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July, 2010 Client Newsletter

April 15th may have passed but that doesn't mean taxes just go away! While summer may be the main thing on your mind, now is a good time to look at how the tax laws may impact your returns next year. The following is a summary of some of the tax law changes (or non-changes) you may see in 2010 as well as some information on what 2011 may bring:

Unemployment income – In 2009, those receiving unemployment benefits could exclude up to $2,400 from their taxable income. This tax benefit will no longer be available in 2010.

Educator expenses – This is likely to be extended but as of now teachers will no longer be allowed to deduct out of pocket expenses incurred for school supplies. In the past, a deduction from adjusted gross income of up to $250 was allowed.

Tuition and fees deduction – Another likely-to-be-extended item that expired as of the end of 2009, this is an up to $4,000 deduction from AGI (subject to income limitations) for tuition and fees paid during the year.

New vehicle sales tax - Effective January 1, 2010, individuals will no longer be able to take the itemized deduction or increase in standard deduction for sales tax on the purchase of a new motor vehicle.

Sales tax – Individuals will no longer be able to take an itemized deduction for state and local sales tax.

Increase to standard deduction for real estate taxes paid – This is likely to be extended but as of now taxpayers will no longer be allowed to add up to $500 ($1,000 if married filing jointly) of real estate taxes paid to their standard deduction amount.

Phase outs - In 2010, there will be no phase out of itemized deductions or personal exemptions. This change will greatly benefit high income earners.

Charitable distributions/contributions – This is likely to be extended but as of now charitable distributions made directly from an IRA account to a qualified charity will no longer be excluded from your income.

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Home buyers credit – If you took the 1st time home buyers tax credit back in 2008, you are required to start paying the credit back in 2010.

Alternative Minimum Tax – The AMT exemption is scheduled to decrease to $33,750 for single filers and to $45,000 for those filing a married joint return which would cause many taxpayers to owe AMT. In the past Congress has passed a last minute "patch" to correct this so hopefully that will happen again this year.

Retirement contributions - There is no change in the maximum contribution and individual can make to a 401(k) plan in 2010. This remains at $16,500. The catch up contribution of $5,500 for individuals age 50 + also remains the same.

Mileage reimbursement rates – The updated mileage reimbursement rates effective for January 1, 2010 are $0.50, $0.165 and $0.14 for miles incurred for business purposes, medical purposes and charitable purposes, respectively.

Personal Exemption/Standard Deduction - As IRS standard deduction and personal exemption amounts are indexed to inflation, you'll see very little change there for 2010. The standard deduction for heads of household will rise by $50 to $8,400 for the 2010 tax year. Everyone else will keep their current deductions of $5,700 for single and married taxpayers filing separately and $11,400 for joint filers. The personal exemption amount will remain at $3,650 for 2010.

Payroll taxes - The maximum amount of wages subject to Social Security tax will remain the same as 2009 at $106,800. As in prior years, there is no limit to wages subject to the Medicare Tax; therefore, all covered wages are still subject to the 1.45% tax.

Making Work Pay Credit – This 6.2% of earned income credit (up to $400/individual or $800/joint return) that many taxpayers saw on their 2009 returns remains in effect for 2010.

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American Opportunity Tax Credit - This credit of up to $2,500 of the cost of tuition and related expenses paid during the tax year was first available in 2009 and remains in effect for 2010. It is available to cover the first four years of post-secondary education in a degree or certificate program, with 40% of the credit refundable. The credit is phased out for individuals with AGI between $80,000 and $90,000 ($160,000 – $180,000 MFJ).

Annual Gift Tax Exclusion - The annual gift tax exclusion remains that same as it was in 2009 at $13,000. This means a person can give away as much as $13,000 each to anyone he or she wishes without any tax considerations. You can give away even more than the exclusion amount by paying someone else's tuition or medical bills but you must make those payments directly to the medical or educational provider.

Roth IRA conversion – In 2010 ONLY, you can roll your traditional IRA into a Roth IRA no matter what your income level. While you will be subject to tax on the amount rolled over (unless some of it was non-deductible and you filed Form 8606 to show that fact), all future withdrawals will be tax-exempt and not subject to mandatory distributions after age 70.

If for some reason you have made non-deductible contributions in the past but haven't submitted a Form 8606 to support them or the number reflected on the current year's 8606 is incorrect, don't worry. The IRS allows you to file this form as a standalone form. Please contact me if this applies to you as it is very important that the IRS have the correct info on file in anticipation of your converting your IRAs to a Roth IRA in 2010.

Because you will need outside funds to pay the tax due on any converted amounts, it is important to note is that if you convert your traditional IRA to a Roth in 2010, the new rules allow a payment plan. Half of the tax will be due in 2011 and the other half will be due in 2012. This is the equivalent of a tax free loan from the US Treasury. This benefit is only available for conversions done in 2010.

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Some planning information:

Capital Gains Rates - Unless Congress decides to extend the Bush-era cuts, capital gains tax rates will revert to pre-2003 levels in 2011. For 2010, the long-term capital gains rate for those in the 10% and 15% tax brackets is 0%. In 2011, it is set to go to 10%. If you fall into the 25%, 28%, 33% or 35% tax brackets, the capital gains rate is 15% in 2010 and 20% in 2011-12. If you have any appreciated stock, you may want to consider selling it in 2010 so you can pay a lower rate of tax on the gain.

Marginal Tax Rates - At present, the marginal tax rates are 10%, 15%, 25%, 28%, 33% and 35%. If Congress doesn't act by the end of 2010, the tax brackets will reset to 15%, 28%, 31%, 36% and 39.6%. President Obama and some Democrats have proposed future tax brackets of 10%, 15%, 25%, 28%, 36% and 39.6% for 2011 (that is, only the highest two brackets would revert to pre-EGGTRA levels). If the brackets are reset and you are in a higher tax bracket, you may want to consider accelerating income or bonuses into 2010.

Final Thoughts:

Your financial situation may vary from year to year. As a result, your tax returns may look different from last year's even before taking the above changes into account. If you are not sure where you stand, it may be helpful to do some tax planning or prepare a 2010 tax projection so you can best manage your cash flow. Please contact me if you if this is something you would be interested in. Please also remember that my goal is to help you make informed decisions. As such, I am available throughout the year to answer your tax and financial questions.