO inventory method; curtailing various deferral strategies used by multinational corporations; and eliminating certain tax deductions used by oil and gas firms (e.g., percentage depletion and expensing of intangible drilling costs).

The current expectations are that the Obama administration will be successful in implementing most of these proposed changes. That said, there has been some push back from Congress regarding the 28% cap on the value of itemized deductions, since there is a fear that imposing this limitation could impact charitable giving and homeownership opportunities.

Regarding the estate tax, scheduled to be eliminated in 2010 (for just one year) and reinstated in 2011 based on 2001 exemption amounts (\$1 million) and rates (top rate of 55%), the Obama proposal calls for continuation of the current regime. Under the current rules, the estate tax exemption is \$3.5 million and the top estate tax rate is 45%. The proposal also calls for the exemption amount to be indexed for inflation.

## **Conclusion**

The announced tax increases for higher-income taxpayers expected in 2011 (higher tax rates and increases in capital gain and dividend income taxation) mean that acceleration of income into 2009 or 2010 may be an appropriate strategy.

The expected tax increase also may impact the decision whether to convert traditional IRA account balances into Roth IRA’s. This election, available in 2010, may have long-term income and estate tax benefits, although the increased rates must be factored into the analysis.

In addition to the above proposals, continued change is likely in the works, especially in light of the findings to be reached by the commission created by President Obama regarding tax reform; their report is due December 4, 2009 and could be the basis for additional legislation.

Stay tuned!

**Questions:** The Nixon Peabody Private Clients Group will be pleased to answer any questions you may have. Please do not hesitate to contact us.

\* \* \* \* \*

To ensure compliance with IRS requirements, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.



# Private Clients Alert<sup>®</sup>

## Legal and financial developments affecting individuals and their families

A publication of Nixon Peabody LLP

For additional information or advice, please feel free to call or e-mail your Nixon Peabody advisor the private clients team members listed below. ([emailname@nixonpeabody.com](mailto:emailname@nixonpeabody.com))

### PARTNERS

Deborah L. Anderson, Esq.

Sarah T. Connolly, Esq.

Cressida A. Dixon, Esq.

Thomas M. Farace, Esq., CPA, CFP<sup>®</sup>

John T. Fitzgerald, Jr., Esq.

John L. Garrett, Esq.

Evelyn V. Moreno, Esq.

Patrice B. Morrison, Esq.

Stephen M. Newman, Esq.

G. Joseph Votava, Jr., Esq., CPA/PFS, CFP<sup>®</sup>

### SENIOR COUNSEL

Elliott W. Gumaer, jr., Esq.

Jon L. Schumacher, Esq.

### COUNSEL

Katherine L. Babson, Jr., Esq.

Cynthia A. Brown, Esq.

John H. Clymer, Esq.

Ronald Garmey, Esq.

David F. Hayes, Esq.

Nicole M. Marro, Esq.

Lazaro J. Mur, Esq.

William V. Tripp III

John D. Witmeyer, Esq.

### ASSOCIATES

Michael S. Canfield, Esq.

Jennifer Collins, Esq.

Courtney Harrison, Esq.

Eric D. Karlberg, Esq.

Christine A. Sackett, Esq.

Patrick J. Simpson, Esq.

Jason P. Torres, Esq.

### PARALEGALS

Karen S. Baumgartner

Sarah Bunt

Vicky Cornish

Yvonne E. Franks

Eileen T. Hansberry

### E-MAIL NAME

danderson

sconnolly

cdixon

tfarace

jfitzgerald

jgarrett

emoreno

pmorrison

snewman

jvotava

egumaer

jschumacher

kbabson

cbrown

jclymer

rgarmey

dhayes

nmarro

lmur

wtripp

jwitmeyer

mcanfield

jcollins

charrison

ekarlberg

csackett

psimpson

jtortes

kbaumgartner

sbunt

vcornish

yfranks

ehansberry

### PHONE

617-345-1206

617-345-6075

585-263-1075

585-263-1440

585-263-1357 Rochester

617-345-1081 Boston

212-940-3034 New York

516-832-7517 Long Island

585-263-1271

617-345-6157

585-263-1657

561-691-5424 Palm Beach

716-853-8127 Buffalo

212-940-3782 New York

585-263-1450 Rochester

202-585-8355 Washington

585-263-1268

585-263-1263

617-345-6008

617-345-1332

617-345-6072

617-345-6113

617-345-1224

585-263-1623

561-691-5427

617-345-1376

585-263-1276

585-263-1042

617-345-6074

617-345-6056

617-345-1248

585-263-1273

585-263-1023

585-263-1165

585-263-1622

617-345-1115

585-263-1204

617-345-6110

617-345-6120

### ALBANY, NY

677 Broadway

10<sup>th</sup> Floor

Albany, NY 12207

(518) 427-2650

Fax: (518) 427-2666

### BOSTON, MA

100 Summer Street

Boston, MA 02110-2131

(617) 345-1000

Fax: (617) 345-1300

### BUFFALO, NY

Key Towers

40 Fountain Plaza

Ste. 500

Buffalo, NY 14202

(716) 853-8100

Fax: (716) 853-8109

### CHICAGO, IL

300 S. Riverside Plaza

16<sup>th</sup> Floor

Chicago, IL 60606-6613

(312) 425-3900

Fax: (312) 425-3909

### LONDON, UK

Hillgate House

26 Old Bailey, 11<sup>th</sup> Floor

London EC4M 7HQ, UK

+44 (0) 20 7653 9760

Fax: +44 (0) 20 7248 6557

### LONG ISLAND, NY

50 Jericho Quadrangle

Suite 300

Jericho, NY 11753-2728

(516) 832-7500

Fax: (516) 832-7555

### LOS ANGELES, CA

Gas Company Tower

555 West Fifth St.

46<sup>th</sup> Floor

Los Angeles, CA 90013

(213) 533-1050

### MANCHESTER, NH

900 Elm Street

Manchester, NH 03101

(603) 628-4000

Fax: (603) 628-4040

### NEW YORK, NY

437 Madison Avenue

New York, NY 10022

(212) 940-3000

Fax: (212) 940-3111

Donna J. Jackson  
Deborah J. Wilcox Mabry  
Mary-Benham B. Nygren  
Kimberly A. Rabideau  
Gail Robinson  
Susan T. Ruef-Statt  
Geri A. Zamber

djackson 585-263-1093  
dmabry 585-263-1350  
mnygren 617-345-6165  
krabideau 585-263-1697  
grobinsou 617-345-6022  
sruef-statt 585-263-1103  
gzamber 716-848-8204

**PALM BEACH GARDENS, FL**  
7121 Fairway Drive  
Suite. 203  
Palm Beach Gardens, FL  
33418  
(561) 691-5420

**PARIS, FRANCE**  
32, rue de Monceau  
75008 Paris, France  
+33 (0)1 70 72 36 00  
+33 (0)1 70 72 36 01

**PROFESSIONAL SPECIALISTS**

Kelly W. Acevedo  
Joseph F. Banach  
Noreen Bayfield-Austin  
Amy G. Bidleman  
Christopher F. Caldwell, EA  
Barry F. Chisholm  
John T. Cole  
Don Collichio, CPA  
John E. Corbett  
Anne Covert, CFP®  
Linda M. Dispensa  
Elaine M. Dixon  
Lawrence F. Dooley, Jr., CFA  
Mary-Ellen Dota  
Ritchie F. Emmons  
Linda R. Feldman  
Brian J. Gibbons  
Stephen G. Green, CFP®  
Lisa Hickey  
Darrell Kamholz, CPA  
Barbara J. Kelley  
Dennis W. Kushmerek  
Yelena Kuznetsova, CPA  
Scott Lefebvre, CPA  
Dimitrios Manou, CPA  
Genie McKeown, CPA, CFP®  
Kevin T. McQuaid, EA, CFP®  
Grant G. McQuillan  
Monica Murray  
Jason Nicholson, CPA  
E. Thomas O'Hara, Jr., CFA  
Masha Rabkin, CPA  
Michael J. Ruschioni  
Paul Russo  
Paula A. Russo  
Gail L. Simonds  
Frederick F. Soares, EA  
Alyson L. Stevenson, CPA  
Christine Tshudy, CFA  
Bethany M. Woods

kacevedo 585-263-1057  
jbanach 585-263-1253  
naustin 617-345-6033  
abidleman 585-263-1256  
ccaldwell 617-345-6058  
bchisholm 617-345-6178  
jcole 617-345-6073  
jcollichio 585-263-1531  
jcorbett 617-345-6034  
Acovert 585-263-1401  
ldispensa 617-345-6119  
edixon 585-263-1588  
ldooley 617-345-6095  
mdota 617-345-6096  
remmons 617-345-6104  
lfeldman 617-345-6108  
bgibbons 617-345-6185  
sgreen 585-263-1669  
lhickey 617-345-6083  
dkamholz 585-263-1272  
bkelley 617-345-1225  
dkushmerek 617-345-6136  
ykuznetsova 585-263-1351  
slefebvre 585-263-1647  
dmanou 585-263-1288  
gmckeown 585-263-1266  
kmcquaid 617-345-6151  
gmcquillan 617-345-6152  
mmurray 585-263-1404  
jnicholson 585-263-1563  
tohara 617-345-6166  
mrabkin 585-263-1117  
mruschioni 617-345-1328  
prusso 617-345-6129  
parusso 617-345-1112  
gsimonds 617-345-6190  
fsoares 617-345-6191  
astevenson 585-263-1262  
ctshudy 617-345-1078  
bwoods 617-345-1075

**PROVIDENCE, RI**  
One Citizens Plaza  
Providence, RI 02903  
(401) 454-1000  
Fax: (401) 454-1030

**ROCHESTER, NY**  
1100 Clinton Square  
Rochester, NY 14604-1792  
(585) 263-1000  
Fax: (585) 263-1600

**SAN FRANCISCO, CA**  
One Embarcadero Center  
18<sup>th</sup> Floor  
San Francisco, CA 94111  
(415) 984-8200  
Fax: (415) 984-8300

**SHANGHAI**  
Bund Center  
18<sup>th</sup> Floor (Office 1863)  
222 Yan An East Road,  
Shanghai  
200002 People's Republic  
of China  
+86 21 6132 3802  
+86 21 6335 1336

**SILICON VALLEY, CA**  
200 Page Mill Road  
2<sup>nd</sup> Floor  
Palo Alto, CA 94306-2022  
Phone: (650) 320-7700

**WASHINGTON, D.C.**  
Suite 900  
401 9<sup>th</sup> Street, N.W.  
Washington, D.C. 20004  
(202) 585-8000  
Fax: (202) 585-8080

**DIRECTOR OF FIDUCIARY AND CONSULTING SERVICES:**

Charles S. Gaziano cgaziano 617-345-6115

Visit our web site at [www.nixonpeabody.com](http://www.nixonpeabody.com)