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SUMMARY OF SELECTED TAX LAW CHANGES FOR 2011 & 2012

The Tax Relief Act, signed into law in December 2010, in large part kept a lot of existing tax code in place through 2012 making 2011 a very quiet year for tax code changes.

In 2011, a new **Payroll tax cut** replaced the Making Work Pay credit. This tax cut **reduced the amount employees contributed to Social Security by 2% for the year**, translating to slightly larger take home pay. Employees contributed 4.2% vs. the standard 6.2%. The employer contribution rate remained at 6.2%. This was the subject of the latest “battle” between the parties in Washington DC around the December holidays. Congress did end up **retaining this payroll tax cut for the first two months of 2012**. The consensus is both parties would like to extend this through 2012 as well, but have additional items on their agendas, so stay tuned for the next skirmish just a few weeks away.

New Tax Forms

1. **Form 8949** which details capital asset sales (stock sales, etc.) and will feed to the Schedule D
2. **Form 8938** which details foreign assets with a value of \$50,000 or more

The following tax breaks remained in place through 2011:

1. deducting sales tax in lieu of income tax on itemized returns
2. extending the educator deduction (for teachers/administrators in grades K-12)
3. extending the Higher Education Deduction (tuition at university/college level)

American Opportunity Credit (college education) – first put in place for 2009, this credit is extended through 2012. It expands education credits to more taxpayers by making the credit available to those with higher Adjusted Gross Income levels. Taxpayers paying education expenses, for themselves or dependents, for the first 4 years of college, may qualify for this credit (up to \$2,500 per student per year).

Converting an IRA to a Roth IRA – the adjusted gross income limitations to convert was removed in 2010. Previously, if a taxpayer’s adjusted gross income was \$100,000 or more, they could not convert a traditional IRA to a Roth IRA. One advantage of a Roth IRA is a withdrawal is tax-free if a taxpayer has held the Roth IRA for at least a 5-year period. However, there may be early withdrawal penalties if taking distributions from a Roth IRA prior to turning age 59 ½. If you converted an IRA to a Roth IRA in 2010 and elected to pay taxes on the conversion over a two-year period, the first half of this conversion is taxable on this year’s tax return.

Energy Credits for 2011 reverted to 2008 dollar limitations and are not so generous as in 2009 & 2010. If you claimed an energy credit on a prior tax return, the amount of credit you are eligible to claim on this year’s return may be little to none.

“Nonbusiness Energy Property Credit” – this is a credit of up to \$500 (lifetime) for energy improvements to your **primary residence**. This credit applies for qualified improvements – insulation, exterior windows & doors, some roofing, high efficiency heat pumps, air conditioners, water heaters, etc. There are lots of details and small print but keep your records or ask when we meet.

“Energy Efficient Credit” – think alternative energy. This credit equals 30% of the cost of solar energy electric and heating property, small wind energy property (wind turbines), fuel cell property and geothermal heat pumps. This can be for either your primary residence or second home.

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Alternative Minimum Tax (AMT) patch was again put in place for 2011, so many middle income taxpayers would not be hit with additional taxes. As a reminder, the AMT is another way to figure tax. Initially put in place so high income taxpayers do not eliminate all tax liability via deductions, it has not been indexed for inflation and would hit many middle income taxpayers if not “patched” each year.

The ability to expense qualified business property in lieu of depreciating over asset lifetime (Section 179 property) remained at \$500,000 for 2011.

Businesses can take **100% bonus depreciation** on business assets purchased and placed in use in 2011. The bonus depreciation rate is 50% for business assets purchased and placed in use in 2012.

Here come the tax implications of the Healthcare Reform Act passed in March 2010. On the W2 for 2012 wages, many employers will be required to report the cost of employer sponsored health insurance in box 12, code DD. The IRS states the purpose is to “provide useful and comparable consumer information to employees on the cost of healthcare insurance”. My opinion is this is the groundwork for identifying at a sweeping level, taxpayers who are maintaining adequate levels of health insurance as mandated by the HealthCare Reform Act. If adequate levels of health insurance are not maintained, taxpayers are subject to penalty starting in 2014. Planning ahead for 2013, higher income taxpayers (\$200,000 Single and \$250,000 Married Filing Jointly) will be subject to additional Medicare taxes. For those of you that may be affected, I will let you know the estimated impact for your situation.

For more information visit my website at www.orovalleycpa.com, or ask me during our tax appointment. Other resources include the IRS website www.irs.gov.

2011

GENERAL ITEMS

Exemption Amount

The amount for each personal exemption increased to \$3,700 in 2011. In 2011, there is no phase-out of exemptions based on adjusted gross income levels.

Standard Deduction Amount

The standard deduction for taxpayers who do not itemize deductions on Schedule A, increased to the following amounts for 2011:

· Married filing jointly	\$11,600
· Single	\$ 5,800
· Head of household	\$ 8,500

Social Security and Medicare Taxes - Wage Limits

The maximum amount of wages that were subject to social security tax (4.2% paid by employee, 6.2% paid by employer) remained at \$106,800. All wages are subject to Medicare tax. (1.45% each for employer and employee).

CHANGE! Alternative Minimum Tax (AMT) Exemptions Increased

In 2011, the AMT exemption amount increased across the board. For taxpayers filing, married filling jointly, the exemption amount increased to \$74,450, for single taxpayers increased to \$48,450.

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Gift Tax Annual Exclusion

The annual amount that you can gift to someone else without filing a gift tax return remains at \$13,000.

Estate Tax

The estate tax exemption and tax rates seems to change from year to year to keep accountants and estate planning attorneys on their toes. In 2011, the amount of a person's estate that is exempt from estate taxes is \$5 million. This means that up to \$5 million in assets that were part of an estate are exempt from estate tax. The exemption amount increases to \$5,120,000 in 2012. Estate tax rates maximize at 35%. However, after 2012 if Congress does not act, only \$1 million in assets are exempt from estate taxes and estate tax rates revert up to 55%. One million dollars may seem like a high threshold but when you add up assets considered part of an estate (real estate, life insurance proceeds, IRA and investment accounts), that threshold may be hit rather quickly. Stay tuned, this should also be an item addressed by Congress in 2012.

RETIREMENT SAVINGS PLANS

Traditional IRA Deductibility

If covered by a workplace retirement plan, your traditional IRA contributions may not be deductible based on your AGI. The complete phase out level is \$66,000 for Single and Head of Household filers. For those filing jointly, the complete phase out level is \$110,000 if the contributor's spouse is covered under a workplace retirement plan, \$179,000 if their spouse is not covered under a workplace retirement plan.

IRA Contribution Limits

Remained the same as past few years. Taxpayers 50 or over at the end of 2011 may contribute up to \$6,000 per person to an IRA. Taxpayers under age 50 can contribute up to \$5,000 per person.

Roth IRA Contributions Adjusted Gross Income (AGI) Phase Out Amounts

Taxpayers may contribute the maximum amount to a Roth IRA if their AGI is under \$107,000 Single, \$169,000 Married Filing Jointly. No Roth IRA contributions are allowed if AGI exceeds \$122,000 Single, \$179,000 Married Filing Jointly. If your AGI is between the above two limits, then prorated Roth IRA contributions are allowed.

Roth IRA Conversions

Conversions from a Traditional IRA to a Roth IRA is a taxable event. Any conversions in 2011 are reported in full on the 2011 tax return. **For any conversions made in 2010 where the taxpayer elected to pay taxes evenly in 2011 and 2012, the first half of the taxable conversion will be on the 2011 tax return.**

401k and 403b Contribution Limits

The maximum contribution a person can make to a company 401k or 403b plan remains at \$16,500 for 2011. Taxpayers 50 or over at the end of 2011 may contribute an additional \$5,500 to these plans making their total 2011 contribution maximum \$22,000.

CREDITS, DEDUCTIONS & EXCLUSIONS

Health Savings Accounts (HSA's)

The maximum HSA deduction remains at \$3,050 (\$6,150 for family coverage) for taxpayers under age 55. Add \$1,000 to these amounts for taxpayers age 55 or over.

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CHANGE! Mileage Rates

The mileage rates for 2011 are as follows:

Type	Rate per mile Before 7/1/11	Rate per mile 7/1/11 – 12/31/11
Medical and Moving	19 cents	23.5 cents
Charity	14 cents	14 cents
Business	51 cents	55.5 cents

REMINDER! American Opportunity Credit

Up to \$2,500 can be claimed per student for the first four years of post-secondary education. Course materials, including books and computers, needed for courses are qualified education expenses.

CHANGE! Residential Energy Improvements Credits

Reduced from 2010 levels, the energy credit was re-established at rules in place for 2008. There is a \$500 lifetime credit for energy improvements (high efficiency air conditioning and cooling, insulation, exterior doors and windows, skylights). **If you have already taken at least \$500 in credits since 2006, you have exhausted this credit.**

REMINDER! Medicare Part D

The amounts paid by taxpayers for Medicare Part D, the voluntary prescription drug coverage are considered eligible medical expenses for itemizing deductions.

REMINDER! Cash Contributions

ALL cash contributions must be supported by a written and dated receipt from the charity or a dated bank record.

REMINDER! Charitable Contributions of Vehicles, Boats and Aircraft

If you donate a vehicle (boat or aircraft) to a qualified organization your deduction is limited to the gross proceeds from its sale by the organization. There are a few exceptions for deducting fair market value. Written acknowledgement from the organization is required.

REMINDER! Non-Cash Charitable Items

Any donations of non-cash charitable items (e.g. clothing, household goods) must be in “good” condition. There is no guideline on how this will be enforced. Industry professionals recommend clients keep a detailed list of what was donated and a receipt from the organization.

BUSINESS RELATED

Section 179 Expense Deduction.

The maximum amount eligible to expense business capital investments was \$500,000 for 2011.

NEW! Identify Income from Credit Cards from Other Income

Business owners & rental property owners must separate and quantify income received from merchant cards (e.g. credit cards) and third party networks from other income. This was supposed to be mandatory for 2011 but IRS has delayed this requirement until 2012. Next year at tax time, business owners should received a new tax form 1099K to aid in identifying credit card income.

Partnership or S-Corporation Tax Return filing Penalty

The penalty for failing to file or late filing of partnership and S-Corporation tax returns increases to \$195 per month, per shareholder or partner, up to 12 months.

2012

GENERAL ITEMS

CHANGE! Exemption Amount

The amount for each personal exemption increases to \$3,800 in 2012.

CHANGE! Standard Deduction Amount

The standard deduction for taxpayers who do not itemize deductions on Schedule A increases to the following amounts in 2012:

- Married filing jointly \$11,900
- Single \$ 5,950
- Head of household \$ 8,700

CHANGE! Social Security and Medicare Taxes - Wage Limits

The maximum amount of wages that are subject to social security tax (6.2% for employer and 4.2% for employees) increases to \$110,100. All wages are subject to Medicare tax. (1.45% each for employer and employee). **Note: the reduced employee contribution rate is currently for the first two months of 2012 only. If Congress does not act, then both employee and employer contribution rates are 6.2% for the remainder of 2012.**

Gift Tax Annual Exclusion

The annual amount that you can gift to someone else without filing a gift tax return remains \$13,000.

CHANGE! Alternative Minimum Tax (AMT) Exemption

Beginning in 2012, the AMT exemptions revert to their 2002 levels if not addressed by Congress again. These AMT exemption levels are significantly lower - \$45,000 for couples married filing jointly and \$33,750 for single taxpayers. The hope exists that someday Congress will provide some type of long term solution for the AMT instead of passing annual patches.

RETIREMENT SAVINGS PLANS

Traditional IRA Deductibility

If covered by a workplace retirement plan, your traditional IRA contributions may not be deductible based on your AGI. The complete phase out level is \$68,000 for Single and Head of Household filers. For those filing jointly, the complete phase out level is \$112,000 if the contributor's spouse is covered under a workplace retirement plan, \$183,000 if their spouse is not covered under a workplace retirement plan.

IRA Contribution Limits

Remain the same as the past few years. Taxpayers 50 or over at the end of 2012 may contribute up to \$6,000 per person to an IRA. Taxpayers under age 50 can contribute up to \$5,000 per person.

Roth IRA Contributions Adjusted Gross Income (AGI) Phase Out Amounts

Single taxpayers with AGI over \$125,000 and Married Filing Joint taxpayers with AGI over \$183,000 will be ineligible to make contributions to a Roth IRA. However, contributions to a traditional IRA are allowed and can eventually be converted to a Roth IRA if that is a desired end result.

401k and 403b Contribution Limits

The maximum contribution a person can make to a company 401k or 403b plan increases to \$17,000 for 2012. Taxpayers 50 or over at the end of 2012 may contribute an additional \$5,500 to these plans making their total 2012 contribution maximum \$22,500.

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CREDITS, DEDUCTIONS & EXCLUSIONS

Mileage Rates

The mileage rates for 2012 are as follows:

Type	2012
Medical and Moving	23 cents
Charity	14 cents
Business	55.5 cents

Itemized Deduction Limits for High-Income Taxpayers

There is no “phase out” of itemized deductions for higher income tax payers, e.g. allowing 100% of itemized deductions to “count” in 2012. In 2013, the phase out of itemized deductions is put back in place.

EXPIRED! Expiration of Deductions & Credits.

These deductions expired 12/31/2011.

- Tuition & Fees
- Educator’s expenses
- Sales Tax
- Mortgage Insurance premiums (PMI)

The following credits expired 12/31/2011.

- Residential Energy Credit
- Electric Vehicle Credit

CHANGE! Future Tax Rates and Reduced Credits – Use for future planning

Unless changed by Congress, the following tax rates and reduced credits will take place in 2013.

Description	2010-2012 Amt	2013 Amt
Child Tax Credit	\$1,000 per child	\$500 per child
Long Term Capital Gains Rate – taxpayer in 25% tax bracket or higher	15%	20% (18% if property held for 5 years)
Long Term Capital Gains Rate – taxpayer below 25% tax bracket	0%	10% (8% if property held for 5 years)
Qualified Dividends	Same as long term capital gains rates	Ordinary income tax rates
Income Tax Rates	10%, 15%, 25%, 28%, 33%, 35%	15%, 28%, 31%, 36%, 39.6%

BUSINESS RELATED

Increased Section 179 Expense Deduction.

The maximum amount is reduced to \$139,000 in 2012.

Bonus Depreciation

Certain business assets placed in service in 2012 are eligible for bonus depreciation of 50%.