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June, 2011 Client Newsletter

Tax Season is over but that doesn't mean taxes just go away! Now is a good time to look at how the tax laws may impact your returns going forward. The following is a summary of some of the tax law changes (or non-changes) you may see in 2011 as well as some information on what 2012 may bring:

Payroll Tax Holiday - The maximum amount of wages subject to Social Security tax will remain the same as 2010 at \$106,800. However, the employee's share of this tax will drop 2% from 6.2% to 4.2%. The employer's share remains the same. 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 2010 and 2010 returns has been phased out and replaced with the payroll tax holiday.

Flexible Spending Accounts – Workers with Flexible Spending Accounts (FSAs) may no longer use pretax funds to pay for many over-the-counter medicines—aside from insulin—without a prescription. FSA funds may still be used for other, nonprescription medical items such as crutches, contact-lens solution or a wig after chemotherapy, if the individual plan allows it.

Educator expenses – The \$250 deduction from gross income for out of pocket expenses incurred for school supplies has been extended through 2011.

Education Credits – The American Opportunity Tax Credit of up to \$2,500 for education expenses was renewed for 2011 and 2012. 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).

Tax Credits for Energy Efficiency Home Improvements - The really nice tax credits for energy efficiency home improvements mostly expired at the end of 2010. (You can still get the 30% credit – no cap – on big green home improvements like installing solar panels, wind turbines or geothermal power). The new tax credit for energy efficient home improvements has caps on specific items, as well as caps your tax credits on small improvements (insulation, energy efficient windows, HVAC, etc.) to \$500 for your lifetime. So if you've already taken \$500 in credits, you are done.

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Repeal of Expanded 1099 Reporting Requirements – As widely anticipated, President Obama signed into law on April 14th a bill to repeal expanded Form 1099 information reporting requirements for rental property expense payments.

Standard Deductions - The standard deduction rates -- or the amount that you can claim if you don't itemize your deductions -- stay largely the same for 2011. They are \$5,800 for single taxpayers or those married taxpayers filing separately, \$11,600 for married taxpayers filing jointly and \$8,500 for taxpayers filing as head of household. The additional standard deduction allowed for senior citizens is \$1,150 for married taxpayers filing jointly and \$1,450 for single taxpayers.

Personal Exemptions – The personal exemption amount for 2011 is \$3,700, an increase from \$3,650 in 2010.

Phase outs – As was the case in 2010, there will be no phase out of itemized deductions or personal exemptions in 2011 or 2012.

Standard Mileage Rates - Beginning on Jan. 1, 2011, the standard mileage rates for the use of a car, van, pickup or panel trucks will be as follows. Remember, to claim mileage on your return, you must maintain a mileage log with date, destination, purpose and miles driven.

- 51 cents per mile for business miles driven (up from 50¢ per mile)
- 19 cents per mile driven for medical or moving purposes (up from 16.5¢ per mile)
- 14 cents per mile driven in service of charitable organizations (same as in 2010)

Capital Gains Tax - The historically low capital gains tax rates (maximum of 15% on long-term capital gains) have been extended through 2012. With that in mind, it might be time to "harvest" some of those unrealized gains in case tax rates rise again in the future. Another tax-savvy way to completely eliminate your capital gains tax might be to donate appreciated stock to charity and receive a deduction equal to the security's current market value.

Retirement contributions - There is no change in the maximum contribution and individual can make to a 401(k) plan in 2011. This remains at \$16,500. The catch up contribution of \$5,500 for individuals age 50 + also remains the same.

Converting to a Roth IRA – Good news - you can continue to convert your traditional IRAs to Roth IRAs as the income limit on converting to Roth IRAs has been permanently lifted. However, the tax deferral option is gone, so if you convert this year, you will have to pay all the taxes you owe for 2011 on your 2011 return.

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Roth IRA planning opportunity - For 2011 the IRS limits for making a Roth IRA contribution are as follows:

- \$179,000 for married taxpayers filing jointly.
- \$10,000 for married taxpayers filing separately who lived with their spouse for any part of the tax year.
- \$122,000 for single taxpayers, married taxpayers filing separately who did not live with your spouse for any part of the tax year and taxpayers who file as head of household.

Thus, while the 2011 Roth IRA conversion rules open the door for anyone to convert to a Roth IRA regardless of income, making new contributions to a Roth IRA appears out of the question for many taxpayers. Fortunately, this is not the case. Anyone can make Roth IRA contributions through use of a traditional IRA and the conversion process. Simply make non-deductible contributions to a traditional IRA and then convert the traditional IRA to a Roth IRA. While it isn't a direct contribution to a Roth IRA, the end result is still the same.

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 2011 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.