27 Things
You Should Know About The
2011 TAX LAWS

Provided by
Arcade Wealth Advisors

2011 is here and there is much to report. Congress has restored the estate tax, cut the payroll tax and retained and/or restored a variety of tax breaks.

Here's a look at some recent developments in federal tax law – not just the changes for 2011-2012, but also the decisions (some quite recent) that may impact your 2010 return. This is by no means a tax planning guide, just an update on what has changed and what hasn't.

Before we get started, some news about filing your 2010 federal return:

- Due to a lag in IRS processing systems, you will need to wait until at least mid-February to file your return if you are going to claim …
  - itemized deductions on Schedule A
  - the Higher Education Tuition & Fees deduction
  - the Educator Expense deduction
- This year, the federal income tax deadline is **April 18**. That's because April 15 is a holiday in the District of Columbia (Emancipation Day).
- Correspondingly, all taxpayers who file for an extension this year will have until **October 17** to file their 2010 returns.[1]

Here's a look at the numerous revisions, alterations and restorations to federal tax law affecting tax years 2010, 2011 and 2012.

1 The federal income tax brackets remain at 10%, 15%, 25%, 28%, 33% and 35% for 2011-2012.

The ordinary taxable income brackets for TY 2011 are set as follows, reflecting minor COLAs:

- Single Taxpayers:
  - 10% bracket has a ceiling of $8,500
  - 15% bracket starts @ $8,501
  - 25% bracket starts @ $34,501
  - 28% bracket starts @ $83,601
  - 33% bracket starts @ $174,401
  - 35% bracket starts @ $379,151
- Married Filing Separately:
  - 10% bracket has a ceiling of $8,500
  - 15% bracket starts @ $8,501
  - 25% bracket starts @ $34,501

- 28% bracket starts @ $69,676
  - 33% bracket starts @ $106,151
  - 35% bracket starts @ $189,576

- Head of Household:
  - 10% bracket has a ceiling of $12,150
  - 15% bracket starts @ $12,151
  - 25% bracket starts @ $46,251
  - 28% bracket starts @ $119,401
  - 33% bracket starts @ $193,351
  - 35% bracket starts @ $379,151

- Married Filing Jointly or Qualifying Widow/Widower:
  - 10% bracket has a ceiling of $17,000
  - 15% bracket starts @ $17,001
  - 25% bracket starts @ $69,001
  - 28% bracket starts @ $139,351
  - 33% bracket starts @ $212,301
  - 35% bracket starts @ $379,151[2]

2 The payroll tax paid by employees and the self-employed has been reduced by 2.0% in 2011.

This means many Americans will effectively get a 2% raise this year. The reduced withholding could mean as much as $2,136 in savings, as earnings up to $106,800 are subject to payroll tax. No phase-outs apply, and if taxpayers are married, both spouses can get the individual deduction.[3,4]

Two related notes:

- The partial credit for payroll taxes paid by employers is gone this year.[5]
- As a result of this payroll tax holiday, the Making Work Pay credit is gone for 2011. However, many taxpayers can still claim the Making Work Pay credit for 2010 ($400 for individual taxpayers, up to $800 for taxpayers married filing jointly, income phase-outs applicable).[6]

3 The estate tax is back for 2011- 2012.

For this year and next, the federal estate tax is set at 35% with a $5 million individual exemption.[4] Please note that:

- The $5 million individual exemption is portable. This means that an executor may elect to transfer an unused $5 million individual estate tax exemption (upon the death of one spouse) to the surviving spouse. So with this new portability, a married couple could potentially transfer up to $10 million of assets without incurring federal estate tax.[7]

- In 2011, an executor of an estate for a decedent who died in 2010 may choose between two options in administering said estate. That executor can elect to
  - Subject the estate to the 2011 federal rules (35% estate tax, $5 million estate exemption, stepped-up basis for appreciated assets per IRC rule 1014).
  - Subject the estate to the 2010 federal rules (0% estate tax and the $1.3 million modified carryover basis for appreciated assets in the estate, which becomes $3 million for assets passing to a surviving spouse).[8]

4 The estate tax, the gift tax and the generation-skipping tax (GST) have all been reunified for 2011-2012.

They all have top rates of 35% with $5 million individual exemptions. The individual estate and gift tax exemptions are portable between married couples; the GST exemption is not. The GST has been restored for 2011; it was 0% in 2010.[4,8]

The **annual gift tax exclusion** remains at $13,000 per donor in 2011. A single taxpayer may gift up to $13,000 to an unlimited number of individuals. The lifetime exclusion (see above) is $5 million.[4]

In addition to the annual exclusion, an unlimited gift tax exclusion is allowed for amounts paid on behalf of a donee directly to an educational organization for tuition. Likewise, amounts paid directly to health care providers also qualify for the unlimited gift tax exclusion.[9]

5 Tax rates on capital gains and dividends haven't been hiked.

In 2011 and 2012, the long-term capital gains rate is

- 0% for taxpayers in the 10% and 15% brackets.
- 15% for everyone else.[4]

6 Traditional IRA owners who go Roth this year can't defer income resulting from the conversion into subsequent tax years.

In 2010, you had that option; this year, you don't. If you went Roth in 2010, you have until October 17, 2011 to choose whether you wish to divide the income from the conversion between your 2011 and 2012 federal returns.[4]

7 High earners won't be bitten by "stealth income taxes" during 2011-2012.

The Pease and PEP limitations – repealed for 2010 – are now on holiday through 2012. A quick explanation if you've never heard of them: the Pease provision cancels out up to 80% of the amount of a taxpayer's itemized deductions if his or her AGI exceeds a certain level. In other words, you can deduct the full amount of your itemized deductions in 2011. The PEP (personal exemption phase-out) whittles away at the personal exemption benefit for taxpayers who reach certain AGI levels.[4,10]

8 The charitable IRA rollover is back – at least for 2011.

In federal tax law, this is known as a Qualified Charitable Distribution – a tax-free donation of IRA proceeds to a qualifying charity or nonprofit. Given the generous $5 million individual estate tax exemption now in place, there may be less impetus to make such gifts – but nonprofits are just glad the opportunity is back.

To be tax-free, the donor must be 70½ or older and the donation has to take the form of a direct transfer (a rollover) from your IRA trustee to the qualifying charity, nonprofit foundation or nonprofit organization. (You can also make a tax-free donation of IRA proceeds to a fund held by a community foundation, but not a donor-advised fund.) You cannot claim a charitable tax deduction from this move.[11]

Will this opportunity stick around after 2011? We don't know. It is set to sunset at the end of the year.

- The Tax Relief Act of 2010 gives donors who make such Qualified Charitable Distributions before through January 31, 2011 the option to have them treated as QCDs on their 2010 federal tax returns.[11]

9 The Small Business Jobs Act of 2010 extended some tax breaks and put some tax changes into play for small companies in 2011.

The SBJA was passed into law during September 2010, and its recently enacted laws will affect both 2011 and 2010 federal returns.

- **Full business expensing is permitted for 2011, just as it was in 2010.** The IRC Section 179 expense deduction limits of 2010 remain in effect this year. A small business can write off 100% of the expense of qualifying equipment or computer software made in 2011 with a $500,000 limit. The capital expenditures can be on new or used equipment. Your company has to be profitable in order for you to take full advantage of the write-off, and you can't take complete advantage of it if you have spent more than $2 million on qualifying capital in the given tax year.[12,13]

- **100% exclusion possible on gains from small business stock.** If you bought such stock after September 27, 2010, any gain may qualify for a 100% exclusion under IRC § 1202.).[13]

- **The bonus first-year depreciation has been extended.** If your company purchases new tangible or intangible property in 2011 (which includes buildings, machinery and equipment, vehicles, furniture, software and even patents and copyrights), your company can claim 100% of its cost as long as your business uses the property before 2012. This 100% depreciation also applies for tangible or intangible property bought after September 8, 2010. You can also claim 50% depreciation on purchases of this kind made from January 1 - September 7, 2010 as long as the tangible or intangible property is put into service prior to 2013. (Real property is not eligible for this tax break.) [12,13]

- **The deduction for start-up expenses has doubled.** The Small Business Jobs Act of 2010 raised it to $10,000 for 2010 and subsequent tax years. Phase-outs on this deduction now kick in at $60,000 worth of startup expenditures (previously, it was $50,000).[13]

- **Some businesses may be able to claim a major health care tax credit.** Does your business have 25 or fewer full-time employees? Are you paying most of them less than $50,000 annually? Do you pick up the tab for 50% or more of their health insurance premiums? If so, you may be able to deduct up to 35% of the money you spend on those premiums in tax years 2010-2013. To get the full 35% credit, you must have 10 or fewer full-time employees with annual wages averaging $25,000 or less. Above that, phase-outs apply. The tax break is unavailable if you have more than 25 full-time employees or if you pay your full-time employees average wages of more than $50,000.[12,13]

- **The carryback period for eligible small business credits under IRC § 38 was extended from 1 year to 5 years.** This was put into effect for the 2010 tax year. Such credits may be used to offset both regular tax liability and AMT liability.[13]

- **The depreciation deduction has increased for business-owned vehicles.** The SBJA increased the maximum deduction for a passenger automobile first placed in service in 2010 to $3,060. The maximum deduction for a truck or van first placed in service in 2010 increased to

$3,160. Remember that the car or truck has to be totally used for business purposes to take full advantage of the deduction.[14]

- **In 2011, the holding period for S corporations is reduced by 2 years.** The SBJA cut the holding period from 7 years to 5 years for 2011. So if your C corp elected to convert to an S corp as recently as 2006, it can sell appreciated assets this year without paying the built-in corporate level tax. This provision only applies in TY 2011.[15]

10 Employers must begin reporting employee health care benefits on Form W-2 in either 2011 or 2012.

This is an effect of the Affordable Care Act. For informational purposes, employers are now required to report the value of the health insurance coverage they offer to employees on W-2s. The IRS is offering employers a one-year grace period, however: it has deferred the reporting requirement for TY 2011, so this year it is optional. Reporting the value of the health care coverage to the IRS will not affect the taxable income of your employees.[16]

11 Landlords must abide by new IRS reporting requirements.

Prior to 2011, only full-time property managers and some lessors had to file 1099 forms with the IRS as a consequence of doing business. The Small Business Jobs Act of 2010 changed that.

Anyone who receives rental income in 2011 has to file a Form 1099 for all payments of $600 or more made to service providers – handymen, plumbers, carpenters, landscapers, electricians, any individual or company providing a service linked to your residential or commercial rental property. You don't need to file 1099 forms for purchases of goods for your rental property, only services. Only aggregate annual payments of $600 or more for services have to be reported.

Unless Congress intervenes, such reporting will be demanded of all businesses, self-employed individuals and independent contractors come 2012.[17]

12 The first-time homebuyer credit is gone.

It expired at the end of September 2010. You can take advantage of the credit on your 2010 federal return if you closed escrow on a home before October 1, 2010 and had a binding contract in place prior to May 1, 2010.[13]

13 The personal exemption and standard deduction amounts have (barely) increased.

For 2011, the personal exemption amount increases by $50 to an even $3,700. Standard deductions are as follows for 2011:

- Single Taxpayers: $5,800
- Married Filing Separately: $5,800
- Head of Household: $8,500
- Married Filing Jointly or Qualifying Widow/Widower: $11,600[2]

14 The AMT has again been patched.

As part of the Tax Relief Act of 2010, the Alternative Minimum Tax exemptions were increased to these levels for 2011:

- Single Taxpayers and Heads of Household: $47,450
- Married Filing Separately: $36,225
- Married Filing Jointly or Qualifying Widow/Widower: $72,450[18]

15 The self-employed may be able to use the self-employed health insurance deduction to reduce their SECA taxes in 2010.

This was a mid-year tax law change that happened as a result of the SBJA. For TY 2010, self-employed business owners may deduct the cost of health insurance for themselves and their family members as a business expense when calculating self-employment tax. (You can do this on Schedule SE, Line 3.) Prior to 2010, the self-employed could only deduct health insurance costs for income tax purposes (on Form 1040, Line 29). A worksheet on all this accompanies IRS Form 1040. The health coverage must be arranged under the umbrella of your business, and you must not be eligible to participate in an employer-sponsored health plan.[18]

16 If you have a Flexible Spending Account, you can no longer use your FSA funds to pay for most over-the-counter medicines.

Insulin is a notable exception to this new rule. You can still use your FSA money for non-prescription medical or medically related items like crutches, wigs, contact lens solution and other items detailed within IRS Publication 502.[4]

17 Investment brokers have to provide the IRS with cost-basis reporting in 2011 when it comes to the sale of certain assets.

They must report the original purchase price of stocks, REIT shares and foreign securities to the IRS in 2011 when these assets are sold. In 2012, they will have to follow new rules for cost-basis reporting for mutual funds, bonds, options and many ETFs.[4]

18 If you own more than $50,000 in foreign financial assets, you may be subject to a new IRS reporting requirement.

You may have to meet additional reporting and disclosure requirements in 2011 in addition to filing an FBAR (Report of Foreign Bank and Financial Accounts). This new reporting requirement may impact hedge fund investors who previously didn't have to file FBARs. Consult your tax advisor.[4]

19 The state and local sales tax deduction option is back for 2011 (and you can also claim it on your 2010 return).

Do you live where there are no local or state income taxes? Once again, you have the choice of taking a deduction for state sales taxes instead of the state income tax deduction for 2011 (and 2010).[18]

20 The $250 classroom supplies deduction for teachers is back for 2011 (and may be claimed for 2010).

Are you a K-12 educator who pays for classroom expenses out-of-pocket? Then you are able to take an above-the-line deduction to offset up to $250 of such costs.[18]

21 The higher education tuition and fees deduction is back for 2011 (and may be claimed for 2010).

The limit on this deduction is $4,000. (And if you're reading this item, don't forget about the American Opportunity Credit, a credit of up to $2,500 that can be used for the first four years of college and applied to the tuition costs and other higher education expenses.)[18,19]

22 The adoption credit is larger – and it has been made refundable.

As you file your 2010 return, note that it is now $13,170 per child as opposed to $12,150 in 2009. As it is refundable, an eligible taxpayer can qualify for the credit even if he or she doesn't owe any federal income tax. The adoption must be documented, so that means you can't claim this credit via eFile.[18]

23 The Earned Income Tax Credit eligibility limit has increased to $48,362 and the Child Tax Credit has been expanded.

The result: more middle class and working class families may qualify for these credits. The CTC is a credit of up to $1,000. Under the new laws, you can claim the CTC if a child was no older than 16 in 2010 lived at home for more than half of 2010, and is claimed as a dependent on your 2010 federal return.[19]

24 If you bought a home in 2008 or 2009, you may have to repay up to 100% of any federal homebuyer credits related to the purchase on your 2010 Form 1040.

This is more likely if you bought your home during 2008. Most taxpayers will merely have to repay 1/15 of their credit in 2010. Consult your tax advisor.[20]

25 Most unemployed individuals will have to report 100% of their 2010 federal jobless benefits as taxable income.

Not everyone who is unemployed realizes this. In 2009, the first $2,400 of federal unemployment insurance came to you tax-free. There was no such tax break offered for 2010.[20]

26 No more real estate tax deduction for those that don't itemize.

This is just a reminder that you can't claim this deduction on your 2010 federal return. The additional standard deduction for property taxes went away at the close of 2009.[20]

27 No more sales tax deductions for buying a new car or truck.

You won't be able to claim these tax breaks for 2010, as they faded away at the end of 2009.[20]

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