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# Temporary Tax Relief Provides Significant Planning Opportunities for Small Business Owners

*By Richard I. Withers, Esq.; Robert J. Naberhaus, Esq.; and Michael D. Minton, Esq.*

Just when it looked like a return to the tax laws in effect prior to the enactment of the so-called "Bush Tax Cuts" was inevitable (see Back to the Future for Estate Tax Planning, Farm Credit Leader, December 2010, at 14-15), Congress and the President gave taxpayers an early Christmas present. On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Act"), which extends the benefits of the Bush Tax Cuts through 2012 and provides significant estate planning opportunities for owners of family businesses (especially those in agriculture). These opportunities, however, are only available for a short time because the provisions of the 2010 Act are set to expire on December 31, 2012, at which time the tax laws in effect prior to the Bush Tax Cuts will be resurrected (absent further action by Congress). This article describes the more significant tax changes effected or continued by the 2010 Act and briefly discusses some of the ways in which small businesses can take advantage of these changes.

**Extension of 2010 Tax Rates.** The 2010 Act extends the lower income tax rates (10%, 15%, 25%, 28%, 33% and 35%), capital gains tax rates (maximum of 15%), and qualified dividend tax rates (maximum of 15%) through 2012.

**Transfer Tax Provisions.** The 2010 Act provides for a combined $5 million exemption from gift and estate tax, and provides a $5 million exemption that can be allocated to generation-skipping transfers (transfers made during life or at death that are to or for the benefit of a person more than one generation below the generation of the donor). Additionally, the 2010 Act reduces the tax rate applicable to transfers in excess of the $5 million exemption to 35%.

The 2010 Act also introduces a new planning opportunity referred to as "portability." Portability allows the personal representative of a deceased spouse's estate to make an election on a timely filed federal estate tax return to transfer the deceased spouse's unused estate tax exemption to the surviving spouse. The surviving spouse can then use the unused exemption of the deceased spouse to make additional gifts during life or at death that are exempt from gift or estate tax. The deceased spouse's exemption from generation-skipping transfer tax, however, is not portable.

Without further action by Congress, the 2010 Act will sunset and the exemptions and rates in effect prior to the Bush Tax Cuts will again become effective on January 1, 2013. This means that the gift and estate tax exemptions will revert to only $1 million, the generation-skipping transfer tax exemption will decrease to $1 million, but will be indexed for inflation since 1997, and the maximum tax rates will increase to 55%.

**Bonus Depreciation.** Under the 2010 Act, bonus depreciation was increased from 50% to 100% for qualifying assets placed in service between September 9, 2010 and December 31, 2011. Qualifying property generally includes property eligible for depreciation with an applicable recovery period of 20 years or less, computer software covered by Section 197, and qualified leasehold improvement property. For qualifying property placed in service during 2012, the 50% depreciation rules will again apply.

**Energy Incentive Credits.** The 2010 Act extended a number of energy incentive credits for businesses, including credits for biodiesel and renewable diesel fuel, credits for refined coal facilities, new energy efficient home credit, excise tax credits/outlay payments for alternative fuel and fuel mixtures, and grants for certain energy property in lieu of tax credits.

**Payroll Tax Holiday.** In 2011, employees would have been required to pay a social security tax of 6.2% of their wages up to $106,800 and a Medicare tax of 1.45% on an unlimited amount of taxable earnings. The employer is required to pay a matching amount. Under the 2010 Act, the employee (not employer) portion of the social security tax is temporarily reduced from 6.2% to 4.2% for 2011 only. Individuals subject to the self-employment tax will also receive the 2% tax reduction (their rate will be a combined 13.3% instead of 15.3%).

**Increase of Section 179 Expensing and Expansion to Certain Real Property.** The tax changes effected by the 2010 Act are in addition to those enacted in the

Small Business Jobs Act of 2010, which was signed into law on September 27, 2010 (the "2010 Small Business Act"). Under the 2010 Small Business Act, for taxable years beginning in 2010 and 2011, taxpayers may write off up to $500,000 of the cost of qualifying property placed in service during those taxable years, subject to a phase-out once these expenditures exceed $2 million. Additionally, the definition of qualifying property was expanded so that taxpayers may expense up to $250,000 of the cost of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property placed in service during 2010 and 2011. The 2010 Act also extends Section 179 expensing for 2012, but reduced the deduction limitation to $125,000 of the cost of qualifying property placed in service during 2012, subject to a phase out once the expenditures exceed $500,000. In 2013, the Section 179 expensing limitations will revert back to a $25,000 maximum deduction with a phase-out beginning at $200,000.

**Opportunities.** The 2010 Act has ushered in a new era of tax planning opportunities for small business owners that are positioned to take advantage of the temporary tax relief provisions in the next two years. Business owners should consider ways to accelerate the recognition of income, capital gains and dividends, where possible, before the tax rates increase in 2013. Additionally, business owners who have been holding off on purchasing qualifying property should consider making those capital expenditures in the next two years and taking advantage of the opportunity to fully depreciate or expense those costs in the year of purchase. Furthermore, business owners considering making investments in energy production should consider how they might structure those investments to take advantage of the myriad energy incentive credits that have been extended through 2012.

Probably the greatest opportunities can be found in the increased exemptions and reduced rates provided with respect to the gift, estate and generation-skipping transfer taxes. The increased gift and estate tax exemption gives family business owners a unique opportunity to make significant transfers either outright or in trust to subsequent generations without incurring any transfer tax. As discussed above, single individuals can transfer up to $5 million in assets and married couples can transfer up to $10 million in assets without incurring gift or estate tax. Additionally, if such transfers are made to trusts, then generation-skipping transfer tax exemption can be allocated to the transfers and the trust can survive exempt from transfer tax for up to 360 years.

Furthermore, the increased exemptions and reduced rates can be coupled with other estate planning techniques to further minimize the transfer tax liability of family business owners. For example, a decedent's estate may elect to value real property used in farming operations or other closely-held small businesses at its special use valuation (rather than at its highest and best use value). Providing that a farming or closely-held small business qualifies, this election allows for a reduction in the valuation of qualified real property included in the decedent's gross estate by a maximum amount of $1,020,000 for 2011 (indexed annually for inflation). Additionally, qualifying small business owners may take advantage of valuation discounts (e.g. discounts for lack of control and lack of marketability) when transferring interests in their business either during life or at death. Such discounts can result in the transfer of a family business at values greatly reduced from the value of the underlying assets of the business. As an added benefit, recent case law and Private Letter Rulings show that the special use valuation is calculated after considering any applicable valuation discounts. This allows for layering of discounts and deductions by first taking into account valuation discounts and then further reducing the value of the estate by any reduction attributable to a special use valuation. A properly structured estate and business plan that takes advantage of the 2010 Act, and the other planning techniques described above, can achieve the transfer of a family business with a value in excess of $20 million to subsequent generations with little, if any, estate, gift or generation-skipping transfer tax.

The window of opportunity to take advantage of these planning techniques and the increased exemptions is only two (2) years, so it would be prudent to review your current estate and tax plans now with a qualified estate and tax attorney or accountant. ■

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