

Tax Saving Strategies for the 2011 Filing Season



In a time of sweeping change and continuing economic uncertainties, finding ways to minimize your tax liability and bolster your financial position can be a challenge.

In 2010, important tax-law changes affected areas ranging from health care options and retirement savings to home ownership and unemployment benefits. What remains constant is the need for in-depth knowledge and insights when preparing your taxes. *Tax Saving Strategies for the 2011 Filing Season* provides an overview of key tax-law provisions that may affect your return and practical strategies for minimizing your tax bill. Information is current as of **Thursday, Dec. 30, 2010**.

Should you have any questions or concerns as you prepare your 2010 tax return, see a CPA tax professional; he or she can provide you with expert tax-planning counsel.



Filing Basics

Filing Status

You can file as single, married filing jointly, married filing separately, head of household or qualifying widow(er)/surviving spouse.

If you are married and filing jointly, you can take advantage of a number of tax credits and benefits. Taxpayers who are single or married filing separately also are eligible for tax credits and benefits; however, they may be subject to additional qualification rules. Unmarried taxpayers may file as single or, if they qualify, head of household. If more than one filing status applies to you, choose the one that results in the lowest tax obligation.

Tax Rates

Tax rates for 2010 remain the same as 2009. The six tax brackets are 10%, 15%, 25%, 28%, 33% and 35%. Legislation enacted on Dec. 17, 2010, extends these tax rates to 2011 and 2012. What changes each year are the income levels for each tax bracket as determined by your filing status.

Exemptions

You may claim a personal exemption for yourself, your spouse and each of your dependents. A dependent child includes children born to your family, stepchildren, eligible foster children and adopted children. A dependent child also can include qualifying grandchildren, brothers, sisters, stepsiblings and children of siblings.

Each exemption reduces your taxable income by \$3,650 in 2010. The full \$3,650 deduction is available for each personal exemption regardless of income because there is no phaseout for 2010. Legislation enacted on Dec. 17, 2010, extends the no phaseout rule to 2011 and 2012.

Alternative Minimum Tax

In addition to the regular income tax, more and more taxpayers are finding themselves subject to the Alternative Minimum Tax (AMT). The AMT is designed to ensure equitable taxes are paid by higher-income taxpayers. Since the AMT is not indexed for inflation, taxpayers are increasingly finding themselves affected by it.

Higher AMT exemption amounts originally expired at the end of 2009.

2010 Personal Exemption Value

| Top Tax Bracket | Exemption Value |
|-----------------|-----------------|
| 10% | \$365 |
| 15% | \$548 |
| 25% | \$913 |
| 28% | \$1,022 |
| 33% | \$1,205 |
| 35% | \$1,278 |

Personalized Company Name

Address, City, State, ZIP code
webmail, email, phone, fax



Deductions from Adjusted Gross Income

Above-the-Line Deductions

(Individual deductions are subject to limits that are dependent on personal circumstances):

- Alimony payments
- Archer Medical Savings Account (MSA) contributions
- Business expenses (military reservists, performing artists and fee-basis government officials)
- Capital-loss deductions
- Domestic-production activities
- Health Savings Account (HSA) contributions
- IRA contributions
- Medical savings account contributions (offered by some small businesses)
- Moving expenses (job relocation)
- Net operating losses
- Penalties on early withdrawals from certificates of deposit
- Rent and royalty expenses
- Self-employed health insurance and long-term care policies
- Self-employed qualified retirement plan contributions
- Self-employed Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) contributions
- Self-employed Simplified Employee Pension (SEP) contributions
- Self-employment tax
- Student loan interest

However, legislation enacted on Dec. 17, 2010, includes an AMT patch for 2010. For 2010, the exemption amounts are \$47,450 for single filers and heads of households, \$72,450 for married taxpayers filing jointly or a qualifying widow(er), and \$36,225 for married taxpayers filing separately.

Health Care

Health Flexible Spending Arrangements

Amounts you contribute to accounts under your employer's Flexible Spending Arrangements (FSAs) are not taxed in 2010. You can access funds any time during the year to pay for health insurance premiums as well as medical costs and other expenses not covered by insurance, although they must qualify as a deductible medical expense.

Your company's plan determines contribution terms and limits. Funds not used during the year, or by the end of any grace period the plan may offer, are lost.

Health Savings Accounts

Health Savings Accounts (HSAs) are designed for individuals covered by a high-deductible health insurance policy and are not covered by Medicare. They offer a number of tax advantages: contributions within certain limits are tax deductible, withdrawals to pay for qualified medical expenses are tax-free and earnings are tax-deferred. However, withdrawals for non-medical expenses are both taxable and subject to a 10% penalty unless they are made when the individual is age 65 or older, or disabled.

You and your employer can make contributions, and the total maximum contribution is \$3,050 for self-only coverage (\$4,050 if age 55 or older) and \$6,150 for family coverage (\$7,150 if age 55 or older and \$8,150 if spouse also is age 55 or older). There also is a \$1,000 catch-up contribution if you are age 55 or older by the end of the year.

Homeownership

First-Time Homebuyer Credit

If you entered into a binding contract to

purchase a principal residence in the U.S. by April 30, 2010, and closed by Sept. 30, 2010, you may be eligible to claim a refundable First-Time Homebuyer Credit if you qualify as a first-time homebuyer or longtime resident. Also, you must occupy the home as your principal residence within 24 months of the purchase.

For first-time homebuyers, the credit is \$8,000 (\$4,000 if married filing separately), or if lower, 10% of your new home's purchase price. If you are a longtime resident, the credit is \$6,250 (\$3,250 if married filing separately), or 10% of the purchase price if lower. This credit is available subject to income qualification rules, is refundable and expired in 2010.

Mortgage Interest

Home mortgage interest on up to \$1 million (\$500,000 if married filing separately) of home acquisition loans secured by your principal residence and/or second home is fully deductible. You can use the loan proceeds to buy, build or significantly renovate your home.

Also, mortgage interest on a home equity loan or line of credit up to \$100,000 (\$50,000 if married filing separately) can be deducted. Therefore, interest can be deducted on total home debt of up to \$1.1 million (\$550,000 if married filing separately).

Mortgage Debt Forgiveness

If you still have mortgage liability after your home is foreclosed, any amount forgiven by the lender is generally ordinary income. However, for debt discharged on or after Jan. 1, 2007, and before Jan. 1, 2013, the debt forgiveness is treated as tax-free if the property is your primary residence. The limit on qualifying debt is \$2 million (\$1 million if married filing separately).

Tax Exclusion of the Sale of a Principal Residence

When you sell your principal residence, you can exclude from income up to \$250,000 in gains (\$500,000 if married filing jointly or a surviving spouse if the sale is within two years of spouse's death).

To qualify, you must have owned and used the home as your principal residence for at least two years during the five-year period ending on the date of sale. The exclusion is available even if you took temporary absences (including vacations) and rented out the home while not living there.

Keep in mind that if you took a First-Time Homebuyer Credit, you may have to recapture some or all of the credit, and, if you used your residence as a home office, you may have other adjustments to make.

Employment

The Making Work Pay Credit

The Making Work Pay Credit, which applies to both full- and part-time workers, provides employees, including the self-employed, with a tax credit equal to 6.2% of earned income up to a maximum of \$400 (\$800 if married filing jointly).

The credit phases out at modified AGI of \$75,000 to \$95,000 if single and \$150,000 to \$190,000 if married filing jointly. Taxpayers receive the credit through a reduction in their tax withholdings. This credit expired at the end of 2010.

COBRA Premium Assistance

The federal government is subsidizing 65% of COBRA premiums for employees who are involuntarily terminated on or after Sept. 1, 2008, and before June 1, 2010. Eligible workers and family members pay only pay 35% of the premium for up to 15 months. In some cases, workers who had their hours reduced and later lost their jobs may also be eligible for the subsidy. If you are laid off, your employer should notify you of this rule.

The subsidy is tax-free if modified AGI is equal to or less than \$125,000 for single filers and \$250,000 for married joint filers. The tax-free element is phased out for singles with modified AGI between \$125,000 and \$145,000, and married joint filers with modified AGI between \$250,000 and \$290,000. For singles with modified AGI above \$145,000 and married joint filers with modified AGI above \$290,000, the subsidy is treated

as gross income. This subsidy expired in 2010.

If you are eligible for the COBRA subsidy and also qualify for the Health Coverage Tax Credit (HCTC), you may want to consider the more generous HCTC benefit.

Children and Education

Child Tax Credit

For 2010, the Child Tax Credit is worth \$1,000 for each qualifying child who is under age 17 at the end of the calendar year and who qualifies as a dependent. The Child Tax Credit is in addition to the child's dependency exemption.

The credit begins to phase out when modified AGI exceeds \$110,000 if married filing jointly, \$55,000 if married filing separately and \$75,000 if single filer, head of household or qualifying widow(er).

Dependent Care Credit

If you are a parent who must pay for the care of a dependent under age 13, whom you also claim as a dependent, while you work or look for work, you may be eligible for a tax credit between 20% and 35% of qualifying expenses (up to \$2,100). You must have earned income to receive the credit.

Also, this credit is not restricted to child-related care costs. If you pay someone to look after an incapacitated dependent of any age, such as a parent or disabled family member, you may also be eligible for this tax break.

The maximum amount of expenses on which the credit can be claimed is \$3,000 for the care of one dependent or \$6,000 for the care of two or more. The value of qualifying day care provided by your employer under a written, non-discriminatory plan generally is not taxable up to \$5,000 (\$2,500 if married filing separately).

The American Opportunity Tax Credit

The American Opportunity Tax Credit is available to each eligible student and for the first four years of college or other

More Deductions from Adjusted Gross Income

Itemized Deductions

(Individual deductions are subject to limits that are dependent on personal circumstances):

- Casualty and theft losses (unreimbursed)
- Charitable contributions – cash, property, donated clothing or household items and appreciated long-term assets
- Employee business expenses (unreimbursed)
- Estate state payments on income (decedents)
- Gambling losses
- Health insurance costs and medical expenses (see Form 1040 and 1040A instructions for complete list). Amount is deducted after insurance reimbursements:
 - Alcohol or drug abuse treatment§
 - Annual physical
 - Crutches, canes and orthopedic shoes§
 - Long-term care insurance
 - Medical transportation§
 - Orthodontia
 - Prescription eyeglasses, contact lenses and hearing aids§
- Income-tax-preparation software and fees*
- Investment expenses*
- Job-search expenses*
- Legal fees to earn income
- Mileage and expenses associated with volunteer work
- Mortgage interest (including interest on equity loans)
- Points paid for a mortgage or refinancing
- Professional investment-advisory fees*
- Taxes – state and local income and personal property
- Unreimbursed employee business expenses*

§ Deductible to the extent the total of all medical and dental expenses exceeds 7.5% of adjusted gross income

* Deductible as miscellaneous itemized deductions to the extent the total exceeds 2% of adjusted gross income

postsecondary school that leads to a degree, certificate or other recognized educational credential. The maximum credit is \$2,500 per student for each year and 40% of the credit is refundable – that is, it can reduce the taxpayer's liability below zero.

The credit applies to 100% of the first \$2,000 of costs and 25% of the next \$2,000 of costs. It phases out at modified AGI levels between \$160,000 and \$180,000 (married filing jointly), and \$80,000 and \$90,000 (other filers).

If modified AGI is less than the \$160,000 and \$80,000 thresholds, the full credit can be claimed. However, if it is equal to or greater than the \$180,000 and \$90,000 thresholds, the credit is not available. This credit is allowed against the AMT.

Investors

Long-Term Capital Gains and Dividends

The maximum tax rate on net long-term capital gains remains at 15% for 2010. However, for taxpayers in the 10% or 15% tax bracket, the tax rate on long-term capital gains is zero. Capital gains on investments held for one year or less are taxed at regular income tax rates.

Qualified dividend income from a domestic or qualified foreign company is taxed at a top rate of 15% (zero for taxpayers in the 10% or 15% tax bracket in 2010).

These rates for net long-term capital gains and dividends expired at the end of 2010.

Offset Capital Gains with Losses

Capital losses are netted against capital gains. If your capital losses exceed your capital gains, you can deduct up to

\$3,000 in net long-term capital losses against ordinary income (\$1,500 if married filing separately) or your total net loss as shown in 1040 Schedule D, *Capital Gains and Losses*, whichever is less. Any remaining net capital losses may be carried over to future years.

Retirement

Traditional and Roth IRAs

You may contribute up to \$5,000 to fund a traditional or Roth Individual Retirement Account (IRA) in 2010. Individuals age 50 or older by the end of 2010 can make an additional catch-up contribution of \$1,000.

Eligibility to contribute to a Roth IRA is phased out for modified AGI between \$105,000 and \$120,000 if single, head of household or married filing separately and not living with spouse at any time in 2010; and \$167,000 to \$177,000 if married filing jointly or qualifying widow(er).

If modified AGI is less than the phaseout thresholds of \$105,000 and \$167,000, contributions can be made up to the contribution maximum, and if modified AGI is greater than the phaseout thresholds of \$120,000 and \$177,000, no contribution can be made. Married taxpayers who file separately and lived with a spouse at any time in 2010 cannot contribute to a Roth IRA if their modified AGI is \$10,000 or more.

Conversion of Traditional IRA to Roth IRA

You can convert a traditional IRA to a Roth IRA, with no dollar limit on the amount converted. Although income tax is due on the amount converted, the 10% early-distribution penalty does not apply if you are younger than age 59½ and keep the funds in the Roth IRA for at least five years. Also, if you do not report all conversion income in 2010, 50% of income from 2010 is automatically deferred to 2011 and the remaining 50% to 2012. A conversion can be reversed no later than the extended due date for your 2011 tax return.

Rollover to In-plan Roth IRA

After Sept. 27, 2010, a 401(k), 403(b) or

457(b) plan that includes a qualified Roth contribution program may now permit a qualified rollover contribution from a participant's non-Roth account to the participant's designated Roth account within the same plan. The converted amount is included in income, but special rules apply to rollovers in 2010 – the amount that would be included in 2010 may be included in equal installments in 2011 and 2012.

A further exception allows you to unwind a conversion prior to filing the 2010 return with extensions.

Employer-Sponsored 401(k)

Pre-tax contributions to your employer-sponsored retirement plan reduce your taxable wages. Matching contributions and income earned within your plan also are tax-deferred. Your contribution limit for 2010 is \$16,500. If you are age 50 or older by the end of 2010 you may make an additional catch-up contribution of \$5,500 to reach \$22,000 for 2010. Also, there is no minimum distribution required in 2010 from your 401(k).

Retirement Savings Contributions (Saver's) Credit

Qualified taxpayers who make contributions to a retirement plan, including traditional IRAs or Roth IRAs, by April 15, 2011, are eligible for the Saver's Credit. The 10%, 20% or 50% credit is based on adjusted gross income and applies to the first \$2,000 of contributions, bringing the top credit to \$1,000.

To claim the nonrefundable credit, adjusted gross income must be less than \$55,500 if married filing jointly, \$41,625 if head of household or \$27,750 if single, married filing separately or a qualifying widow(er).

Obtain Professional Advice

A CPA tax professional understands the business of taxes and finances and can provide trusted advice and services during the tax season and throughout the calendar year.



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