

TaxTips2011

In this issue, we will review some of the provisions that affect 2011 tax returns. For coverage of tax provisions affecting children and education (applicable to both parents and non-parents), please see our **TaxTips Education/Parents**. You may also want to read our other tax letters and bulletins for valuable information that may benefit you. You will find them on our web site under **Tax Info** and **Other Info**.

■ CURRENT TAX RATES

Rates have remained steady over the last number of years with only slight changes for inflation.

2011 TAXABLE INCOME RATES

	10% TAX BRACKET	15% TAX BRACKET
SINGLE	0 – \$8,500	\$8,501 – \$34,500
MFJ	0 – \$17,000	\$17,001 – \$69,000
	25% TAX BRACKET	28% TAX BRACKET
SINGLE	\$34,501 – \$83,600	\$83,601 – \$174,400
MFJ	\$69,001 – \$139,350	\$139,351 – \$212,300
	33% TAX BRACKET	35% TAX BRACKET
SINGLE	\$174,401 – \$379,150	\$379,151 or more
MFJ	\$212,301 – \$379,150	\$379,151 or more

■ TAX ON CAPITAL GAINS AND DIVIDENDS

The lower tax on capital gains and certain qualified dividends has been extended through 2012. If you are in 10% or 15% ordinary income tax bracket, you'll pay 0% on capital gains through 2012. For those of you in the ordinary income tax brackets above 15%, the capital gains tax rate will stay at 15% through 2012.

■ KIDDIE TAX

“Kiddie Tax” applies to unearned income, such as interest, dividends, and capital gains, of a minor child under age 18. Unearned income over \$950 will be taxed at 10% and over \$1,900 will be taxed at the parents' tax rate.

■ TAX DEDUCTIONS AND CREDITS:

WHAT DOES IT ALL MEAN AND HOW DOES IT WORK?

The tax system works as follows, broken down to its basic elements: income less deductions = taxable income, multiplied by the applicable tax rates = your tax liability, minus tax credits = your net tax liability. On this basic structure we build multiple layers of complexity. Tax deductions are expenses that you are allowed to use in order to reduce your total income. Of course, less taxable income = less taxes.

Tax credits are bit more complex. A tax credit is a direct reduction of your tax liability. There are numerous tax credits including the child tax credit (which remains at \$1,000), child care tax credit, earned income tax credit, education tax credit, adoption tax credit and many more.

Therefore, you get two chances to reduce your taxes. Once with tax deductions and a second time with tax credits. And if this was not enough, should you reduce your taxes to zero and still have some credits left over, you may get the government to fork over to you some of its money.

How? By using a refundable tax credit. A refundable tax credit - there are not many - such as the earned income tax credit or the child tax credit, differs from an ordinary tax credit. A refundable tax credit allows you to reduce your tax liability below zero, to a minus figure, which means that the government has to pay you out of its money. What a joy. However, before you celebrate, read on

■ THE DREADED PHASEOUT:

IT ROBS YOU OF YOUR TAX DEDUCTIONS + CREDITS

Many of the provisions we refer to in this letter “phase-out” at certain income levels. These phase-outs can limit — or even eliminate— your various tax breaks. If your Adjusted Gross Income (AGI) falls below the phase-out level, a full deduction or tax credit is allowed. If your AGI is exactly in the middle of the phase-out range, then 50% of the deduction or credit is allowed. If your income falls above the phase-out range no deduction or credit is allowed. Not a joy.

■ WHO IS AFRAID OF THE AMT? THE WHAT?!

Your tax return is actually calculated twice. The first method is the standard way that we have all become familiar with. However, while the computer calculates your tax the standard way, it also calculates your tax the AMT way. Whichever is higher, wins – and you lose. Meaning, you get stuck with higher taxes.

The Alternative Minimum Tax (AMT) was originally designed to ensure that people with high incomes pay at least a “minimum amount of tax” by reducing the benefits to them of certain tax deductions, such as personal and dependent exemptions, miscellaneous itemized deductions, state and local taxes, property taxes, etc. Furthermore, your capital gains get taxed at a higher AMT rate.

However, the AMT is no longer a tax on just the wealthy. It was estimated that in 2011 about one in four taxpayers, will be forced to pay higher taxes because of AMT

■ NEW DEFINITION OF A DEPENDENT

To be a dependent for 2011, a person must be either a “qualifying child” or a “qualifying relative”, and in either case must be a U.S. citizen, U.S. resident alien, U.S. national, or resident of the United States, Canada or Mexico. A “qualifying child” can be a child or grandchild of the taxpayer; a brother, sister, stepbrother or stepsister, or a descendent of such relative, or an adopted or foster child. The “qualifying child” must live in the taxpayer’s home for more than one-half of the year. He/she must be one or more of the following: (1) under the age of 19, (2) under the age of 24 and a full time student for at least 5 months during the year, (3) permanently and totally disabled. In addition, the taxpayer must provide over one-half of his/her support during the tax year.

A “qualifying relative” may be a father or mother, or an ancestor or sibling of either; a step-father or step-mother;

a son-,daughter-, father-, mother-, brother-, or sister-in-law; or any individual who lives in the taxpayers home and is a member of the taxpayer’s household for the entire year. The “qualifying relative” cannot have gross income of \$3,700 or more. The taxpayer must provide over one-half of the individual’s support for the tax year. In order to claim the status of Head of Household, the taxpayer’s home must have been the home of the “qualifying child” or “qualifying relative” for more than 6 months of the year.

■ EDUCATOR EXPENSES

Eligible educators may deduct up to \$250 each as an adjustment to income. An eligible educator can be a teacher, instructor, counselor, principal or aide in a school with grades K through 12 who has worked for at least 900 hours during the school year. Qualified expenses include books, supplies, equipment, computers, software and services. Expenses over \$250 may be deducted as an itemized deduction

■ INTEREST ON STUDENT LOANS

The interest deduction on student loans remains \$2,500. The income (AGI) phase-out is between \$60,000 to \$75,000 for singles and \$120,000 to \$150,000 for joint filers.

■ HEALTH INSURANCE DEDUCTION FOR THE SELF-EMPLOYED

Self-Employed persons are able to deduct 100% of their health insurance cost as an adjustment to income, thereby reducing their AGI. Starting again in 2011, no deduction from self-employment income will be allowed. Married self-employed taxpayers should read our Tax Prep Times for possible tax planning opportunities with potential big savings.

■ HSA – (HEALTH SAVINGS ACCOUNTS)

A Health Savings Account is tax-exempt account that you set up specifically to pay or reimburse certain medical expenses you incur. Payments made from this account for qualified medical expenses are tax-free. Payments made from this account for any other purposes are subject to income tax and to an additional 10% tax. Contributions to an HSA can be made by the self-employed individual or employee for which it is set up, as well as by the employee's employer, by a family member or by any other person on behalf of the account holder. For 2011, you can contribute up to your annual deductible, which is up to \$3,050 for individual plans and up to \$6,150 for family plans. If you are age 55 or older, you can contribute an additional \$1000. You have until April 17, 2012 to make 2011 contributions.

TO BE ELIGIBLE TO OPEN AN HSA YOU:

1. must have a high deductible health plan (HDHP)
2. have no other health coverage except for certain types allowed for coverage of specific conditions
3. not be enrolled in Medicare
4. cannot be claimed as a dependent on someone else's tax return.

HEALTH SAVINGS ACCOUNT REQUIREMENTS

	SINGLE	FAMILIES (MFJ)
HDHP DEDUCTIBLE RANGE	\$1,200–5,950	\$2,400–11,900
HSA CONTRIBUTION LIMIT	\$3,050	\$6,150

* IF OLDER THAN 55 AND NOT ENROLLED IN MEDICARE AN EXTRA \$1000 CONTRIBUTION IS ALLOWED

If you are an eligible individual on the first day of the last month of your tax year, you are treated as being an eligible individual for the entire tax year for the purposes of computing the amount that you can contribute to your

HSA. You can also exclude from your gross income a qualified HSA funding distribution from your traditional or Roth IRAs.

■ STANDARD BUSINESS MILEAGE RATES

TAX YEAR 2012		TAX YEAR 2011		
MILEAGE RATES		MILEAGE RATES		
Business	55.5¢	Business	51¢ JAN–JUNE	55.5¢ JULY–DEC
Charitable	14¢	Charitable	14¢	
Medical	23¢	Medical	19¢ JAN–JUNE	23.5¢ JULY–DEC
Moving	23¢	Moving	19¢ JAN–JUNE	23.5¢ JULY–DEC

■ SECTION 179 DEDUCTIONS

Section 179 of the IRS code allows taxpayers to deduct outright the cost of fixed assets instead of depreciating them over a number of years.

For 2011, "Section 179" deduction limit is \$500,000 for **new** equipment, furniture, and off-the-shelf computer software.

■ CHARITABLE CONTRIBUTIONS

• DONATING VEHICLES AND BOATS

The rules for the contribution of used vehicles and boats changed in 2005. Under the new rules, what the charitable organization does with the donated property determines your deduction amount. If the claimed value of the donated property exceeds \$500 and the charitable organization sells it, your deduction is limited to the gross proceeds from the sale. If the charitable organization significantly uses or materially improves the donated property then, in general, you may deduct its market value. In either situation the charitable organization must provide you, within thirty days from the date of the sale or donation, with a written acknowledgement stating the amount of gross proceeds or certifying the item's intended use and duration. You may only deduct the amount that is reported to you by the charitable organization. Gone are the days of the Kelly Blue Book value deductions.

- CASH DONATIONS –

Taxpayers are required to have "proof of payment" (receipt, cancelled check, credit card statement, etc.) for ALL charitable contributions made. In addition, taxpayers should be aware of an ongoing requirement to obtain receipts from charitable organizations to which a donation of \$250 or more is made on any given day in cash, non cash or other form.

- NON-CASH DONATIONS

Clothing and household items (furniture, furnishings, electronics, appliances, linens and similar items) must be in good used condition or better. Any item valued at more than \$500 and not in good used condition or better may only be deducted if a qualified appraisal is attached to the tax return. Any item or group of items valued over \$5,000 require a qualified appraisal.

■ CHARITABLE DONATION OF REQUIRED MINIMUM IRA DISTRIBUTION (RMD)

For 2011, taxpayers aged 70 1/2 or older who are Required to make a Minimum Distribution (RMD) from their traditional IRAs are allowed to exclude from income up to \$100,000, any RMD that is paid to a qualified charity by the trustee of the IRA. Taxpayers who are eligible for this exclusion should take care to ensure that the required procedures are followed and that no distribution, designated as charitable contribution, is made to the taxpayer.

■ TUITION & FEES DEDUCTION AND EDUCATION CREDIT

Please read our [TaxTips Education/Parents](#)

■ IRAs GALORE

There are Traditional IRAs and Roth IRAs. Contributions to traditional IRAs can be deductible or non-deductible. In 2011, the contribution limit for all IRAs is \$5,000 (\$6,000 for taxpayers 50 or older as of 12/31/11), sub-

ject to limitations discussed below. In order to contribute to an IRA, a taxpayer must have "earned income" (from W-2s and/or schedule C self employment income) and be under 70 1/2 years old (please note there is no age limit for a Roth IRA). In case of married couples, only one spouse must have earned income. However, having earned income is not enough. There are multiple layers of rules and regulations that may prevent you from contributing to an IRA, So read on.

❖ TRADITIONAL IRA – DEDUCTIBILITY RULES

If you are covered by a pension, deferred compensation plan, 401(k), etc. you will be subject to the income phase-out. The AGI (Adjusted Gross Income) phase-out range for individuals has been increased to \$56,000 - \$66,000 and to \$90,000 - \$110,000 for married taxpayers filing jointly. Moreover, if your spouse is covered under a qualified pension plan but you are not, you may be allowed to make a deductible IRA contribution. In this situation, the income phase-out range limitation is from \$169,000 to \$179,000. The non-covered spouse does not have to have earned income to contribute to an IRA.

❖ TRADITIONAL IRA – NON-DEDUCTIBLE

If you are not eligible to deduct contributions to an IRA, you may still contribute to one, provided you fulfill the basic requirements of having earnings from work and being under 70 1/2 years old. A nondeductible IRA allows its owner to accumulate tax deferred earnings and the lifetime burden of keeping track of the non deductibility portion of the IRA. Ultimately when distribution is made, the non deductible portion of the distribution is not subject to tax, but the earnings are. Because of this minimal tax advantage, many tax practitioners do not encourage making a nondeductible contribution to an IRA, unless there is a plan to convert it directly to a Roth IRA.

❖ *PREMATURE IRA WITHDRAWALS
WITHOUT PENALTIES*

Taking money out of your regular IRA to use for educational purposes is not subject to the 10% penalty, but the amount withdrawn is included in your income and taxed accordingly. You can also withdraw money from your IRA, without the 10% penalty, to pay for any medical costs that are in excess of 7.5% of your AGI. Unemployed taxpayers who have received unemployment benefits for at least 12 weeks may also withdraw from their IRA, without penalty, to pay for medical insurance. Finally, first time home buyers may withdraw up to \$10,000 per taxpayer without penalty.

❖ *ROTH IRA: THE "DREAM IRA"*

Taxpayers are allowed to make a nondeductible contribution of up to \$5,000 per year (\$6,000 if 50 years or older). The income phase-out is \$107,000 to \$122,000 for single taxpayers and \$169,000 to \$179,000 for married couples filing jointly. Taxpayers over the age of 70 1/2 are also eligible to contribute, provided they have earned income. The major benefit of Roth IRAs is its tax-free withdrawal features. You may withdraw your principal at any time and for any purpose, tax free, after 5 years from the initial deposit into your Roth IRA. You may also withdraw the earnings, without penalty and taxes, after you reach age of 59 1/2, as long as five years have elapsed since the tax year of the initial contribution

❖ *IRA CONTRIBUTIONS FROM TAX REFUNDS*

If your tax returns results in a refund, you will now be able to direct the IRS to deposit up to \$5,000 (\$6,000 if you are over age 50) directly into your IRA account.

❖ *THE NEW ROTH 401(K) PLAN*

Beginning in Jan. 2006, a new Roth 401(k) plan became available regardless of taxpayer's income. The rules governing the Roth 401(k) will be the same as for the Roth IRA.

❖ *CONVERTING REGULAR IRAS TO ROTH IRAS*

You may convert (rollover) your regular IRA (deductible or nondeductible), in its entirety or partially, to a Roth IRA. Continuing in 2012, there is no modified AGI limit holding back high income taxpayers from conversion.

Also continuing in 2012, you will be able to roll over your company retirement plan, such as a 401(k), directly to a Roth IRA. This new law skips the middle step of having to roll it into a traditional IRA and then convert it into a Roth.

❖ *TO CONVERT OR NOT TO CONVERT –
THAT IS THE QUESTION*

We have seen many articles on this topic and not all of them come to the same conclusion. In general it is recognized that the younger the IRA owner, the more beneficial it is to convert a regular IRA to a Roth IRA. However, there are other factors that should be considered, such as the applicable tax bracket and state and local taxes. New York State and New York City, for example, do not tax the first \$20,000 of retirees' (age 59 1/2 or older) retirement distributions. This is a big savings. However, these savings are not applicable to a Roth conversion. We therefore recommend that you call us to discuss your situation.

■ **2010 – THE YEAR TO CONVERT**

The tax year 2010 was a great year to convert your Traditional IRA to Roth IRA. Instead of the conversion being completely taxable in 2010, the taxes on the conversion amount are due in 2011 and 2012 in equal parts.

■ **SELF-EMPLOYED SEP AND KEOGH PROFIT
SHARING PLANS**

In 2011, self-employed taxpayers may contribute and deduct up to 25% of their net income, up to a maximum deduction of \$49,000 per taxpayer, to their SEP and/or Keogh accounts. If you are self-employed and do not have a

Keogh, (Profit Sharing or a Money Purchase Pension Plan), then we recommend that you set up an SEP (sometimes called SEP-IRA). SEPs may be set up for the prior year **up to the tax filing deadline, including extension**. If you have a Keogh or you are considering setting one up, we highly recommend that you discuss your plan with us. **Keoghs must be set up by the end of the tax year**. Keoghs are complex plans with rules, regulations and penalties that are not comparable to most other tax provisions.

Keoghs and SEP may be funded for the prior year up to April 17, or October 15 if extension has been filed.

■ 401(k) AND 403(b) –

INCREASE IN CONTRIBUTION LIMITS

For tax year 2011, you are allowed to contribute up to \$16,500 to your 401(k) and 403(b) plans. In addition, participants who are 50 years or older by 12/31/11, are allowed to make a catch up contribution of \$5,500. Maximizing your 401(k) deduction will reduce your AGI, thereby helping you to stay under the various phase out thresholds.

■ STATE SALES TAX DEDUCTION

You may choose to deduct as itemized deductions either state and local income taxes OR state and local sales taxes. If you decide to deduct your sales taxes you have the option of choosing an amount based on actual receipts of your purchases for the year or an amount from IRS generated tables based on your income. The tables do not reflect large purchases such as automobiles or boats (furniture does not count as "large purchases" and are included in the tables). Therefore, the sales tax on such large purchases may be added to the table figure.

■ SAVERS CREDIT

For 2011, if you contributed to your 401(k), 403(b), to IRA (traditional or ROTH), to a Profit Sharing Plan or Pension Plan of your own **AND** your income is lower than the income thresholds (\$28,250 for singles, 42,375 for Head of

Household and \$56,500 for married couple) then, you may qualify for the very generous Saver's Credit.

You must be at least 18 years of age, not a full-time student, and not claimed as a dependent on someone else's tax return. Depending on your income, the tax credit is from 10% of your contribution to as high as 50% of your contribution, not to exceed \$1,000 for single and \$2,000 for married couples.

■ NEW TAX IMPLICATIONS FOR NEW YORK AREA BUSINESSES

MTA TAX

The MCTMT (or MTA) taxes employers and self-employed individuals at a rate of .34% (.0034) if they are located in any of the NYC boroughs, Long Island, and the counties: Dutchess, Orange, Putnam, Rockland, and Westchester.

For self-employed individuals, if Net Schedule C Income (line 31) is greater than \$10,000, then a tax of .34% is imposed on all self-employed income.

Employers are subject to the MTA tax at .34% of their payroll wages if they have payroll wages more than \$2,500 per quarter. However, taxpayers with a household employee are exempt from the MTA tax.

■ UNINCORPORATED BUSINESS TAX (UBT)

The UBT affects taxpayers with unincorporated gross business income greater than \$95,000 (this figure does not include a deduction for cost of goods sold or services performed). This means that even if you don't end up owing any tax as a result of UBT, you are still required to file the Form NYC-202 if your Schedule C Gross Income (line 7) is greater than \$95,000.

The tax imposed is equal to 4% of a unincorporated business' income (UBI), which in most cases is equal to Net Schedule C Income (line 31) less \$10,000. Effectively, individuals with net self-employment income of

\$95,000 or lower will not be subject to the Unincorporated Business Tax.

**THE DEADLINE TO FILE YOUR
INCOME TAX RETURN OR EXTENSION
REQUEST IS APRIL 17, 2012, AND THE
EXTENDED DEADLINE TO FILE IS
OCTOBER 15, 2012.**

■ EXTENSION TO FILE YOUR INCOME TAX –

FEDERAL AND STATES

Taxpayers are allowed an automatic six-month extension from April 17th to October 15th, as long as an extension request is filed by the due date of the original return. Please contact us for more information. But as usual, an extension to file your tax return is not an extension to pay your taxes. The IRS and most states require that when you file for an extension, you make a reasonable estimate of your tax liability and pay it by April 17th. If you do not pay the full amount of taxes owed by April 17th, the IRS and most states will still grant you an extension. However, if you owe taxes, you will be subject to (1) a late payment penalty of 1/2 % per month of the amount owed, up to 25%, (2) Interest at the rate of 3-4% per annum. Therefore you will be paying 9-10% per annum on your late tax payments. However, if you do not file for an extension, the late filing penalty, combined with the late payment penalty of 5% per month, for up to five months, or 25% in total. Ouch! Add to that the interest at 3-4% and it will really hurt. So be sure to file your extensions.



■ SPECIAL ALERT FOR NJ + NY FILERS

New Jersey taxpayers, both residents and non residents, should be aware of a NJ rule which may catch the unwary with substantial late filing penalties, in spite of filing for extensions. NJ requires taxpayers to pay 80% of their final tax liability by April 17th or else their filed extension will not be valid. We suggest you estimate your tax liability as accurately as possible and add 10% to 20% more to prevent underpayment.

NY requires us to e-file all extensions and provide bank information to enable NY to debit the balance due on extension date. Failure to pay will invalidate your extensions.



■ THANK YOU FOR READING

If you have any questions about the above material please call us soon, before we get busy with the tax season. Feel free to pass on a copy of this newsletter to friends and colleagues. We appreciate and welcome your referrals.