

2011 MID-YEAR NEWSLETTER

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STANDARD MILEAGE RATES INCREASE AS OF JULY 1ST

The IRS announced that the standard mileage rate will increase to 55.5 cents per business mile driven, effective July 1, 2011. That is a jump of approximately 9% over the 51 cents allowed for the first part of 2011. According to the IRS, the primary reason for the rate hike is higher gasoline prices.

When you use your car for business, driving between job sites is deductible. So is driving between your home and a temporary job site, job interviews, and conferences. Commuting between your home and a regular place of business generally isn't tax deductible.

Read more on how to calculate your miles deduction and other deductible miles: <http://www.mdtaxes.com/news0711.html>

IRS ALERTS ON IDENTITY THEFT SCAMS

Last month, a client forwarded our office a fraudulent e-mail he received from someone posing as a representative of the Internal Revenue Service. The e-mail asked this client to complete a form including social security numbers and banking information, and then fax the completed form to a number listed on the e-mail.

It's important to remember that the IRS does not correspond with taxpayers electronically. If you receive an e-mail from the Internal Revenue Service asking you to provide information, that e-mail is most likely fraudulent.

To learn more about IRS Warnings about Suspicious Emails and what you can do to shut them down, please visit their website at:

<http://www.irs.gov/newsroom/article/0,,id=155682,00.html>

SO WHO'S PAYING THE TAXES?

According to the New York Times on March 25, 2011, GE earned more than \$14 billion in profits last year, yet didn't pay a dime in U.S. Corporate Income taxes. Does news like that make you wonder who is paying the nation's taxes?

When it comes to personal taxes, the IRS tracks and reports the demographics of who is actually paying. According to their report, there were approximately 140 million individual tax returns filed with positive Adjusted Gross Income (AGI) for each of the prior two years. Here are the highlights:

- **Top 1 Percent:** To be in the top 1 percent of filers, your AGI needs to exceed \$380k. This group of taxpayers currently reports 20% of the country's income and pays 38% of the personal income taxes.
- **Top 5 Percent:** Tax returns showing AGI of at least \$160k made the top 5 percentile of all filers. In 2009, these taxpayers reported 35% of the country's income, but paid 59% of the personal income taxes.
- **Top 10 Percent:** Anyone reporting AGI in excess of \$114k would be in the top 10 percentile. This group reported 46% of the country's income, but paid 70% of the personal taxes.
- **Bottom 50 Percent:** The bottom half of the income reporting population paid just 2.7% of the personal income taxes.

Can a tax system survive when only half the population pays into it? Stay tuned.

RX FOR HIGHER TAXES: MEDICAL EXPENSES

There are a few different ways for people to save taxes based on the medical expenses they incur. Sadly, the Patient Protection and Affordable Care Act, signed into law on March 23, 2010, reduces many of these tax breaks.

2011 Changes:

The first changes took effect on January 1, 2011. As of New Year's Day, you can no longer use money set aside in your flexible spending account to pay for over the counter medications. According to the IRS:

Under the new standard, the cost of an over-the-counter medicine or drug cannot be reimbursed from the account unless a prescription is obtained. The change does not affect insulin, even if purchased without a prescription, or other health care expenses such as medical devices, eye glasses, contact lenses, co-pays and deductibles. The new standard applies only to purchases made on or after Jan. 1, 2011, so claims for medicines or drugs purchased without a prescription in 2010 can still be reimbursed in 2011, if allowed by the employer's plan.

A second revenue raiser deals with the penalty for withdrawing money from a Health Savings Account that is not used to pay for your family's health care costs. Prior to this year, this penalty was equal of 10% of each dollar withdrawn. Beginning in 2011, the penalty doubles to 20% for non-healthcare withdrawals from an HSA.

2013 Changes:

The next wave of tax increases takes effect in 2013. For starters, the annual max you can set aside through your employer sponsored Flexible Spending Account for medical expenses is cut in half to \$2,500. Remember, with an FSA, you pay for medical expenses with pre-tax dollars. Married couples where both spouses work, therefore, stand to lose out on up to \$5k of pre-tax medical spending each year.

The second change impacts the medical deduction you can claim as an itemized deduction on your tax return. Starting in 2013, you can only deduct medical expenses paid on behalf of you and your family to the extent the amount spent during the year exceeds 10% of your Adjusted Gross Income. Under the current rules, the threshold is 7.5% of AGI. For every \$100k of income, therefore, expect to lose out on as much as \$2.5k of your medical deduction. Please note that this increase will not affect taxpayers over the age of 65 until 2017.

There is some good news, however. The rules do not impact the medical expenses allowed when calculating the dreaded AMT. Since the current threshold for deducting medical expenses under the AMT is already 10% of AGI, many people who are hit by this tax every year might not see any tax increase due to this change.

Thereafter:

Like the universal health insurance rules we have here in Massachusetts, the Patient Protection Act adds a penalty for individuals who don't have health insurance that meets a "minimum essential coverage" threshold. This new non-coverage penalty starts at \$95 per person in 2014, jumps to \$325 per person in 2015, and then jumps again to \$695 per person the next year. After 2016, this penalty is indexed for inflation. Expect to report and remit this penalty as part of your federal income tax return.

There will also be an excise tax on "High Cost Employer-Sponsored Health Coverage" starting in 2018. This excise tax will be equal to 40% of the amount that the annual health insurance premium paid exceeds \$10,200 for single individuals and \$27,500 from families. The Act did include a higher threshold for the first three years for taxpayers who live in the 17 states with the highest health insurance costs.

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Get Your Mid-Year Checkup!

We'll calculate a mid-year tax projection and give you advice on what you can do for the rest of 2011 to reduce your tax burden on April 15.

Visit our home page at www.schwartzaccountants.com
to learn more about our Mid-Year Tax Projection service!

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HSAs Look Even Better:

Besides increasing the penalty for money withdrawn from a Health Savings Account (HSA) not used for your family's health care expenses, the Act did not affect HSAs. As we wrote in our February 2009 Newsletter (www.mdtaxes.com/news0209.html), HSAs are a great tool to help you minimize your healthcare costs and save taxes.

Here are four tax breaks available to you if you contribute to an HSA:

- Money contributed into an HSA is tax-deductible. Either you contribute into an HSA on your own, or your employer contributes on your behalf.
- Money invested within the HSA is your money and grows tax-deferred. Unlike Flexible Spending Accounts (FSA) offered to you as part of your employee benefit package where you set aside a set amount of money to pay for your family's healthcare costs with pre-tax dollars, there is no "use it or lose it" pitfall with HSAs.
- Money can be withdrawn tax-free from your HSA at any time to pay for your family's healthcare expenses.
- Any money remaining in your HSA upon your reaching the age of 65 is available to subsidize your retirement.

For 2011, you qualify to set up an HSA if your health insurance plan has a deductible of at least \$1,200 for an individual plan or \$2,400 for a family plan. Single taxpayers can then contribute up to \$3,050 (in 2010) into an HSA while Married Couples can contribute up to \$6,150 (in 2010) annually. Please note that the amount you can contribute into an HSA exceeds your annual deductible, which is one reason that HSAs are so attractive.

To find out more about HSAs, check out IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans. You can also read through the instructions to the Form 8889, Health Savings Accounts. Both are available at www.irs.gov.

KEEP ON CONVERTING INTO 2011

Did you convert all of your IRAs to a Roth IRA during 2010? If so, don't forget to continue to contribute to your non-deductible traditional IRA each year, and then immediately convert that account to your Roth IRA.

Back in 2006, President Bush signed the Tax Increase Prevention and Reconciliation Act into law. This Tax Act included a provision that eliminated the income limitation for people looking to convert their IRAs and other eligible retirement accounts to a Roth IRA as of 2010.

Contribute then Convert

Starting in 2010, there is no rule prohibiting high-income taxpayers from completing a Roth Conversion each year. So while married couples who earn more than \$179k and single individuals who earn more than \$120k can't contribute directly to a Roth IRA, those who have no other IRA money can indirectly contribute to a Roth without owing any taxes.

Just make sure to first contribute \$5k into a traditional IRA, and then convert that IRA to a Roth IRA soon after. As long as you have no other traditional IRA, SEP IRAs, or SIMPLE IRAs, you shouldn't be taxed on this Roth Conversion.

\$7,500! NOW THAT'S ELECTRIC!

With gas prices finally drifting down from their recent highs of \$4.00 per gallon, drivers are once again deciding whether it makes sense to replace their current gas powered automobile with a more fuel efficient vehicle. Five years ago, Hybrids were all the rage. Now, thanks in part to a \$7,500 tax credit from the federal government, some US drivers are beginning to seriously look at purchasing Plug-in Electric vehicles.

According to the IRS, "For plug-in electric vehicles acquired after December 31, 2009, the credit is equal to \$2,500 plus, for a vehicle which draws propulsion energy from a battery with at least 5 kilowatt hours of capacity, \$417, plus an additional \$417 for each kilowatt hour of battery capacity in excess of 5 kilowatt hours. The total amount of the credit allowed for a vehicle is limited to \$7,500."

Currently, all seven certified vehicles meet the requirements making them eligible for the full \$7,500 tax break. Read the full article, including which vehicles qualify for the tax credit at: <http://www.mdtaxes.com/news0711.html>

BUSH TAX CUTS EXTENDED THROUGH 2012

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 into law. From a tax perspective, this Act extended the Bush tax cuts for two years through 2012. Let's look at some of the specific tax changes:

No Change to Tax Rates:

- **The six tax brackets will remain unchanged through 2012.** That means we'll continue with the 10%, 15%, 25%, 28%, 33% and 35% brackets for two more years. Each of these brackets was set to rise by 3% or more.
- Congress included a **patch to limit the impact of the Alternative Minimum Tax (AMT)** through 2011. Each year, Congress struggles to pass a one-year fix to the AMT that keeps millions of taxpayers from paying this secondary tax. A few years back, it was estimated that the number of people paying the AMT would jump six-fold – from 4 million to 23 million if the AMT patch were not extended that year.
- **The tax rate on long-term capital gains and corporate dividends remains at 15% through 2012.** Without an extension of these tax cuts, the tax rate on long-term capital gains would have jumped to 20%, while corporate dividends would have been taxed at your marginal tax bracket.

Let's Give Credit Where Credit Is Due:

The Bush tax breaks also extended many of the tax credits claimed by working Americans, including:

- **Child Tax Credit:** This credit worth \$1,000 per child under the age of 17 would have been cut in half to \$500 per eligible child.
- **Dependent Care Credit:** Under the extended rules, you can claim this credit based on the first \$3,000 of dependent care expenses paid on behalf of one child, or \$6,000 if you have two or more children under the age of 13. Had no extension been passed, this credit would have been cut by 20% - to be based on the first \$2,400 of qualified expenses for one child or \$4,800 for two or more eligible children.
- **The new American Opportunity Credit,** which was passed by Obama in 2009 and improved upon the Hope Education Credit, was extended through 2012. Originally, this lucrative tax credit would have expired at the end of 2010.

Extended Deductions:

- **The elimination of the Stealth Tax continues through 2012.** For many years, the tax rates for the top tax brackets was higher than advertised due to the fact that taxpayers had their personal exemptions and itemized deductions phased-out once their Adjusted Gross Income exceeded a certain threshold. These phase-outs finally disappeared in 2010, but were set to return on January 1, 2011.
- Anyone **paying student loans who is eligible to deduct the interest** paid will continue to write-off the first \$2,500 of interest paid annually. Due to this Tax Act, the rule stating that you can only claim this interest for the first 60 months of repayment will not return until after 2012.

More Depreciation:

This Tax Act makes it a great time to purchase equipment. For starters, purchases of new equipment qualify for unlimited 100% bonus depreciation. That means you can write off the full cost of these assets, no matter how much assets you purchase or how much income you earn. Only new assets purchased between 9/9/10 and 12/31/11 qualify.

If you purchase used equipment, you can still write-off the first \$500k that you purchase as a Section 179 deduction. Starting in 2012, the Section 179 deduction falls to \$125k per year.

Tax Planning Became a Little Easier

After suffering through 2010 when there was a lot of uncertainty about the upcoming tax rules, we can now say confidently that we know exactly what to expect for 2011 and, to a lesser degree, for 2012.