

# **Summer Newsletter**

There have been so many legislative tax changes in the past couple of years that it makes it hard for clients to keep track of what's new and what's been changed. You can use the following information to keep your clients up-to-date and together you can formulate a new financial plan that takes into account the changes that taxpayers face.

Dear Client:

In order to keep you informed of what's new in the tax rules, here is a summary of key points you need to know for 2011. These key changes have been broken down into three categories: Personal Income Taxes, Personal and Business Retirement Changes, and Tax Changes for Businesses. This is not an exhaustive list. The intent here is to briefly explain the changes; especially the ones that can potentially benefit you. At the end, you'll also find some additional tips to help you prepare and plan for the 2011 tax year. If after reading this information you think that a financial and tax planning review may be something you are interested in, or if you have any questions, please give me a call. The really significant methods to reduce your tax liability require not only planning ahead, but the expert guidance of a licensed tax practitioner.

Tax Savings opportunities to take advantage of as you plan for the current tax year:

## **Income Tax Provisions**

These provisions were created or extended as a result of the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the "2010 Tax Act")

- Maintaining long term capital gains and dividend tax rate at 15%
  - If you have appreciated stock positions, you might consider liquidating the stock in order to recognize the capital gain at the current preferential rate of 15%.
  - If you've avoided paying dividends to avoid paying income tax on the distribution, you should consider declaring and paying a dividend to take advantage of the reduced income tax rate of 15%.
- Allowing 100% bonus depreciation allowance for equipment placed in service between September 8, 2010 and December 31, 2011
  - This includes buildings, machinery, vehicles, and furniture as well as intangible property such as patents, copyrights and computer software.
- Permits a Section 179 deduction for property placed in service up to \$500,000
  - Be aware of availability of bonus depreciation and Sec 179 deductions to place equipment in service-or upgrade computers and software during 2011.
- Permitting taxpayers to elect through 2011 to deduct State and local sales taxes in lieu of State and local income taxes

## **Personal Income Taxes**

### **Payroll Tax Holiday**

Employees will only pay 4.2% OASDI (Social Security) tax on compensation received during 2011, rather than the 6.2%, up to \$106,800 which is the wage base for 2011. Beginning in 2011, self-employed persons will pay only 10.4% Social Security self-employment taxes on self-employment income up to the wage base for 2011 (\$106,800). In both cases, the maximum savings for 2011 will be \$2,136 (2% of the wage base) per taxpayer. If both spouses earn at least as much as the wage base, the maximum savings will be \$4,272.

### **"Green" Upgrades**

The majority of tax credits for energy efficiency home improvements expired at the end of 2010. However, you can still get the 30% credit (no cap) on larger "green" home improvements such as 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 like insulation, energy efficient windows, and HVAC, to \$500 for your lifetime.

### **Health Plan Reimbursements**

Beginning this year, over the counter medications cannot be reimbursed with excludible income through a health flexible spending arrangement (FSA), health reimbursement account (HRA), health savings account (HSA), or Archer MSA (medical savings account) unless the medicine is prescribed by a doctor or is insulin. This new rule applies to amounts paid after 2010, however it does not apply to amounts paid in 2011 for medications or drugs bought prior to Jan 1 2011. Additionally, for distributions after 2010, the additional tax on distributions from an HSA that are not used for qualified medical expenses increases from 10% to 20% of the disbursed amount. Archer MSA increases from 15% to 20% of the disbursed amount.

## **Personal and Business Retirement Changes**

### **Retirement Plans**

Income limitations on the ability to convert a traditional IRA to a Roth IRA have been eliminated. Therefore any taxpayer may choose to convert from IRA to Roth IRA. Qualified distributions from Roth IRA are not included in gross taxable income and there are no minimum distributions from Roth IRA. Contributions to Roth IRA *ARE NOT* deductible and the value of the traditional IRA account that is converted *IS* included in taxpayer's taxable income in such year and subject to current income tax rates.

Despite the resulting tax liability, this conversion may be worth considering if you're working under the assumption that income tax rates will increase in the future. By converting to a Roth IRA, it's possible to "lock in" a lower effective tax rate. Also, converting a portion of IRA to Roth IRA, a taxpayer has "diversified" their IRA assets by presenting the opportunity to take distributions from a Roth IRA which are not subject to income tax. This minimizes the overall income tax in a given (future) tax year.

Through the end of 2011, a taxpayer over 70<sup>1</sup>/<sub>2</sub> years old may direct distribution of up to 100k from their IRA to a qualified public charity; this amount will count toward the taxpayer's required minimum distribution, but is excluded from the taxpayer's taxable income. Taxpayers will not receive a charitable deduction for the donation, however the exclusion of the distribution from taxable income provides a greater income tax benefit.

After December 31, 2010, small employers may provide employees with a "simple cafeteria plan." An employer that uses this kind of plan gets safe harbor from the nondiscrimination requirements for cafeteria plans as well as from the requirements for certain types for qualified benefits offered under a cafeteria plan, including group term life insurance, benefits under a self-insured medical expense reimbursement plan, and benefits under a dependent care assistance program.

## **Tax Changes for Businesses**

### **Built in Gain Tax**

C corporations that elect to be taxed as an S corporation may be subject to tax on the sale of appreciated assets owned at the time the S election is made - the "built in gain tax." This tax is imposed upon the sale of an asset within a certain period of time after S election-generally 10 years. However, in 2011, this period is reduced to 5 years. For an S corporation with appreciated assets potentially subject to the Built in Gain Tax, if the election was made effective in 2006 or earlier, the appreciated assets could be sold prior to December 31, 2011 without the imposition of Built in Gain Tax. The 10-yr period is scheduled to be effective January 1 2012, so S corporations and their shareholders should consider selling assets that otherwise would be subject to the Built in Gain Tax in 2011.

### **Up-to-\$1000 credit for "retained workers"**

Employers may claim a "retention credit" for retaining qualifying new employees (some formerly unemployed workers who meet specific requirements). The amount of the credit is either \$1000 or 6.2% of wages, whichever's less, paid to the retained qualified employee during a 52 consecutive week period. The wages for such employment for the last 26 weeks must be at least 80% of the wages earned in the first 26 weeks. This credit may be claimed for a qualified retained worker for the first tax year ending after March 18, 2010, assuming the retained employee satisfies the 52 consecutive week requirement. Just a reminder, this credit only applies to qualifying employees hired after February 3, 2010 and before January 1, 2011.

There are a lot of tax changes coming your way and likely your business is experiencing some unusual ups and downs. Here are some additional tips to get your tax planning for 2011 off to the right start:

- Get your 2011 bookkeeping caught up as soon as possible with projections for the year. Is your income going up, down or staying the same?
- Check for state nexus issues. Are there are other states you now need to plan for?
- What new projects or investments are coming up that may change your current strategy?
- Review your income projections, state nexus changes and tax law changes with your EA at a minimum three times: Now, September (creating your year-end planning) and December.

There are also some tax breaks that you should be thinking about this year, and every year. Plan for deductions, such as mortgage interest and points paid on refinancing. Keep receipts and documentation of goods and money donated to charity. You can even get a mileage deduction when you travel on behalf of working for charity, so note this information. Other tax breaks include those related to your home office and home business. Think about what you might spend your money on this year, and then prepare yourself to properly document it so that you can minimize your tax liability.