

## TAX UPDATE

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (H.R. 4853) (2010 Tax Relief Act) was signed by the President on December 17<sup>th</sup>. Most of the Act's provisions are temporary and include provisions for expiring tax cuts, estate tax and an alternative minimum tax (AMT) patch.

In an effort to keep you informed of changes and put forth some tax planning strategies, we have prepared the following brief summaries:

1. **Individual Tax Rates.** The 2010 Tax Relief Act extends all individual tax rates (10, 15, 25, 28, 33 and 35 percent) for the years 2011 and 2012.
2. **Health Savings Account (HSA).** The maximum amount of contributions to a HSA for 2010 are \$3,050 for single coverage and \$6,150 for family coverage. Over 55 years of age can contribute an additional \$1,000. For tax years beginning after 12/31/10, the costs of over-the-counter medicines and drugs (except for insulin) will be treated as qualified medical expenses only if those medicines and drugs have been prescribed by a physician. Also, the penalty on non-qualified distributions is increased from 10% to 20%, for both HSAs and MSAs.
3. **Qualified Capital Gain and Dividends tax rates.** The maximum rate is currently at 15% (0% for taxpayers in the 10 and 15 percent income brackets) and will remain the same for an additional two years through 12/31/12.
4. **Qualified Small Business Stock.** The 2010 Tax Relief Act extends the 100 percent exclusion (for non-corporate taxpayers) of gain realized from qualified small business stock held for more than five years. This exclusion applies to qualified small business stock acquired after September 27, 2010 and before January 1, 2012.
5. **Social Security Tax Rates.** The employee portion of Social Security Tax (6.2 percent) will be reduced by 2 percent to 4.2 percent for wages earned in 2011. Self-employed individuals will see a corresponding reduction in their self-employment tax. This reduction is available to all wage earners, with income phase out limits.
6. **The Mortgage Forgiveness Debt Relief Act of 2007** law excludes discharges on up to \$2 million (\$1 million for married filing separately) of mortgage indebtedness that has been secured by a principal residence. Qualified principal residence indebtedness is any debt incurred in acquiring, constructing, or substantially improving your principal residence. Qualified principal residence indebtedness also includes any debt secured by your principal residence resulting from the refinancing of debt incurred to acquire, construct, or substantially improve your principal residence but only to the extent the amount of debt does not exceed the amount of the refinanced debt. You cannot exclude canceled qualified principal residence indebtedness from income if the cancellation was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

If only a part of a loan is qualified principal residence indebtedness, the exclusion from income for canceled qualified principal residence indebtedness applies only to the extent the amount

canceled exceeds the amount of the loan (immediately before the cancellation). This exclusion is effective for years 2007 – 2012.

7. **The 2010 Tax Relief Act** extended the following deductions for 2010 and 2011:

1. Election to claim an itemized deduction for state and local general sales taxes.
2. Higher Education Tuition Deduction.
3. Up to \$250 above the line deduction for teachers out of pocket classroom related expenses.
4. Charitable Contribution of IRA proceeds. Up to \$100,000 annual exclusion from gross income for taxpayers age 70 ½ or older who make direct transfers of otherwise taxable individual retirement account (IRA) distributions to qualified charitable organizations for 2010 and 2011. Individuals will be allowed to make charitable transfers during January of 2011 and treat them as if made during 2010.
5. Charitable Contributions of appreciated property for conservation purposes.
6. The increase in the monthly exclusion for employer-provided transit and vanpool benefits to equal that of the exclusion for employer-provided parking benefits.
7. Premiums for Mortgage insurance will be continue to be deductible as qualified residence interest through 2011.

8. **The 2010 Tax Relief Act** extended the following tax credits and deductions through 2012

1. The deduction for higher education expenses. (American Opportunity Tax Credit)
2. The \$1,000 Child Tax Credit.
3. The Dependent Care Credit.
4. The Adoption Credit.
5. The enhancements to the Earned Income Credit.
6. The repeal of the Personal Exemption Phase-out.
7. The income exclusion for employer-provided education assistance up to \$5,250.
8. The enhancements to the Student Loan Interest Deduction.
9. Marriage penalty relief by increasing the standard deduction for a married couple to twice the amount for a single individual and expanding the size of the 15 percent income tax bracket for married couples filing a joint return to twice that of single filers.

10. The enhancements to Coverdell Education Savings Accounts (increase in the amount of the maximum contribution to \$2,000 and made elementary, secondary and post-secondary school expenses qualified expenses).

9. **Energy Provisions.** The following energy provisions were extended through 2011:

- a. The credit for energy-efficient improvements to existing homes and
- b. The 30 percent investment tax credit for alternative vehicle refueling property.

10. **Alternative Minimum Tax (AMT) “Patch”:** Has been extended for tax years 2010 and 2011. For 2010 the maximum AMT exemption amount is \$72,450 for joint filers and surviving spouses; and \$47,450 for singles and heads of household. For 2011 the maximum AMT exemption amount is \$74,450 for joint filers and surviving spouses and \$48,450 for singles and heads of household.

11. **Making Work Pay Credit:** Allows a credit against income tax in an amount equal to the lesser of 6.2% of the individual’s earned income or \$400 (\$800 for married couples filing jointly). The credit applied retroactively to the start of 2009 and will be repeated again in 2010. The credit applies in full for individuals whose modified adjusted gross income does not exceed \$75,000 or \$150,000 in the case of married couples filing jointly. The credit is phased out at a two percent rate above that limit. Qualified taxpayers would take this credit through a reduction in wage withholding or in a lump sum when filing their returns for the tax year.

You cannot take the credit if: a) your modified AGI is \$95,000 (\$190,000 if married filing jointly) or more, b) you are a nonresident alien, or c) you can be claimed as a dependent on someone else’s return.

The credit will be reduced if you: a) receive a \$250 economic recovery payment (described below) during 2010, b) your modified AGI is more than \$75,000 (\$150,000 if married filing jointly) or c) you take the government retiree credit (described below).

12. **Any Economic Recovery Payment** you receive during 2010 is not taxable.

13. The **“Kiddie Tax”** (unearned income of specified children that exceeds an inflation-adjusted prescribed amount, \$1,900 for 2010, is taxed to the children, but at the rates that would apply if that income were included in the parent’s return, if that rate is higher than what the child would otherwise pay) will apply to children up to age 18 and full time students up to age 23 (for ages 18 – under 24 the provision applies only to children whose earned income doesn’t exceed one-half of the amount of their support), for tax years beginning after May 25, 2007.

14. **COBRA Benefits:** The new law allows an individual who is involuntarily separated from employment between September 1, 2008 and January 1, 2010, to elect to pay 35 percent of his/her COBRA coverage and have it treated as paying the full amount. The former employer will be required to pay the remaining 65 percent but, in effect, will be reimbursed by crediting those amounts against income tax withholding and payroll taxes it is otherwise required to remit to the federal government. Income and other limitations on COBRA coverage apply. **THE 65**

**PERCENT COBRA PREMIUM ASSISTANCE IS EXTENDED THROUGH MARCH 31, 2010 AND ADDITIONALLY EXTENDED BY THE CONTINUING EXTENSION ACT OF 2010 TO MAY 31, 2010. In addition,** eligibility for the subsidy is extended to certain individuals who lose their group health care coverage as a result of a reduction in hours of employment, followed by an involuntary termination of employment.

**15. REMINDER - CHARITABLE CONTRIBUTIONS:** Substantiation requires taxpayers to maintain documented written records of **ALL** contributions of money and property regardless of the amount. Substantiation may consist of bank records, receipts, or written communications from donors. No deduction will be allowed for any contribution of cash, check or other monetary gift unless the donor can show a bank record or a written communication from the charity indicating the amount of the contribution. The documentation must include the following:

1. Date of the contribution
2. Name of the Donee
3. Amount of the contribution

For noncash contributions (clothing, household items, etc.) of less than \$250 the donor must receive a receipt from the charity or keep reliable written records of the donation. For noncash contributions of \$250 - \$499 the donor must obtain a contemporaneous written acknowledgement from the charity. For noncash contributions of \$500 - \$4,999 the donor must obtain a contemporaneous written acknowledgement and must file Form 8283. Keep reliable written records of any noncash donation regardless of the donated property's value.

We recommend that you keep a detailed listing of each item of clothing and household items and the value you assigned with the receipt from the donee. Remember the clothing and household items must be in good or better used condition

**Other Information:**

	<u>2010</u>	<u>2011</u>
Child Tax Credit (per child)	\$1,000	\$1,000
Maximum Earnings Subject to FICA	\$106,800	\$106,800

**Other Information continued:**

	<u>2010</u>	<u>2011</u>
<b><u>Permissible Earnings for Social Security Recipients:</u></b>		
Between 62 and full retirement age	\$14,160 year	\$14,160 year
After reaching full retirement age	Unlimited	Unlimited

**Auto mileage rates:**

Business	50 cents per mile	51 cents per mile
Charity	14 cents per mile	(Same as 2010)
Medical/Moving	16.5 cents per mile	19 cents per mile

**Standard Deduction:**

Joint or Qualifying Widow(er)	\$11,400
Single	\$ 5,700
Head of Household	\$ 8,400
Married Filing Separately	\$ 5,700
Additional for Elderly/Blind	\$ 1,100

<b><u>Personal and Dependency Exemption</u></b>	\$ 3,650
---	----------

Estate/Gift Tax Unified Credit	Repealed	\$5,000,000 to 12/31/12
--------------------------------	----------	-------------------------

The 2010 Tax Relief Act gives estates of decedents dying after December 31, 2009 and before January 1, 2011, the option to elect not to come under the revived estate tax. These estates have the option to elect to apply the estate tax based on the new 35 percent top rate and \$5 million exemption, with a stepped up basis or no estate tax and a modified carryover basis.

Gift Tax Annual Exclusion	\$ 13,000
---------------------------	-----------

**IRA Contributions:**

For 2010 the maximum contribution to an IRA is the lesser of \$5,000 or earned income, if over age 50 the maximum contribution is the lesser of \$6,000 or earned income. The last day to establish and fund an IRA for 2010 is 4/15/11.

**Service Animals**

The costs of buying, training, and maintaining a service animal to assist you will be deductible as a medical expense, subject to AGI limitations.

**Health Coverage for Children up to age 27**

Employer health plans are now allowed to extend coverage for children up to age 27.

**Chinese Drywall**

Homeowners victimized by Chinese drywall can take a casualty loss on the decrease in your home's value.

**Note:** Higher income individuals will be faced with additional taxes after 2012. There will be a .9 percent additional Medicare tax and a 3.8 percent Medicare contribution tax.

**Business and Corporate Information**

1. **The Small Business Jobs Act of 2010 (enacted 9/27/10)** provides first-year bonus depreciation of 50% for new property acquired and placed in service after December 31, 2007 and before January 1, 2011. This accelerated benefit is applied to tangible personal property and other property described in Code Sec. 168(k). **The Small Business Jobs Act of 2010 (enacted 9/27/10) increases the first year bonus depreciation to 100 percent for property placed in service after September 8, 2010 and before January 1, 2012. The 2010 Tax Relief Act also extends the 50 percent first year bonus depreciation to qualified property placed in service after December 31, 2011 and before January 1, 2013. Certain long lived property and**

**transportation property is eligible for 100 percent expensing if placed in service before January 1, 2013**

2. **The Small Business Jobs Act of 2010 (enacted 9/27/10)** increased the code section 179 dollar and investing limits to \$500,000 and \$2,000,000 respectively for property placed in service in tax years 2010 and 2011. **The 2010 Tax Relief Act provides for a \$125,000 dollar limit and a \$500,000 investment limit for the tax year 2012.**

3. The Business Energy Tax Credit for Solar Energy Property has increased from 10% to 30% and is extended to 12/31/16, as are the credits for Qualified Fuel Cell Property and the 10% credit for Qualified Micro turbine Property.

A few of the business energy incentives extended by the 2010 Tax Relief Act are:

- a. Credits for Biodiesel and renewable diesel fuel (2 years)
- b. New energy efficient home credit for qualified builders and manufacturers (homes purchased before January 1, 2012)
- c. Percentage depletion for oil and gas from marginal wells (two years)
- d. Energy efficient appliance credit (one year with modifications)

4. Retirement Plan Dollar Limits: **2010 and 2011**

Defined Benefit Plans	195,000
Defined Contribution Plans	49,000
Elective Deferrals 402(g)(1) & 402(g)(3)	16,500
Deferred Compensation Plans 457(e)(15)	16,500
Simple	11,500

5. Prior law temporarily shortened, from 10 to 7 years, the holding period for assets subject to the **built in gains tax** imposed after a C corp. elects to become an S corp. This reduction applies to C corps. that convert to S corps. in tax years 2009 and 2010.

**Temporary Reduction in S Corporation Built-in Gain Period.** The Small Business Jobs Act of 2010 (enacted 9/27/10) provides that for S corporation tax years beginning in 2011, no tax is imposed on the net unrecognized built-in-gain of an S corporation if the fifth year in the recognition period preceded the 2011 tax year.

6. **Health insurance Costs for Self and Family are Deductible in Computing 2010 Self Employment Tax.**

7. **Cell phones are Removed from Listed Property Category.** You still have to separate personal from business use.

8. Up to \$250,000 of qualified Real Property eligible for Section 179 Expensing in 2010 and 2011. Qualified real property includes:

- a. Qualified Leasehold Improvement Property
- b. Qualified Restaurant Property and
- c. Qualified Retail Improvement Property

9. **Charitable Incentives.** The 2010 Tax Relief Act also extends through 2011:

- a. Charitable deduction for contributions by C corporations of books to public schools.
- b. Charitable deduction for corporate contributions of computer equipment for educational purposes and
- c. Basis adjustment to stock of S-Corporations making charitable contributions of property.

10. **Other Law changes:**

- a. First Year Depreciation Cap for 2010 Autos and Trucks Increased by \$8,000
- b. Deduction for Start-up expenses increased from \$5,000 to \$10,000 for 2010

11. **New 1099 Reporting Requirements.** The changes made by the Patient Protection and Affordable Health Care Act have greatly expanded the business reporting rules and extended the reporting requirements to virtually all types of business transactions. Beginning in 2012, a small business owner will have to issue 1099s to all businesses and persons to which they have paid over \$600 per year for goods and/or services. You will need to have W-9s filled out by all your vendors and service providers.

Using a credit card to pay for goods and/or services will negate the need to file the 1099 forms for goods and services. Credit card transactions already must be reported by credit card companies under IRS rules. However, many of you still use cash and checks, as well as credit cards, to make payments to the same vendors. Since credit card transactions will not be reported, businesses will have to trace and keep separate reports for different types of payments made to the same vendor.

12. Small employers can receive a tax credit for providing health insurance for employees.

If you have any questions or want further information on any of the above, please contact Maryse Kluun, our Tax Manager, by phone at 813-936-0313 or by e-mail at [mkluun@stahlconsulting.com](mailto:mkluun@stahlconsulting.com).