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Summary of Important Tax Changes in 2011 Affecting Affluent Taxpayers

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Under current law, nearly all of the 2001 and 2003 tax cuts expire in 2011, returning the individual income tax to its pre-2001 level (except for a few permanent changes). In the Administration's 2011 budget many of these tax cuts will become permanent, particularly those benefiting lower income households. However, taxes on affluent households are likely to increase or revert back to 2003 levels. High-income taxpayers have been redefined as couples with income over $250,000 and single people with income above $200,000. Whether this will actually happen will be at the heart of a spirited battle in Congress during 2010.

Specifically, the Administration proposes:

- Raising the top two tax rates back to their pre-2001 levels
- Changing the income threshold for the next-to-highest rate
- Reinstate the personal exemption phase-out and the limitation on itemized deductions
- Imposing a 20 percent tax rate on long-term capital gains and qualified dividends.

Higher Tax Rates

Beginning in 2011, tax rates that were in effect prior to 2001 automatically return. The top income tax rate goes back to 39.6%, and the special low 10% bracket is eliminated. Please see the attached table of proposed tax rate changes.

Medicare Tax Increases

The new health care law increases the Medicare payroll tax on employee wages and salaries from 1.45 percent to 2.35 percent on earnings above a certain amount — $200,000 for individuals and $250,000 for couples who file jointly. The employer's share would remain at 1.45 percent for all wages and salaries — creating an effective 3.8 percent tax rate for income in those higher brackets.

Secondly, the bill would apply Medicare taxes to several forms of "unearned income" — capital gains, dividends, interest, royalties and other sources besides wages and salaries — above the $200,000 and $250,000 thresholds. The individual or couple must pay the whole 3.8 percent Medicare tax because there is no employer with whom to split the bill on "unearned income." However, if you are already at max AMT tax levels, this additional tax should only have limited impact.

Exemptions for the Alternative Minimum Tax (AMT)
For many, higher tax rates will be offset by a decline in their AMT tax. For 2010, the exemption levels drop to $45,000 for married filing jointly, $33,750 for singles and heads of household, and $22,500 for married couples filing separately. If your base tax rate is increasing, you should have an offsetting decline in your AMT taxes unless you are beyond the max AMT tax zone.

Increase in Capital Gains and Dividend Tax Rates
The tax rate reductions for long-term capital gains and dividends are scheduled to automatically expire in 2011.

- The maximum long-term capital gains tax rate goes back up to 20 percent from 15 percent.
- Since 2003, Qualified Dividend Income (QDI) has been taxed at a 15% rate. This policy was extended in the 2009 Stimulus plan through 2010. Unless changed, dividend income will be taxed as ordinary income at your highest marginal tax rate in 2011. Currently, the Administration's budget proposes capping QDI at 20%.
- For the first time, unearned income, interest dividends and capital gains, will be subject to the Medicare tax at a 3.8% rate.

Estate Tax Repealed
The federal estate tax will be eliminated for estates of individuals who die in 2010 unless Congress acts to retain it. For individuals dying after 2010, the federal estate tax returns with a $1,000,000 exemption and a 50% maximum rate. Congress is likely to take some action on these rules during 2010. We expect the tax exemption to fall between $3,500,000 (Democrats) and $5,000,000 (Republicans).

Roth IRA Conversions
Starting in 2010, individuals with any amount of modified Adjusted Gross Income are free to switch a Traditional IRA to a Roth IRA. Conversions are fully taxable at your regular tax rate. For conversions in 2010, taxpayers can spread the tax due over two years. Half the tax will be due in 2011, and the remaining half will be payable in 2012. Removing the limit on conversions effectively eliminates the income limit on contributions to Roth IRAs. A taxpayer with income too high to use a Roth will be able to contribute to a Traditional IRA (which does not have income limits for contributions) and immediately convert to a Roth.

In 2010, IRA and Roth contributions are limited to $5,000 if under age 50 and $6,000 if over age 50 but subject to an income cap of $167,000 -$177,000*.

Credit for Energy-Saving Home Improvements
The tax credit for the cost of energy-saving home improvements is 30 percent for 2009 and 2010, up to a maximum total of $1,500 in the two-year period. It applies to qualified skylights, windows, outside doors, biomass fuel stoves and high-efficiency furnaces, water heaters and central air conditioners. The 30 percent tax credit of the cost of energy-saving home improvements reverts to 10 percent in 2011, and is capped at $500.

Contribution Limit for 401(k) Plans
The maximum employee contribution increases to $16,500 in 2009 and 2010 from $15,500 for 401(k) and similar workplace retirement plans, including 403(b)'s and the federal Thrift Savings Plan. Workers age 50 and older in 2009 can put in an additional $5,500, making their maximum $22,000. These limits remain the same in 2010 and 2001 is unknown.

Higher Annual Gift Tax Exemption
For 2009 and 2010, you can give any individual up to $13,000 without owing any gift tax.

State and Property Taxes
I would expect many state and local property taxes to increase in 2011. Good luck.

2011 Tax Rates under Extended Baseline and as Proposed in 2010 Budget

Taxable Income		Marginal Tax Rate	
Over	But not over	Extended Baseline	Budget Proposal
Single			
$0	$8,425	10%	10%
$8,425	$34,200	15%	15%
$34,200	$82,850	25%	25%
$82,850	$172,800	28%	28%
$172,800	$192,000	33%	28%
$192,000	$375,700	33%	36%
$375,700	---	35%	39.6%
Married Filing Jointly			
$0	$16,850	10%	10%
$16,850	$68,400	15%	15%
$68,400	$138,050	25%	25%
$138,050	$210,400	28%	28%
$210,400	$232,950	33%	28%
$232,950	$375,700	33%	36%
$375,700	---	35%	39.6%
Head of Household			
$0	$12,000	10%	10%
$12,000	$45,800	15%	15%
$45,800	$118,300	25%	25%
$118,300	$189,350	28%	28%
$189,350	$191,600	28%	36%
$191,600	$375,700	33%	36%
$375,700	---	35%	39.6%

Tax rate would decrease

Tax rate would increase