



# TAX NEWS & TIPS

MID-YEAR 2010

## Thank You!

My busy "season" is tough. But, you made it easier.

**You're The Best!** Thank you for having your records in order. Thank you for your patience at my busiest time. Especially, thank you for your trust and confidence. I'll be working to keep earning this from you.

## What Now?

Your return's been filed. Don't relax yet. IRS and the Congress never rest. Be ready for what may happen before next year.

**On Extension?** October 15 is the return deadline, but April 15 was the deadline for payments. If you owe tax IRS adds carrying charges. Gather missing information quickly. I won't rest easy until you're safely filed. Any last-minute surprise can be expensive!

**Refund Late?** IRS can track e-filed returns within days, but for paper returns won't help until 4-6 weeks after you file. Try:  
1-800-829-4477 – automated help  
1-800-829-1954 – refund hotline  
The IRS website [www.irs.gov](http://www.irs.gov) has a "Where's My Refund?" link.

**Still Owe?** IRS sends bills in June. They show the balance, plus any interest and/or penalty. The bills only allow a 10-day "grace period" before the amount changes again. Write your Social Security Number on the check and "Income Tax - Year 2009". If you can pay off the bill within a couple of months, do it.

**Installment Plans.** IRS has installment plans, but charge up to \$105 to set one up. If you can pay the balance with the second billing from IRS, don't waste money by asking for a plan.

**Pay by Credit Card.** You can pay this way, but "convenience fees" up to 3.5% apply. The fee is now deductible, but there's still a cost. Call: 1-800-UPAY-TAX, or 1-888-PAY-1040. Or, go to [www.irs.gov](http://www.irs.gov).

**Find Late Information?** If you forgot some key information, we can file an amendment. Both you and IRS have 3 years after the filing deadline to change a return. If you owe IRS, you pay tax plus interest. If they owe you, it works the same. You collect the savings plus interest.

**Uh-Oh – an IRS Letter!** If you get a letter from IRS, call me. The letters are confusing. Don't risk making an even bigger mess – I'll be glad to handle it.

**Will You Be Audited?** There's no sure way to know. Most "audits" are done by computer. It compares your return with W-2 forms and 1099 reports from banks and brokers. If there is a discrepancy, you get a letter showing how much you owe if IRS is right – it looks like a bill. Don't pay! Send it to me, and we'll see what's what. Many of these "audits" contain errors!


About 15% of "audits" involve a face-to-face meeting with an IRS employee. Call me right away if you get a letter requesting a meeting!

**Keep Your Records.** For now, put your return and all records in a safe place. You might need to dig them out for an audit some day.

**Older Records.** It's a good idea to keep tax returns indefinitely. Also, keep records of investments and properties you still own. Other records – cancelled checks, receipts, bank statements, etc. – I recommend you keep five years' worth of these for safety. Destroy or shred older records to protect sensitive financial information. DO NOT simply toss them in the trash!

## So Many New Laws!

The past couple of years have seen more new tax laws than any period in our history.

 **Protect Yourself.** Please take note of items that may affect you. Some are so new IRS has not yet given complete rules. Others are more familiar. If you need help, I welcome your calls. It's your money. Let me help you protect it.

**Estate Tax Dead?** Estate tax laws ended December 31, 2009. Congress wants to fix this, but so far, nothing. Current rules are a mess. Suppose Uncle Ben passed away and left you his home and a couple of stocks. Old law caused no estate tax unless Ben's assets were worth more than \$3.5 Million. No tax then, no tax now. But, look at your inheritance. Old law set a value for the home and stocks at what they would sell for when Ben died. Now we must find what Ben paid for the items, then apply complex "carryover basis" rules to know if you face a tax when you sell. Congress wants to reinstate the simpler rules. Wait and see.

(Continued on next page)

## This Issue

- What Now?
- So Many New Laws!
- Familiar Rules Expired – Will They Return?
- Hot Idea In 2010 – Roth IRA Conversion
- Kids In College?
- Tips For You
- Your Tax Calendar

**Homebuyer Credits.** This was passed last November and is already dead. Direct refunds of up to \$8,000 applied to some home purchases. The law ended on April 30, with an extension until June 30 for those who were already working under a written contract to buy. Members of the Military and Foreign Services have an extra one year to qualify. Will it be extended? Not likely.

**Health Care Reform.** This one's only a couple of months old. Most rules kick in over several years.

**Small Employers** who provide health insurance get a tax credit in 2010. Lots of rules. The credit can be as much as 35% of what employer spends on premiums. The maximum applies for employers who have no more than 10 employees and/or who pay salaries under \$25,000. The credit is reduced and eventually disappears for businesses with more employees and as salaries increase. IRS is struggling to explain all this, and has posted some early rules at their website.

**Future Years** will bring more changes. Higher penalties will apply to using money from HSA accounts for non-medical items. The "floor" for deducting medical expenses goes from 7.5% to 10% of income in 2011, but only for those under 65. High income folks will pay surtaxes after 2012. Eventually all employers must provide coverage or pay fines, and low-income folks will receive vouchers to buy coverage. It'll take at least a year to sort this out.

### **Special "Stimulus" Provisions.**

**Most Workers** got the "Making Work Pay" credit of up to \$400 in 2009. Couples got up to \$800. This will apply in 2010, but disappears in 2011. Withholding tables will go up to keep most folks at the same tax position for 2011.

**Most retired folks** got a \$250 one-time check in May 2009 – some got their \$250 when we filed the tax return. These payments were for 2009 only.

**Education Credits.** For 2009 we saw the new American Opportunity Tax Credit (AOTC). New rules, but what a pleasant surprise! It'll be here for 2010, but then expires.

**Undergrads Only.** The credit can only be used for the first four years of college. Students must be enrolled at least half-time, and must be enrolled in a degree or certificate program.

**Tuition plus Supplies!** Until 2009 we could only look at tuition and class fees (net of any grants or scholarships). Now we include books and class supplies. Today most students need computers, and it appears we may include this cost if the machine is purchased during the year. Add needed software and other class supplies.

**Valuable Credit.** The credit can be as high as \$2,500 per student. It's a dollar-for-dollar tax reduction on the first \$2,000 spent, then 25% of the next \$2,000. Costs above \$4,000 offer no help. Even if your tax bill is low, the first 40% of the

credit is "refundable" – you get it even if you owe no tax.

**Easier To Qualify.** Before 2009 phaseout rules kept many from getting the education credits. The new credit has higher limits. Single filers can get the full credit until income passes \$80,000 - double this for couples.

**Other Changes.** Several items which already expired are listed in the box below. Other helpful rules are due to expire after 2010. They may or may not be extended:

- Election to expense up to \$250,000 of new equipment.
- Marriage Penalty issues. Until 2001 people saw a tax increase if they married. In 2001, new rules removed many inequities. Problem – those rules are set to expire after 2010.
- Capital gains rates of 0% / 15% depending on income. They are set to return to 10% / 20%.
- Most dividends being taxed at the favorable capital gain rates.
- Loss of deductions/exemptions based on income.
- Mileage deductions were 55¢ per mile in 2009. They drop to 50¢ this year.

**Estimated Tax.** If you send out estimated tax payments, we may need to re-think your position if any of these apply to you. Also check the items in the box below.

Please call me if one of these affects you and we didn't plan for it.

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## **Familiar Rules Expired - Will They Return?**

**Over 40 Rules** used by individuals expired back on December 31, 2009. Congress wants to extend several, but no results yet. Here are some of the best known:

**Non-Itemizers** were allowed to claim extra deductions for sales tax on new cars, real estate taxes, and disaster losses. All three of these have expired.

**Education & Educators.** The "Tuition & Fees Deduction" up to \$4,000 for post-secondary tuitions (including vocational schools) expired. Educators could deduct up to \$250 of classroom supplies - also gone.

**Age Over 70½.** These folks lost two valuable rules. Required Minimum Distributions from IRAs were gone in 2009, return in 2010, and aren't likely to be extended. Also these folks could make charitable contributions directly from IRA accounts and get the deduction without a need to itemize deductions. Plus, it was considered as part of the required distribution even though not taxed.

**Alternative Minimum Tax** was enacted over 26 years ago to keep the wealthy from taking undue advantage of tax laws. Unfortunately, the measure of "wealthy" in 1983 looks "normal" today. Since 2001 we've had annual "patches" to keep the tax at bay. The 2009 patch expired in December. Unless Congress acts, single filers can run into this at income of \$45,000 or so, couples at around \$70,000. It raises taxes and eats up valuable tax credits.

**Several Other Provisions** died on December 31. We might or might not see a revival of:

- Sales Tax vs. State Income Tax choice for itemizers.
- COBRA subsidies for laid-off employees.
- Research Credits for small businesses.
- Bonus Depreciation - 50% of costs in first year, then depreciate the balance.
- Shorter depreciation lives for leasehold improvements, retail spaces, and farming machinery.

## Hot Idea In 2010 – Roth IRA Conversion

Investing is about time and taxes. It takes *time* for money to "grow". Taxes take some of the value out of the growth.

Usually we pay tax on our income as growth accumulates. "Retirement-like" accounts are an exception – you pay the taxes later. Good news – this "deferral" allows the money to grow faster, as none is diverted for taxes. Bad News – the growth is "ordinary income" – all taxable with no breaks for capital gains or tax-free income.

The IRA lets ordinary folks invest in more than simple bank accounts – stocks, bonds, even real estate, with full tax deferral. Folks without a retirement plan at work can even get a tax deduction when the money is contributed – this allows a smaller out-of-pocket cost. Other folks get no deduction, but want the deferral. These folks must keep track of the non-deductible parts to avoid being taxed a second time when the money is withdrawn.

### Regular IRA vs. Roth IRA.

Normally IRA contributions are deductible – you save money now, but pay tax on everything later. Roth IRA contributions are not deductible, but all growth is tax free. IRA – save now, or Roth – save later.

Of course, taxes are never quite this simple. For your Roth IRA to be fully non-taxable there's a test. You must reach the *later of* (1) age 59½, or (2) 5 full tax years after first opening a Roth IRA.

**Which Is Better?** Tax brackets are part of the answer. For a big enough savings now, you'd be willing to pay later, especially if you expect lower tax brackets in the future.

**Age Factor.** If you're 21 years old, forget about tax brackets! The money will grow so much before you're 59½ that you'd be foolish not to choose the Roth IRA. If you're 62, it's a much tougher choice.

**Wealthy Barred From Roth.** If your income is too high, you can't even *make* Roth contributions. For 2010 the ability to contribute to a Roth IRA is phased out for single filers as income ranges from \$105,000 to \$120,000. It's \$167,000 to \$177,000 for couples.

**"Conversion" To Roth.** You can take money from retirement accounts and "convert" the money into a Roth Account. Simplest is the IRA to Roth IRA conversion. Two problems:

(1) You must pay any tax due on the converted funds, and (2) there's no penalty even if you're under 59½, but you can't touch the money for at least 5 years, or the penalty will apply retroactively.

**Open To All After 2009.** Until December 31, conversions were not allowed if your income exceeded \$100,000. The limit is now gone. Even Bill Gates can convert into a Roth Account! Bonus: Conversions in 2010 (but not later years) are taxed over two years – 2011 and 2012.

**How It Works.** Let's use an example. Suppose you have a 401(k) plan from a former job – it's now an IRA and worth \$170,000. You also contributed \$20,000 into an IRA at your bank over the years, but were not allowed any deductions, and it's now worth \$30,000. (These values must be determined at December 31 of the year prior to conversion.) Tax law says to combine *all* your IRA accounts. You have \$200,000 of IRA money, but you've already paid tax on \$20,000, or 10%, of this. Thus 90% of any withdrawal is taxable.

**Scenario 1.** If you convert all this to Roth, you must pay tax on \$180,000 (90% of \$200,000). Future growth is tax-free after the 5-year waiting period. Hmmm. Is it worth paying the tax? For most folks, it's near \$60,000. Ouch! It would take a long time to earn this again.

**Scenario 2.** Suppose you move only \$30,000 to Roth. 90% of it is taxable – that's \$27,000. Probable tax bill is between \$6K and \$9K. Easier to swallow?

**Scenario 3.** You might plan to convert only about \$10,000 each year. Suppose this was a small enough amount that your tax bracket is only 15%. Tax on the \$9,000 would be around \$1,300 yearly.

**Two-Year Spread For 2010.** Sounded good when the law passed over 3 years ago. Now there's a fear of rising tax rates. It might be wise to pay the tax in 2010 if you expect higher taxes in 2011 and 2012.

Remember - Time & Taxes. How much *Time* is needed for the tax-free lure of Roth to "earn back" the *Tax* you paid on the conversion?

## Kids In College?

It's easy to misunderstand the tax implications when a youngster begins college. Some key ideas:

**Dependency To Parent.** Unless the youngster is self-supporting, the personal exemption is claimed by parent(s). For separated parents we look at "custody" – where does the youngster expect to return?

**Temporary Absence.** Even while living away from home, a youngster's "domicile" is probably with parent(s). This is true unless the student never intends to return.

**Tax Benefits With Dependency.** Tax law is a little strange here – the valuable education credits may only be taken on the return where the personal exemption (dependency) is claimed. It doesn't matter where the money comes from. Grandma's trust, student loans, or the absent former spouse might pay the bills, but the tax benefit can only be claimed on the tax return where the exemption is claimed. For separated spouses, the custodial parent can use a special tax form to waive a student's exemption to the other spouse – the chance to claim the education credits was also waived! This can be a valuable tax strategy where one spouse has too much income to get the credit.

**"Kiddie Tax" Issues.** Youngsters with investment income over \$1,900 have special rules. (Look at items like interest, dividends, and capital gains.) Beyond the \$1,900 limit the youngster must pay tax at the higher of his/her own tax rates, or those of parent(s). Wealthy families cannot move income into a youngster's lower tax brackets. Normally this means both tax returns must be done at the same time. Don't let the student file his/her own return!

**Ends At Age 24.** In the year when a youngster turns 24 things change. Kiddie Tax rules disappear. And, to claim the youngster as a dependent you face much tougher tests.

College is expensive, but the special tax breaks can be a big help.

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## Tips For You

**Taxes Going Up?** There's lots of talk about tax increases lately. A group called *The Tax Foundation* studies our total tax burden. They measure a date called "Tax Freedom Day". It's the date when Americans will have earned enough to pay a year's worth of federal, state, and local taxes. In 2010 it was April 9, a day later than in 2009. The date has not fallen this early since the group began checking in 1948. One way to look at this – we have never seen such a large gap between what the government spends and what it collects. One logical solution is to begin collecting more!

**Employer-Paid Cell Phones.** Back in 1984 Congress wrote rules for things called "listed property". They covered items associated with "leisure, recreation, or entertainment". Things we'd all "like" to get deductions for. Cell phones were on the list. The mobile phone of 1984 was bulky and costly – a toy for the wealthy. Today we all have them. They are more necessity than toy. The rules say an employer providing one to an employee must add the value as "income" onto the W-2 unless they keep detailed records of every call, then add only the value of personal calls to the W-2. Sounds silly in view of today's "flat rate" billings. Congress is re-thinking the issue. Expect new rules.

**Mutual Fund Investors** need to keep careful records. This is not a savings account. You bought stock. When you sell you must report your cost to measure gain or loss. This is easy if you simply buy and hold. But, most investors "reinvest" the dividends. Each dividend represents another purchase! After a couple of years you have several purchases. Their total is your real investment. Without the monthly records the calculation is impossible. Lucky you if the broker keeps records for you, but not all brokers do this.

**Hire The Unemployed.** New rule for employers. It's part of the HIRE Act, passed March 18. Employers normally "match" the 6.2% FICA tax on the first \$106,800 paid to each employee. This year, employers who hire anyone who certifies he/she was not employed more than 40 hours in the 60-day period before hiring get a tax "holiday". Key rules: employee must be hired after February 3, can't replace another employee unless former left voluntarily or for cause, applies to wages between March 19, 2010 and end of year. IRS issued a revised Form W-11 for the hire to certify the unemployment, and is revising Form 941 to allow for the credit. In 2011 the law expires, but a credit of up to \$1,000 can be earned for any qualified employee who is retained for at least 52 weeks. As I write this, not all rules are in place. The IRS website has more details.

**Estimated Taxes.** If you pay estimated taxes, perhaps you saw something in this issue that neither of us thought of when we set your payments. If you expect the tax bill might be higher or lower than we expected, please give me a call. It's easy to change the schedule of payments. I'd like to see you pay the smallest amount allowed with no penalty. This let's your money work for you, rather than for the IRS.

*In my many years I have come to a conclusion that one useless man is a shame, two is a law firm, and three or more is a Congress.*

John Adams

### Your Tax Calendar

June 15	2 <sup>nd</sup> quarter estimated tax payments due.
Aug. 2	2 <sup>nd</sup> quarter payroll returns due (Aug. 11 if all deposits were paid). Forms 5500 due for pension or Keogh plans.
Sept. 15	3 <sup>rd</sup> quarter estimated tax payments due.
Oct. 15	Extended returns for 2009 due.
Today	Be sure to call if you have large changes to income or deductions!