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Re: Expiring Tax Laws

To Our Clients, Friends and Colleagues:

As we approach the November elections taxes are once again becoming a hot topic. Of particular concern is the upcoming expiration (known as the "sunset") of a wide ranging set of tax cuts enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

With elections looming, our federal government appears to finally be taking EGTRRA's sunset seriously. Although we have no way of predicting whether Congress will actually have any new tax legislation in place this year, we are starting to get some sense of what the major players involved are expecting to get done in terms of tax reform.

This letter is intended to provide you with an explanation of what our firm considers the most significant expiring tax provisions of EGTRRA, how these changes may impact you and what course of planning you may want to consider. When such information is available, we are also providing you with the changes to the tax laws that have been proposed by President Obama and/or members of Congress.

In this letter you will find a discussion of tax law changes concerning:

- Income tax rates and brackets
- Itemized deduction phaseouts
- Marriage penalty relief
- Alternative minimum taxes and exemption amounts
- Capital gain tax rates
- Changes involving the taxation of investment income
- Expensing small business investments and acquisitions
- Estate and gift tax rates and exemption amounts

We hope you find this summary helpful.

Individual Income Tax Rates

EGTRRA gradually reduced individual income tax rates and created a new 10% tax bracket for a portion of income previously included in the 15% tax bracket. For tax years beginning after December 31, 2010 we will revert to pre-EGTRRA tax rates.

Here's a comparison of the tax rates before, after and during EGTRRA:

Pre/Post-EGTRRA	EGTRRA
-	10%
15%	15%
28%	25%
31%	28%
36%	33%
39.6%	35%

After EGTRRA those taxpayers in the higher brackets will not only see higher marginal tax rates, but for tax years beginning after December 31, 2012 they will also be subject to an additional 0.9% Medicare tax on earned income above \$200,000 (\$250,000 for married couples filing jointly), and a 3.8% Medicare tax on the lesser of net investment income or modified adjusted gross income in excess of \$200,000 (\$250,000 for joint filers). For more information on the additional Medicare taxes visit the tax library on our website www.preeosilverman.com (or <http://www.preeosilverman.com/CM/Custom/2010-Health-Care-Act.asp>).

President Obama has proposed making the four lowest EGTRRA brackets permanent, but would allow the top two tiers to revert to pre-EGTRRA levels. He has also proposed widening the 28% bracket so that individuals with adjusted gross incomes of \$200,000 (\$237,300 for joint filers) or less would not be subject to a higher tax bracket.

Planning Opportunities: Individuals subject to the top two brackets should consider accelerating the recognition of income to 2010, and/or deferring deductions to 2011. Such consideration may include converting a traditional IRA to a Roth IRA in 2010, as taxpayers have the option of recognizing conversion income in 2010 or recognizing income pro-rata over 2011 and 2012.

Itemized Deduction Phaseouts

Prior to EGTRRA the amount of itemized deductions individual taxpayers could claim on their tax returns was limited. Under EGTRRA, this limitation was phased out over time so that in 2010 there is no limitation on the amount of itemized deductions individual taxpayers can claim. After EGTRRA sunsets these limitations will return in full force. President Obama has proposed modifying the itemized deduction limitation so that it applies only when adjusted gross income reaches and exceeds \$200,000 (\$250,000 for joint filers).

Planning Opportunities: Higher income taxpayers who anticipate being subject to the income limitations should consider accelerating the recognition of deductions to 2010. However, this consideration should also take into account the possible exposure to higher tax brackets in 2011.

Marriage Penalty Relief

Individual taxpayers that do not itemize deductions are entitled to take a basic standard deduction which is subtracted from income in arriving at taxable income. EGTRRA provided that the standard deduction available to joint filers (married couples) was twice the basic standard deduction available to single filers. Additionally, EGTRRA increased the size of the 15% tax bracket for married couples so it was twice the size of the 15% tax bracket applicable for single taxpayers. to exactly Prior to 2001 this was not the case and two married persons would have saved tax by remaining unmarried and filing tax returns as single individuals (collectively claiming greater amounts of standard deductions). This problem with the standard

deductions and tax rate brackets became known as the “marriage penalty.” EGTRRA eliminated the marriage penalty by increasing the standard deduction and size of the 15% tax bracket for married couples so they were twice the size of the standard deduction and 15% tax bracket available to single individuals.

For tax years beginning after EGTRRA sunsets, the marriage penalty will return. President Obama has proposed retaining these provisions of EGTRRA permanently.

Alternative Minimum Tax

In very simple terms the alternative minimum tax (AMT) is a tax system that operates parallel to the ordinary federal income tax, with its own definition of taxable income, allowable deductions, exemptions and tax rates. It was originally called the “millionaire’s tax” as it was originally intended to apply only to the wealthiest households. The income triggers for the AMT never provided that they should be indexed for inflation and over time, more and more taxpayers became subject to the tax without periodic Congressional action. Although EGTRRA increased the amount of exemptions from the AMT the increases expired after 2004 and Congress has since enacted temporary “patches.”

So far, Congress has not extended any “patch” for 2010, much less 2011. Without action many individuals will face an AMT liability for these tax years.

Capital Gain Tax Rates

Changes to the capital gain tax rates actually occur on account of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). JGTRRA (and enhanced by a following piece of legislation) reduced the capital gain tax rate to 15% (this rate was an even lower 5% rate, subsequently reduced to zero for taxpayers in the 10% and 15% tax brackets). JGTRRA will sunset December 31, 2010 and the capital gain tax rate will revert to 20% (18% for assets held over five years). For taxpayers previously subject to the zero-percent tax rate, the rate will increase to 10% (8% for assets held over five years).

President Obama has proposed a permanent extension of the 15% and zero-percent tax rates for everyone other than those in the highest two tax brackets. For individuals in the top two tax brackets he proposes a 20% capital gains tax rate.

Planning Opportunities: Individuals should consider accelerating the recognition of capital gain to 2010 while capital gain tax rates are lower.

Dividend Income

The upcoming change to the tax rates applicable to the receipt of dividend income by individual taxpayers is also a by-product of JGTRRA. JGTRRA reduced the maximum tax rate on the receipt of qualified dividends to 15%. A zero-percent rate applies if the recipient individual is in the 10% or 15% tax brackets. After December 31, 2010 the applicable tax rate is scheduled to revert back to pre-JGTRRA law, which provided that dividends are subject to ordinary income tax rates (currently scheduled to be 15-39.6%, as described above).

President Obama has proposed permanently extending the 15% and zero-percent rates for taxpayers whose incomes do not exceed \$200,000 (\$250,000 for joint filers).

Planning Opportunities: Qualifying corporations with accumulated earnings and profits may want to consider accelerating the payment of dividends to 2010.

Expensing Small Business Investments and Acquisitions

Under JGTRRA and subsequent legislation, taxpayers purchasing tangible depreciable property are entitled to deduct the cost of such property (rather than taking depreciation expenses over time); however, the amount allowable as an expense was limited and phased out at certain levels. For example, current legislation allows for a maximum annual expense of \$250,000 (depreciation deductions in lieu of disallowed expenses may be claimed over time). After December 31, 2010 the maximum allowable current year expense will revert to \$25,000.

President Obama has proposed a permanent maximum expensing limit of \$125,000.

Planning Opportunities: Businesses planning to make significant assets acquisitions in the near future should consider accelerating those acquisitions to 2010.

Estate and Gift Tax Rates

Some of EGTRRA's most significant tax reforms concerned the federal estate, gift and generation skipping transfer taxes. Many of these changes were phased in over time, culminating with the complete repeal of the estate and generation skipping transfer taxes for 2010. As a result of EGTRRA sunseting on December 31, 2010, we will return to pre-EGTRRA law with respect to these taxes.

As a consequence, estate and generation skipping transfer tax rates, which were 45% as recently as 2009, and gift tax rates which are currently 35%, will revert to their old 55% tax rates.

In December 2009, the House of Representatives passed legislation that would have permanently extended 2009 transfer tax rates (45% for estate, gift and generation skipping transfer taxes). This legislation has not moved forward through Congress.

Planning Opportunities: Taxpayers may want to consider making taxable gifts during 2010, while the gift tax rates are set at 35% in an effort to avoid the possibility of a return to 55% transfer tax rates in 2011. The impact a return to pre-EGTRRA law may have on wealthier taxpayers is significant and the tax planning opportunities cannot adequately be summarized in this letter. We urge you to consult with your advisor(s).

Estate and Gift Tax Exemption Amounts

Prior to EGTRRA the Internal Revenue Code provided each individual taxpayer with a credit that effectively exempted a portion of wealth from transfer taxes. As recently as 2009, the credit effectively eliminated estate and generation skipping transfer taxes on the first \$3.5 million of wealth (\$1 million of which could be used during a taxpayer's lifetime against gift taxes). The credit is eliminated for 2010 as a result of the repeal of the estate and generation skipping transfer taxes, though the \$1 million credit still exists for gift tax purposes.

As a result of EGTRRA's sunset, the applicable credit for all transfer tax purposes will revert to \$1 million.

Planning Opportunities: As a result of the repeal of the generation skipping transfer tax for 2010, taxpayers may want to consider making gifts (whether

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taxable or utilizing their \$1 million gift tax credit) to remote generations (e.g., grandchildren) whether as outright gifts or in trust.

Tax-Free Stepped-Up Basis In Assets

Until the 2010 repeal of the estate and generation skipping transfer taxes, at a person's death their assets were entitled to a tax-free step up in basis (the tax basis was increased to fair market value). This enabled heirs to sell inherited assets shortly after death while paying little or no tax. These rules have been repealed for 2010 (though a stepped up basis is allowed for the first \$1.3 million of assets – with an additional \$3 million available to a surviving spouse inheriting assets). When EGTRRA sunsets we will return to the more favorable and unlimited step-up in basis rules.

The information presented in this letter is not intended to be an exhaustive review of the current state of the law, or the changes that loom if EGTRRA sunsets without further legislative action. If you have any questions about how you may be impacted by the scheduled change in law, feel free to contact Bob Preeo, Mark Berger or myself.

Very truly yours,

Steven M. Weiser

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