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RSM McGladrey Tax Digest

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A periodic electronic newsletter highlighting developments of interest to today's companies on the move.

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There was a significant volume of legislation with tax implications introduced in 2009. Much of this legislation was not finalized when Congress recessed for the holidays. There was a significant volume of legislation with tax implications introduced in 2009. Much of this legislation was not finalized when Congress recessed for the holidays. Most of the legislation will be acted upon once Congress reconvenes in January 2010. Following is a summary of key legislation, which also will be covered in the upcoming Web seminar Tax legislation: Healthcare, estate tax, extenders and more. Please plan to attend to get an update on the progress Congress makes on these pieces of legislation in the next month.

Estate Tax

Estate Tax and Generation Skipping Tax Repeal – What to Do Now?

Effective January 1, 2010, the estate tax and the generation skipping tax will be repealed. The gift tax will not be repealed, but will have its bracket reduced from 45% to 35%. Most observers assumed that Congress would pass legislation that would, at a minimum, carry forward the 2009 rates and exemptions into 2010. The imminent repeal raises a variety of planning issues. Consider the following repercussions:

Elimination of the step up in basis rule.

For decedents dying after December 31, 2009, the basis of property acquired from a decedent would be the lesser of the decedent's adjusted basis or the fair market value of the property on the decedent's death. This results in assets potentially being "stepped down" should FMV be lower than the asset's basis at date of death, which exposes modest estates that would not have been affected without an estate tax repeal to additional tax in the form of a capital gains tax. Calculating the date of death basis may be daunting.

There are two exceptions from the carryover basis provisions:

(1) The executor can allocate up to $1.3 million (increased by unused losses and loss carryovers) to increase the basis of assets; and

(2) The executor can also allocate up to $3.0 million to increase the basis of assets passing to a surviving spouse, either outright or in a QTIP trust. This is an increased basis of $1.3 and $3.0 million, not assets having a value of $1.3 or $3.0 million, so the allocation process may get complicated.

To properly account for these "step up" exceptions, many taxpayers with smaller estates who would not have had to file estate tax returns previously will now need to file. House officials have estimated that an extension of the 2009 estate tax into 2010 impacts only 6,000 estates, but the new carryover basis provisions will affect more than 70,000 estates.

Estate tax recapture provisions would continue to stay in force.

Persons who are subject to various "recapture" provisions are not off the hook in 2010. For example, the QDOT tax (with respect to a qualified domestic trust created to obtain a marital deduction for amounts passing to a noncitizen spouse) continues on trust distributions for 10 years after the estate tax is repealed. However, this QDOT tax that is otherwise applied at the surviving spouse's subsequent death would not apply if the surviving spouse dies after 2009.

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The recapture provisions for special use valuation, QFOBI (qualified family-owned business interests) deductions, §6166 installments, and qualified conservation easements also continue to apply in 2010. Therefore, post mortem requirements related to these elections would need to be continued.

Will the repeal actually happen?

There will likely be an estate and GST tax established sometime during 2010. The issue is whether there will be a "repeal window" available for donor and decedents. There has been a rumor that Senator Baucus, Chairman of the Senate Finance Committee, and Representative Rangel, Chairman of the House Ways and Means Committee, would sign a "letter of intent" to give notice to taxpayers not to rely on the repeal and to anticipate an estate tax that would be retroactively applied back to January 1, 2010. Pomeroy and Baucus are sponsoring similar bills (SB 722 and HR 4154) that would carry 2009 estate tax laws forward into 2010, serving as a band aid until more substantive action can be taken. There is some question, however, concerning the constitutionality of instituting an estate tax and GST tax system retroactively when no system exists, and many Senate Republicans will use this delay to push for either favorable estate tax changes (e.g., an increase of the estate tax lifetime exclusion to $5 million) or a permanent repeal of the estate tax altogether. So this issue could continue well into 2010, and the result is uncertain.

Tax Implications of Healthcare Legislation

On December 24, the Senate passed the *Patient Protection and Affordable Care Act* with significant tax implications. The legislation is much different than that passed earlier by the House so there should be considerable debate as the House and Senate negotiate to develop a conference report containing final legislation agreeable to the House, Senate and President. Preconference discussions are undoubtedly taking place and conference work on this is expected in early January.

Key tax provisions in the Senate bill include:

- A new excise tax would be imposed on high-cost or so-called Cadillac insurance plans. The 40% nondeductible excise tax would apply to plans costing more than $8,500 for individuals and $23,000 for families. The threshold would increase to $9,850 for individuals and $26,000 for families with certain high-risk jobs or those older than 55 but not yet receiving Medicare.
- The hospital insurance payroll tax on wages and self-employment earnings in excess of $200,000 would be raised to 2.35%, up almost an additional percentage point.
- It would limit annual contributions to health flexible spending arrangements to $2,500 and the types of expenses that can be reimbursed.
- It would increase the penalty for nonqualified withdrawals from health savings accounts to 20%.
- Only medical expenses in excess of 10% of a taxpayer's adjusted gross income would be deductible as itemized deductions. The current 7.5% level would remain for taxpayers 65 and older.
- A new excise tax on indoor tanning services equal to 10% of the amount paid for the procedure was introduced. This replaced an earlier proposal to impose a tax on cosmetic surgery.
- Small businesses with up to 25 employees and wages of less than $50,000 may qualify for a tax credit of up to 50% when they provide insurance for their employees. For employers with fewer than 10 employees and average wages of less than $20,000, a full credit could be available.

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- Businesses would be faced with new information reporting burdens.
- A new 50% tax credit for certain investments made for new therapies to prevent, diagnose, and treat acute and chronic diseases was introduced.
- The bill does not include the House's proposal for the 5.4% surtax on individuals earning more than $500,000 and joint filers with more than $1 million of income.

Extension of Tax Credits and other Provisions

On December 8, 2009, the House passed the *Tax Extenders Act of 2009* which would extend for one year more than forty provisions scheduled to expire at the end of 2009. While the Senate did not act on this legislation in 2009, leaders of the Senate Finance Committee have indicated they intend to extend the various provisions without a gap in coverage. Furthermore, the Administration has issued a statement strongly supporting the passage of this legislation. We look for the President to sign legislation extending these provisions into law in early 2010.

Key provisions include:

- Extension of the R&D credit
- Extension of the special 15-year cost recovery period for certain improvements
- Extension of the active financing exception from Subpart F of the tax code
- Extension of look-through treatment of payments between related controlled foreign corporations
- Extension of tax credits for biodiesel and renewable diesel
- Extension of the deduction of sales taxes
- Extension of disaster relief provisions

However, the House version of the legislation would tax certain investment management services income received as carried interest as ordinary income rather than at capital gains rates.

Technical Corrections of Existing Laws

A technical corrections bill passed the House on December 9 and we expect the Senate to address technical corrections in 2010.

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