

How you may benefit from the tax compromise

Extending relief to taxpayers



If you've been bracing for the tax increases that were scheduled to occur on Dec. 31, 2010, you can finally relax; Congress and the White House came to a compromise regarding extending the Bush-era tax cuts. Now you need to prepare to face the new reality.

Together we'll go far



Washington acted, now it's your turn

Washington went down to the wire in addressing the “sunset” provisions included in the 2001 legislation that introduced the Bush-era tax cuts. The signing of the “Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010” means taxpayers will temporarily not be subject to the tax increases that were scheduled to take place under the old legislation. But it also means they need to rethink their tax-planning strategies in light of the new legislation.

The act affects many different taxes. *The three primary areas are:*

Income taxes

Ordinary income tax brackets (projected)		2011- 2012 rates
Single filer	Joint filer	
\$0 - \$8,500	\$0 - \$17,000	10%
\$8,500 - \$34,500	\$17,000 - \$69,000	15
\$34,500 - \$83,600	\$69,000 - \$139,350	25
\$83,600 - \$174,400	\$139,350 - \$212,300	28
\$174,400 - \$379,150	\$212,300 - \$379,150	33
Over \$379,150	Over \$379,150	35

The 10% bracket, which was scheduled to sunset, will continue to exist for 2011 and 2012. The remaining brackets, except the 15% bracket, were set to increase but will remain unchanged.

Long-term capital gains taxes

2011-2012 ordinary income tax brackets	2011- 2012 long-term capital gains rates
10%	0%
15	0
25	15
28	15
33	15
35	15

Taxpayers in the 10% and 15% brackets may enjoy the 0% long-term capital gains tax rate. Those in the higher ordinary income tax brackets will continue to pay a 15% long-term capital gains tax as opposed to the scheduled 20% under the old legislation.

Qualified dividend taxes

Character of dividend	2011- 2012 rates
Ordinary dividend	Ordinary income rates
Qualified dividend	Long-term capital gains rates

Qualified dividends will still be taxed at long-term capital gains tax rates rather than the higher ordinary income tax rates stipulated under the old legislation. Consequently, qualified-dividend-paying stocks still may be attractive for generating income that can be used for everyday expenses or reinvested.

Hitting the act's highlights

The following are highlights – but certainly not a comprehensive listing – of features of the act. First, we'll look at income-tax related issues. Starting on page 6, we examine provisions pertaining to the estate tax. As always, you should consult your tax advisor regarding the potential effects on your specific tax situation.

Income-tax related provisions

Taking a smaller bite

The legislation's most obvious benefit will be that the IRS will be taking smaller amounts of tax from a variety of different types of income than it would have under the old legislation. Those primarily affected include:

Ordinary income. The 2010 ordinary income tax rates (which include the historically low 10% bracket) will continue in effect for two additional years. This is good news for investors and provides time to plan for higher income tax rates that may come in the future.

Capital gains. The act also extended the 15% long-term capital gains tax rate for taxpayers in the 25% and higher tax brackets as well as the 0% long-term capital gains tax rate for taxpayers in the 10% and 15% tax brackets. This provision is extended for 2011 and 2012.

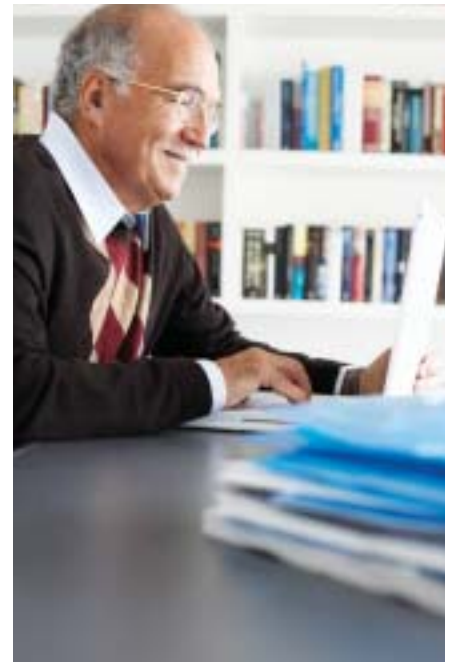
Qualified dividend rates. The act keeps the 15% and 0% long-term capital gains tax rate on qualified dividends, which are paid by common and some preferred stock of U.S. corporations and mutual funds where the income is derived from U.S. equity securities. They do not include distributions from preferred debt. Dividends paid by certain foreign corporations may also be qualified. If you are uncertain regarding whether a dividend is qualified, check with your tax advisor.

Keeping deductions for high-income taxpayers

Unlike under prior law, higher-income taxpayers have no loss of itemized deductions and personal exemptions due to phase-outs for 2010. This elimination of deduction phase-outs has been extended through 2012.

Extending marriage penalty relief

Prior to the landmark 2001 tax-relief legislation, certain couples paid more in taxes when filing "married" than if they had been "single." Through the subsequent years, this "marriage penalty" was reduced by gradually increasing the standard deduction and the size of the 15% ordinary income tax bracket for married couples. This relief is extended through 2012.



Looking at the long term

Keep in mind that Congress will eventually revisit today's low income tax brackets and may find it prudent or necessary to increase income taxes – at least for certain taxpayers. Some of the newly enacted provisions expire at the end of 2011 and others at the end of 2012. Remember that health-care reform has already legislated higher Medicare taxes on investment income for higher-income taxpayers beginning in 2013. Now is the time to begin thinking about how you might reposition your portfolio to reduce income taxes in this ever-changing environment.



Increasing paycheck sizes

The Making Work Pay credit reduced the amount of tax your employer withheld in 2009 and 2010 for federal-income-tax purposes. In its place, the new act reduces the employee portion of Social Security payroll taxes from the current 6.2% to 4.2% – two full percentage points. This reduction is scheduled for 2011 only. For a taxpayer earning \$50,000, this could translate into \$1,000 less withholding over the full year. For a taxpayer who earns the Social Security maximum in 2011 (\$106,800) or more, the withholding savings total will be up to \$2,136. The act also drops the Social Security tax rate for self-employed individuals from 12.4% to 10.4%.

Finding alternative minimum tax (AMT) relief

The legislation increased the exemption amounts used to adjust a taxpayer’s AMT income. As a result, an estimated 21 million households will avoid the AMT. The 2010 and 2011 exemptions include the following:

Filing status	2010	2011
Married filing jointly	\$72,450	\$74,450
Single	47,450	48,450

The AMT calculation is separate from the regular taxable-income calculation; your chances of paying the AMT may increase if you have:

- ▶ Several dependents
- ▶ Interest deductions from home equity loans or refinanced mortgages that were not used to buy, build or improve your home
- ▶ Interest from certain private activity municipal bonds (AMT bonds)
- ▶ A large spike in ordinary income or capital gains
- ▶ High state and local taxes
- ▶ Exercised incentive stock options (ISOs)

Extending the increased child tax credit

The 2001 tax legislation gradually increased the child tax credit to \$1,000. The new act extends the \$1,000 credit through the 2012 tax year.

Helping make college more affordable

The 2009 tax legislation renamed the Hope Credit as the American Opportunity Credit and provided an expanded credit for 2009 and 2010. The new act extended the expanded credit into 2011 and 2012. The American Opportunity Credit provides a tax credit of up to \$2,500 for tuition and related expenses paid during any of the first four years of college. The credit is phased out at \$80,000 modified adjusted gross income (MAGI) for single filers and \$160,000 for joint filers.

Keeping Education Savings Account enhancements

The act kept the current Education Savings Accounts (ESAs) provisions for 2011 and 2012. Some of these extended provisions include the:

- ▶ Maximum annual contribution amount remains at \$2,000 per beneficiary
- ▶ Definition of a qualified expense continues to include expenses related to enrollment in elementary and secondary education in addition to post-secondary expenses for 2011 and 2012
- ▶ Contribution phase-out limit remains at \$190,000 - \$220,000 for taxpayers who file a joint return
- ▶ Contribution deadline remains April 15 following the applicable contribution year

Although these benefits have been extended, you may want to consider the additional benefits of a 529 plan for helping to build sizable account balances to cover college and post-graduate expenses. Talk with your Financial Advisor about the various resources available to save for education expenses.

Please consider the investment objectives, risk, charges and expenses carefully before investing in a 529 savings plan. The official statement, which contains this and other information, can be obtained by calling your Financial Advisor. Read it carefully before you invest.



Parents be aware

529 plan expanded qualified expense **NOT** extended

For 2009 and 2010 only, the definition of “qualified expenses” from 529 plan account balances was expanded to include computers, related equipment and Internet access expenses. This provision has not been extended, so withdrawals to pay for these items will no longer be considered “qualified expenses” and will no longer be federal-income-tax-free.



Helping IRA owners assist their favorite charities

The act reinstates qualified charitable distributions (QCDs) (which expired in 2009) for 2010 and 2011 only. QCDs let IRA owners who are age 70½ or older contribute up to \$100,000 per year directly from an IRA to the owner's choice of qualified charities with no federal-tax consequences. However, note the following:

- ▶ The IRA trustee or custodian must make the payment from the IRA directly to the charity.
- ▶ A taxpayer cannot make a QCD until after he or she turns age 70½ (six months after the individual's 70th birthday).
- ▶ QCDs may count toward satisfying required minimum distribution (RMD) amounts.
- ▶ The taxpayer will not receive a deduction for the charitable contribution because the IRA distribution will not be included in his or her taxable income.
- ▶ This provision applies only to traditional and Roth IRA distributions that would otherwise be taxable.
- ▶ A special rule allows QCDs made through Jan. 31, 2011, to be treated as though they were made on Dec. 31, 2010. Thus, an IRA owner age 70½ or older could make an additional charitable contribution directly from his or her IRA to a qualified charity in January and treat that as a 2010 distribution.

Making energy savings less costly

The Energy Efficient Property Credit is extended for property placed in service in 2011. However, the credit calculation is much different than the 2009/2010 version. For 2011, this benefit provides a credit of up to \$500 for qualifying improvements (such as exterior doors or windows) completed in the tax year. No more than \$200 of the credit can be from expenditures on windows. Taxpayers must complete IRS Form 5695 to claim this credit.

Estate-tax related provisions

Raising the exemption; lowering the rate

The act reinstates the estate tax but with a higher applicable exclusion – the value an estate must exceed before estate taxes are due. The exclusion for 2011 and 2012 will be \$5 million, essentially protecting estates below that amount from federal estate taxes. A 35% flat rate will apply. The estate and gift exemptions will be “reunited” at \$5 million.

In light of these changes, individuals should revisit estate planning strategies and documents, including:

- ▶ **Credit shelter trust planning**, which married couples may be able to use to transfer up to \$10 million estate tax free in 2011 and 2012. The act also provides “portability,” letting one spouse transfer his or her applicable exclusion to a surviving spouse. These “portability” rules apply only if both spouses die in 2011 and 2012.
- ▶ **Life insurance policies (both within the taxable estate as well as outside the taxable estate in irrevocable life insurance trusts).**
- ▶ **Account titling and beneficiary designations.**
- ▶ **Business-succession and wealth-transfer planning.** (Grantor retained annuity trusts [GRATs], valuation discount planning, charitable lead trusts and sales to younger generations offer a remarkable planning opportunity for higher-net-worth families.)

This two-year window should be a reason to take action now and not procrastinate. In two years, Congress will need to revisit the estate tax. The desire to raise revenue may lead it to limit or eliminate certain strategies that are available in 2011 and 2012. If you are uncertain about how these temporary new provisions affect your estate plan, make an appointment with your estate planning attorney to review your documents and strategies.

For more information about the provisions relating to the estate tax, ask your Financial Advisor for our report, “Estate Planning and the 2010 Tax-Relief Legislation.”

Providing flexibility for estates of those who died in 2010

The act provides some flexibility for the estates of individuals who died in 2010. Executors will be permitted to choose between either of these estate tax rules:

- ▶ The “old” 2010 rules, which do not impose any estate tax but allow only a limited “step up” in cost basis at death, or
- ▶ Retroactive application of the new rules that provide a \$5 million applicable exclusion and an automatic basis adjustment for all assets.

Very large estates would most likely prefer the former; estates under the \$5 million threshold might prefer the latter.

In addition, the due dates for filing returns and making various tax elections is extended until nine months after the date of enactment for the estates of individuals who died during 2010.

Tax relief for businesses

The act includes a variety of business tax breaks. A key provision provides a temporary option for businesses to write off 100% of their investments, including plants and equipment, in 2011 only. Here is a short list of some other business provisions:

- Research and development credit reinstated for 2010 and 2011
- 100% bonus depreciation for investments placed in service after Sept. 8, 2010, and through Dec. 31, 2011
- 50% bonus depreciation for investments placed in service in 2012

Many of the bill’s other provisions affect businesses, industries and organizations in very specific ways. Contact your CPA or tax advisor for complete details on the tax-related provisions and how they may relate to your individual situation.



What should you do now?

To take advantage of the act's many potential tax-saving benefits, consider the following:

- ▶ In the near term, work with your Financial Advisor to review your portfolio for any existing opportunities to reduce the income tax you pay on investment income.
- ▶ Work closely with your CPA or tax advisor to determine if the AMT applies to your situation and to calculate your appropriate tax liability. You'll also want to involve your tax advisor to factor in any AMT consequences in your year-by-year strategy for the future.
- ▶ Work with your tax advisor to determine if certain family members can take advantage of the historically low 0% long-term capital gains rate.
- ▶ If you have significant equity compensation from your employer – such as stock options, restricted stock or stock in your retirement plan – create a strategy for exercising and/or selling these valuable assets in a tax-efficient manner. Realize that you may want to exercise vested stock options sooner than you anticipated to avoid higher income tax rates that may occur after 2012.
- ▶ Look at dividend-paying stocks in this low-interest-rate environment as a way to generate tax-efficient spendable income. Keep in mind that the stock investment's value will fluctuate and dividend payments are not guaranteed. But as long as you hold the stock, you'll have the opportunity to receive dividend payments that can be used to meet everyday expenses or reinvest. Your Financial Advisor can discuss specific stocks, mutual funds, exchange-traded funds (ETFs) or managed programs that focus on qualified-dividend-paying investments.

Looking beyond taxes

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You, your Financial Advisor and your tax advisor should work closely as you compile the documentation to prepare your 2010 income tax return. Review your situation to assess how you might reposition your portfolio to be more tax efficient if income tax rates rise in the future. You may want to evaluate the role of federally-tax-free municipal bonds, tax-efficient mutual funds and ETFs, growth stocks, and master limited partnerships (MLPs). Your Financial Advisor can provide details on the tax features and benefits of each of these investment types.

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