

How the new tax law may affect you

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What it means for your take-home pay, investments, and more.

After weeks of heated Congressional negotiations on Capitol Hill, a tax bill has finally been cleared for President Obama's signature. The bill temporarily extends the 2001 and 2003 federal income tax rate cuts, extends unemployment insurance for 13 months, provides new payroll tax breaks, reinstates the estate tax, and more.

The good news: The new law will give taxpayers a bit of clarity—and an opportunity to plan with relative confidence knowing that the playing field won't change dramatically, at least for two years. But beyond that, an increase in the Medicare tax for upper-income Americans is slated for 2013. And more changes are likely in the future, given the pressure to raise revenues to reduce the deficit, and talk of sweeping tax reform.

"Passage of this tax bill ensures that individuals at all income levels won't face an automatic tax increase in January," says Shahira Knight, Fidelity's vice president of government relations. "The bill provides taxpayers with some certainty, but Congress will be back at the table having the same debate in two years"

So what can you do now? Let's take a look at how the new law may impact you in four key areas: your take-home pay, your investments, your estate and gifting plans, and, if you're over age 70½, qualified charitable distributions from your IRA. We'll summarize what's changed, and what you should be thinking about for both year-end and longer-term tax planning.

Are you up-to-date on the new TAX laws?		
NEW	2010	2011 only
Payroll FICA tax	6.2% tax on earned income up to \$106,800	4.2% tax on earned income up to \$106,800*
NEW	2010	2011 and 2012
Estate tax	Repealed with conditions**	\$5 million individual exclusion with a 35% top tax rate
EXTENDED	2010	2011 and 2012
Taxable income ranges***		
Individual income tax rates		
\$0-\$16,750	10%	10%
\$16,751-\$68,000	15%	15%
\$68,001-\$137,300	25%	25%
\$137,301-\$209,250	28%	28%
\$209,251-\$373,650	33%	33%
\$373,651 and over	35%	35%
Long-term capital gains & qualified dividends tax rates		
< \$68,000	0%	0%
> \$68,000	15%	15%
AMT	The patch has been extended for tax years 2010 and 2011.	
Qualified charitable distributions	Allows investors age 70½ or older to make a qualified charitable distribution of up to \$100,000 from an IRA directly to a qualified charity.	
EXPIRED		
MRD Suspensions	The new tax law does not include an extension of MRD suspensions. Retirees are generally required to take MRDs from their retirement accounts for the year in which they turn 70 1/2, and all subsequent years, by December 31, 2010.	

*FICA limits are adjusted for inflation each year. 2011 rates have not yet been set and this is an estimate only.
 **Note: Beneficiaries of those who died in 2010 would be allowed to choose which estate tax rules to follow: those of 2010 or those of 2011. Under 2010 rules, there is no estate tax but also no step-up rules; there is only an option to exempt \$1.3 million worth of capital gains from tax.
 ***2010 through 2012 estimated tax rates are for married filing jointly. 2011 and 2012 estimated ranges are subject to changes, such as for inflation, and should not be relied on for planning purposes. Source: IRS data & Fidelity.

One important caveat: An extension of the minimum required distribution (MRD) suspension is not part of the new tax law, so retirees must take applicable MRDs for 2010 or face a hefty penalty.

How it affects your take-home pay

NEW—Payroll tax relief: There is now a 2 percentage point reduction in an employee's share of the Social Security portion of the FICA tax, from 6.2% to 4.2%, in 2011. So, if you make \$80,000 a year, you could take home an additional \$1,600 a year in 2011.

What to consider now:

- Increase any tax-advantaged retirement account contributions: If you are not already maximizing pretax contributions to your 401(k) plan, 403(b) plan, or other workplace savings plan, consider increasing your payroll deduction by 2%, or at least enough to garner the full company match. In 2010 and 2011 you can contribute up to \$16,500 to 401(k) plans (up to \$22,000 if you're 50 or older), and \$5,000 to IRAs (\$6,000 for ages 50 and older). Fidelity believes this is a smart plan of action, unless you have high interest-rate credit card debt. If so, consider using the extra money from the payroll tax relief to pay down your plastic first.

What to consider going forward:

- Automatic increases in your workplace savings plan: If you are still not maximizing your workplace savings contributions, consider increasing automatic payroll deductions in 2011.

Extended—2001 and 2003 income tax cuts: The new tax law provides a two-year extension of the 2001 and 2003 Bush-era income tax cuts (through 2012), regardless of a person's income level. This means there will be no change in the income tax rates for the next two years although the alternative minimum tax (AMT) patch extends only through 2011 and is not indexed for inflation in 2011.

What to consider now:

- A Roth IRA conversion: You may want to consider converting a traditional IRA or other eligible retirement balance to a Roth IRA¹ before December 31, 2010. For conversions made in 2010, because of a special one-time tax rule, you can elect to either pay the entire tax bill on your 2010 return or pay it over the next two years by splitting the taxable income generated evenly between your 2011 and 2012 tax returns. The extension of the current tax rates may make the latter a better option. However, although spreading out the tax bill from your conversion over two years may sound appealing, there are other considerations to take into account, so you should carefully weigh the pros and cons.
- Your income and deductions: Tax advisers often suggest that those who itemize deductions should defer income into future tax years while accelerating deductions into the current tax year. While you may end up with virtually the same tax bill, you would pay it at a later date. In the meantime, you may be able to benefit from the use of that money. Since tax rates will stay the same next year, this popular year-end tax move may be helpful in 2010 and 2011 as well, with one important exception. If you are or may be subject to the AMT, you may be better off doing the opposite. As always, you should consult your tax adviser. And don't dally: You only have until December 31, 2010, to make these moves.

Extended—AMT relief: There is now a two-year extension (through 2011) of the AMT "patch".

How it affects your investments

Extended—Capital gains tax: The top rate on long-term capital gains will remain at 15% for the next two years.

Extended—Qualified dividends tax: The top rate for qualified dividends—those on certain stocks held longer than 60 days—will remain at 15% for the next two years.

What to consider now:

- Employ an effective tax-loss harvesting strategy: Tax-loss harvesting is the practice of selling investments that have lost value to offset current-and future-year capital gains. Unlike one-time or occasional-loss sales, however, a systematic tax-loss harvesting strategy requires diligent investment tracking and detailed tax accounting.
- Exploit the 0% capital gains rate: You also may have the opportunity to eliminate taxes on the capital gains you realize from taxable accounts. In 2010, taxpayers in the 10% and 15% federal income tax brackets can realize long-term capital gains (and qualified dividends) without triggering capital gains taxes. (In 2010, the 15% bracket tops out at \$68,000 of taxable income for married couples filing jointly.) The result: If your taxable income falls into the two lowest tax brackets, selling stocks held longer than a year may be a highly tax-efficient way to generate cash flow. If you're retired, this strategy may be most advantageous if you have a relatively high proportion of your retirement assets in taxable accounts.

What to consider going forward:

- Plan ahead for future tax increases: No one can predict how or when tax rates might rise or what form proposed tax reforms may take. But at least one new tax is already slated to hit the net investment income of upper-income taxpayers in 2013: an additional 3.8% Medicare tax, which will affect married couples filing jointly with a modified adjusted gross income (MAGI) of more than \$250,000 (\$200,000 for single filers). The tax will apply to the lesser of net investment income or MAGI over the threshold. Investment income would include income from interest, dividends, capital gains, annuities, rents, and royalties.
- It's not too soon to begin preparing for this 2013 tax change. You'll want to consider maximizing savings in tax-advantaged accounts such as IRAs and 401(k)s, because withdrawals from them will not be included when determining investment income for the new Medicare tax. Further, qualifying Roth IRA withdrawals aren't considered investment income or an addition to your MAGI under current law—possibly making conversions and contributions to Roth-type accounts more relevant for the near term. If you don't have a Roth IRA, you may want to consider converting to one.

How it affects small businesses and the self-employed

NEW—Business Expensing: The new law provides for 100% expensing of qualified capital investments in 2011 and 50% expensing in 2012.

How it affects estate planning and gifting

NEW—Estate tax rate and exclusion: The new law reinstates the estate tax in 2011 and 2012 at a maximum rate of 35% with a \$5 million exemption per person. This compares to a 45% maximum rate and \$3.5 million exclusion in 2009. The new rules will sunset after 2012. Beginning in 2013, there will be a \$1 million per person exclusion with a 55% estate and gift tax rate unless further legislation is enacted.

Here are some additional estate tax changes you should know about:

- Portability. New portability rules allow any unused exemption to be passed to a surviving spouse, so a married couple can exempt up to \$10 million.
- Estates of decedents who died in 2010. The new law gives executors of these estates a choice: distribute assets to heirs estate-tax-free but with a carryover basis (generally the original purchase price), or step up the basis to the market value (generally at time of death) and pay the 35% rate on anything above the \$5 million exemption. A step-up in basis means the value of an appreciated asset is readjusted at a higher market value for tax purposes upon inheritance versus what the value of the asset was when it was originally purchased.
- Gift Tax exemption. The new law reunifies the federal estate tax exemption and the federal gift tax exemption. This means that the new lifetime gift tax exemption is \$5 million per person (\$10 million per couple) beginning in 2011. Taxable gifts made in 2011 and 2012 will be taxed at the rate of 35%.
- Generation Skipping Transfer Tax (GSTT). Beginning in 2011, the generation skipping transfer tax exemption will also be \$5 million per person (\$10 million per couple) with a 35% tax rate. Note: The GSTT is not portable.
- Extension of time for certain filings. The new law extends the time to file certain estate and gift tax returns to nine months after the enactment of the new law.

What to consider now:

- Make tax-smart charitable year-end contributions if you haven't already. For this year, given the stock market's gains, donating long-term appreciated securities may be a particularly tax-savvy strategy. As a general rule, donations of long-term appreciated securities (either stock or mutual funds) directly to a qualified charity are deductible at their fair market value on the date of contribution, and you don't pay capital gains taxes on the donated security. For those considering a major gift in 2010 (or 2011), combining a charitable gift with a Roth IRA conversion may help offset the tax cost of the conversion and perhaps allow you to convert a larger amount at a lower tax cost.
- Consider generation skipping transfers. The generation skipping transfer tax remains repealed for 2010. Individuals thinking of making gifts to grandchildren, gifts that would otherwise be subject to GST tax, have until December 31, 2010, to complete these gifts.
- Weigh the tax elections for 2010 estates. Executors of 2010 estates over \$5 million with highly appreciated assets should consider whether it may be better to subject the estate to the new law or choose the zero estate tax law of 2010. If you choose the former, the first \$5 million of estate assets will be exempt from federal estate taxes, but any amount above \$5 million may be subject to estate tax. However, the entire estate will receive a full step up in basis. If the latter is chosen, no federal estate tax will be assessed on the estate, but all of the estate assets may not receive a step-up in basis. In this case, the executor can allocate \$3 million in basis adjustments for assets passing to a surviving spouse, and another \$1.3 million in basis adjustments to property passing to a non-spouse. This is a complex decision. Contact your attorney, tax adviser, or your Fidelity Representative to understand your options.

What to consider going forward:

- Set up a meeting with your tax adviser or estate planning attorney to review your estate plan and make any necessary changes.
- Consider a Grantor Retained Annuity Trust (GRAT): A Grantor Retained Annuity Trust (GRAT) is an irrevocable trust that pays a fixed annuity to the grantor for a defined period, then pays the remainder to a non-charitable beneficiary. Contrary to expectations, the new law did not restrict GRATs. And, with the increased gift tax exemption, a grantor can now potentially put even more money into a GRAT without having to pay gift taxes. Current low interest rates are also beneficial to GRATs, because they help increase the value of the annuity while lowering the value of the remainder interest. So, the grantor may potentially use even less of the new gift tax exemption. As always, consult your Fidelity representative or speak with your attorney or tax adviser before making any decisions.

How it affects retirees

Extended—qualified charitable distributions (QCDs) from IRAs: The new tax law extends provisions of the Pension Protection Act of 2006 that allow investors age 70½ or older to make a qualified distribution of up to \$100,000 from an IRA directly to a qualified charity for both 2010 and 2011.

Not extended—Minimum Required Distribution (MRD) suspension: The new tax law does not extend the 2009 suspension of MRDs. Retirees are generally required to take MRDs from their retirement accounts for the year in which they turn 70½, and all subsequent years, by December 31. Failure to comply with this IRS regulation could result in a 50% penalty on the amount that should have been distributed.

What to consider now:

- Make sure you take an MRD in 2010. If you're 70½ or over, take a moment to ensure you've met your MRD obligation for 2010. If you were born before July 1, 1939, your 2010 MRD deadline is December 31, 2010. If you were born between July 1, 1939, and June 30, 1940, your deadline is April 1, 2011. Just remember, you'll have to take two MRDs in 2011 (one for 2010 and one for 2011).
- Think about QCDs and MRDs together. Qualified charitable distributions from IRAs made directly to qualifying charities count toward any MRD. For example, if you have a \$75,000 MRD for 2010, you can make an IRA distribution of up to \$100,000 directly to a qualifying charity and \$75,000 of that \$100,000 is counted as your MRD.
- One other important note: Any QCDs made through January 2011 can count towards your 2010 MRD, but if you already took your MRD in 2010, it appears you cannot take advantage of the QCD this year. However, if you still have to take your 2010 MRD, you may make a 2010 QCD and have it count toward your MRD even if you don't complete it until next year.

What to consider going forward:

- QCDs will count as MRDs in 2011, so you may want to consider making two QCDs: one in 2010 and one in 2011.
- Talk to your tax adviser about IRA strategies for 2011. If you are a high-net-worth investor with high IRA balances, next year may be a tax-efficient time to give away some of that money.

Views expressed are as of 12/16/2010 and may change based on market and other conditions. Unless otherwise noted, the opinions provided are not necessarily those of Fidelity Investments.

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1. A distribution from a Roth IRA is tax free and penalty free provided that the five-year aging requirement has been satisfied and at least one of the following conditions is met: you reach age 59½, die, become disabled, or make a qualified first-time home purchase.

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