

TAX NEWS & TIPS

FALL 2011

Budget "Deal" Made

As I write this, Congress has just made a "deal" on debt limits and the Federal budget. Since few tax laws are mixed in, I've decided to get this issue to the printer. Congress is still talking about major tax reform, but few expect this until next year. For now, there are several important areas I'd like to cover.

Tax Tune-Up

2011 ends in a few short months. This is a good time to ask yourself, "How am I doing?"

Are you safe to presume things will be similar to 2010? Or, has your income or withholding changed by a significant amount?

Check Income First. Any significant change in income can have a big impact on your tax bill. Our "graduated" tax rates can fool you. Sometimes a 10% income jump can cause a 20% increase in your tax bill. If your wages increased, you also have increased withholding. Probably no big surprise. But, if there is income I wasn't told to expect, give me a call. I'd like to give you an early warning. No need to wait until next March or April.

Unscheduled Income? Look for unemployment benefits, starting to collect social security or pension income, the sale of an investment property or rental.

Life-Situation Changes. Did you marry or divorce? Is there a new child? Changing how you "look" to the government can cause a big tax surprise. A job change, sale of your home, a move, starting or stopping work, a new business. Alert me to any such changes.

Withholding Changes. Did your "take-home" change abruptly? Each year I meet a couple of people who had a withholding change – they didn't request a change in status, but there was a slip-up in the payroll department. Don't wait until next year. Call me right away!

When You Call Me. I work for a living, too. My fee is related to the work I do for you. Please don't be afraid to call. If *both of us* have realistic estimates of your position, we'll *save* time overall. Please have full details so we can work quickly and accurately. I'd like to think we *each* reach December with a pretty solid idea of where you stand. If either of us is surprised by the final results, *one of us* dropped the ball!

Top 10 Tax Savers

For weeks all the news was about Congress working to pass a debt package. Clearly we have a budget problem. We face record deficits. To fix a deficit you either decrease spending or increase revenue.

Most people believe we'll see some of both. Revenue is closely related to our tax laws. Whenever Congress reviews tax laws, they look at statistics given by the Treasury Department. Each year these list the biggest tax savers (revenue losers). It's always tempting to start where the biggest reward lies.

Here are the biggest tax savers on the Treasury list back in April:

- 1. Employer-Paid Health Care** is the biggest revenue loser. If the cost was taxed to employees - - -
- 2. Mortgage Interest Deduction** ranks second in helping us lower our income tax bills.
- 3. Retirement Plans** let you put aside money and pay the tax later.

Paying the tax now would give a big boost to revenues.

4. Lower Rates On Capital Gain.

5. Lower Rates On Dividends.

6. Earned Income Credit. This gives refundable tax credits (direct refunds) to lower-income families with children.

7. Child Tax Credit knocks up to \$1,000 off your tax bill for each child under 17 years of age.

8. Medicare Benefits often cost more than retirees pay in premiums. The government pays the excess.

9. Charitable Contributions are time-honored deductions. They also mean big losses in revenue.

10. State/Local Tax Deductions round out the top ten.

Would Congress attack any of these? I can't say. Hard choices lie ahead. Removing any of these would not be easy to sell to Americans. All I'm saying is – whenever Congress sits to discuss revenue, the most recent version of this list pops up.

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Mileage Deductions Add Up Quickly!

IRS allows a simple “cents per mile” method for claiming mileage deductions. Most folks use this simple allowance.

As 2011 began, IRS had set the allowance at 51¢ per mile. Recently IRS says we may use 55.5¢ for miles after mid-year. This leaves us with a problem. You must segregate the two halves of 2011. But, notice the *size* of the possible deduction - - -

100 Miles – Deduct Over \$50!

If you have deductible driving, your deductions add up quickly! Driving you forget to claim is costly. If you forget to claim 10 miles per week this year, you just lost a deduction of more than \$250!

Who Can Claim Miles? Driving must relate to your trade or business, investments, or to charity. Personal driving never gives deductions.

Self-Employed & Landlords get full value for driving related to the activity. Don't miss any!

Job, Investment, & Charity. You must be able to itemize your deductions to benefit. Driving for job or investments also has a “floor” of 2% of your income before you get a benefit from mileage deductions.

Commuting is any drive between home and a business site. For trade or business driving IRS uses special rules. To find deductible drives, they distinguish between “regular” and “temporary” business sites. This depends on how often you do it:

“Business” Sites are any places you have a legitimate business reason to visit. Besides your regular work location, think of special meetings, workshops, buying supplies, visiting clients or customers, and so on. These are all “business” sites.

“Regular” Sites are ones you visit 35 or more times in a given year. This commute is *not* deductible. Most folks have a single “regular” business location, some have more.

“Temporary” Sites are ones you visit fewer than 35 times a year. A drive between home and one of these sites *is* deductible.

Business-To-Business driving is always deductible. Leave work to visit a customer or make a delivery, and then return to work – you have

Where Do Your Tax Dollars Go?

A special White House announcement back in April offers to help you understand how your tax dollars are spent. They built a little calculator you can see at www.whitehouse.gov/taxreceipt. You enter the amount you paid in 2010 and you get a “receipt” showing how much went to various items.

You can also look at five “types” of taxpayers, such as a married couple with \$50,000 of income and one child, or a single parent with \$60,000 of income and one child.

The calculator reveals important information about our nation's budget. It says 26.3% of all income tax payments we make goes to national defense, 24.3% to health care, and 21.9% to job and family security. These “top three” account for 72.5% of America's total budget.

Far smaller amounts go to other purposes. Interest on Treasury securities (which is most of the cost of our “national debt”) accounts for 7.4% of our taxes. Veterans benefits use up another 4.1%, education and job training got a little bit more, 4.8%. Foreign aid and other international programs consume only 1.7% of our tax payments. National disaster response was allotted only 0.4%. Last, but not least, I noticed the figure for immigration and law enforcement (this is where IRS draws its enforcement budget!) consumed only 2% of our taxes.

deductible driving. Some employers reimburse for this driving at the same rate allowed for deductions, currently 55.5¢ per mile.

Plan Your Driving – You Win! Suppose you need supplies or tools from a store 1.5 miles from home.

Saturday – Wrong! If you run out Saturday morning to get these, you can deduct the 3-mile round trip. Each trip is between your home and a “temporary” business-purpose site.

Along The Way – Right! If you stop on the way to or from work, you drive two legs of a triangle: One between work and a temporary site, one between home and a temporary site. *Both legs are deductible!* One is “business-to-business”, the other is a commute for a “temporary” site. Suppose you normally drive 12 miles to work. Today, the “triangle” made you drive 13 miles. You deduct for 13 miles of driving, not just 3 miles! And – it's *legal!*

Charity & Investments. IRS allows all legitimate driving for these purposes. If you read to children at the library every Saturday, deduct each trip, even though you have more than 35 visits. Driving for charity has a single drawback – you only get to deduct 14¢ per mile.

Not For Everyone. The rules I've discussed apply to most folks, but not all. Different rules come into play in three special cases:

(1) More liberal rules apply if you can say your home is your “principal

place” of business. (2) Tougher rules apply if you have no “regular” work location. (3) Very strict rules apply for folks who have no “tax home”.

If you think one of these might apply, please call me. I'll need to ask lots of questions to be sure you fall into one of these groups, and I'll be happy to explain the rules.

Records Are Essential. Mileage deductions demand *written* records! Best is to keep a log of some sort. This can be a simple pocket calendar, a little booklet for recording such trips, or even notations on a business planner. A thorough log lists date, purpose of the trip, location, and odometer readings.

Constructive Laziness is a good way to think. Find the least difficult way to keep records. Is there a calendar or planner you use regularly? If so, adapt it to also give records of driving. For sites you visit often, give odometer readings once or twice, then simply count the other visits. When visiting several sites in succession, you only need to record the beginning and ending mileage. When there is a deductible expense connected to the trip (for example, you bought tools) the receipt is proof of the trip. You could note the other legs of the trip right on the receipt.

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Back To School? Maybe Big Savings!

Several tax laws help cut the cost of education expenses. The biggest benefits apply for college courses. Rules are confusing, but if you have records for all expenses, I'll see to it you get the largest possible savings.

Pre-College – Coverdell ESA.

The only tax breaks given for the costs of primary and secondary school go to folks with Coverdell Education Savings Accounts (ESA). These are similar to an IRA. Your money grows tax-free. When you withdraw funds, Form 1099-Q is sent, showing the total distribution, and the amount of growth which was never taxed. You must be able to show you paid education expenses equal to the full withdrawal, else the growth is now taxed, and a stiff 10% penalty applies.

Undergraduate College. There are 3 different tax laws I can use to help you save on college costs. The most beneficial can give you a dollar-for-dollar rebate on the first \$2,000 spent, plus 25% of the next \$2,000! I'll need information on the student, and on two groups of expenses.

Student. Who took the classes? You? Your spouse? One of your children? Any of you might qualify. Usually the parent gets the benefit of a child's expenses, but I'll need full details on the youngster's income to be sure who gets the benefits. Warn the youngster not to file a tax return until we're certain who gets the tax savings. Special rules apply for children of divorced or separated parents. If I know the facts before anyone files a return, I'll help you get the maximum benefit.

Tuition & Fees. Schools report actual fees on Form 1098-T. NOTE: the form is sent to the *student*, even though the tax savings normally go to the parent. Have the student watch for the form. It shows total tuition and fees. Parking costs, insurance, and other fees not related to actual coursework are not counted. The fees must be reduced by any grants or scholarships reported on the Form.

Look for other costs, too. Many courses demand a computer, and its cost may qualify. Also, look for special software needed to submit

What Do Others Claim?

IRS publishes data on our tax returns each year. A few months ago they gave figures for the 2009 income tax returns. You can find data for several years' returns at www.irs.gov. Search the term "tax return statistics".

IRS says we filed just over 140 million returns reporting \$7.6 trillion of adjusted gross income and \$5.1 trillion of this was "taxable income". Both figures were more than 7% lower than for 2008. The decline is no surprise, in view of our current economic recession.

Most income categories declined. Wages and salaries dropped "only" 3.7%. Capital gains dropped a whopping 46%, and capital gain distributions (you see these from mutual funds and regulated investment companies) were down nearly 90%! Dividend income dropped 22%, and interest nearly 25%.

At the IRS website, you can even see people's average deductions grouped according to their adjusted gross income. For instance, folks in the \$20,000 - \$50,000 range deducted \$3,943 of taxes and \$2,274 for charity. The \$50,000 - \$100,000 group claimed \$6,247 and \$2,775, respectively.

However, 65.8% of all returns used the "standard deduction", so their figures are not included. Looking at this number another way. Only 34.2% of Americans are able to "itemize" their deductions,

The largest deduction? Interest deductions head the list, at 36.7% of all deductions. Deductions for taxes came in second at 35.8%. Contributions accounted for 12.6%, and medical deductions were just under 7%.

Total income tax liability (what we really paid) was \$868 billion. It was just over \$1 Trillion in 2008!

If you check these out, be wary! IRS does not enforce "averages". *You* can claim what your records show!

required papers. If this is the case, we may be able to add some of the on-line fees. Art and/or science classes can require many additional supplies. Track them!

Student Loans. You may have paid these fees with a student loan, in your name, or in the student's name. Even though you took a student loan, the fees were still paid! You are fully entitled to the tax benefits. Be sure to keep the records!

Tax Benefits & 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.

Graduate Courses. A couple of benefits can apply, but the savings

are not as large as for undergrad expenses. Only Tuition & Fees may be counted. Worse, income limits might eliminate your savings. But, if you have the information, I'll see to it you get the maximum benefit.

Job-Related Courses. Courses to "maintain or improve job skills" open another possibility. If you itemize your deductions, we may be able to claim *all* the costs for your classes. We can even claim an allowance for the mileage to go to and from classes.

Individual classes, even at "trade schools" can be claimed. Courses to qualify for a new occupation won't count here. Degree programs are tricky. IRS tends to think any new degree automatically opens the door to new occupations.

Keep The Records! Education benefits can be very valuable. Please keep records carefully. If the courses are taken by your child, you are most likely the one to benefit. Encourage the student to keep records of costs beyond the fees paid to the college.

As I've said, the actual rules are too complex to discuss here. If I know the details of the student, the courses, and the costs, I can compare the alternatives and secure the biggest possible savings for you.

Tips For You

Social Security Projections. The social security system is not really a pension. Workers pay into to the system. Benefits are paid when you reach "retirement age". The problem – record numbers of Americans are reaching that age. The system also pays others – certain spouses, the handicapped, and more. Thus, each year more is paid out. Total benefits are rising more rapidly than pay-ins. Those who work are asked to pay more and more.

How Much You Pay. Since the 1970s our payments into social security are in two parts. We pay a little over 6% into the "retirement" side, and 1.5% into the part covering medical benefits (Medicare). The employer *matches* these amounts.

Wage Base. You always pay the 1.5% for the medical coverage. The larger (over 6%) part stops in any year when your income passes the "wage base". This is indexed each year. Look how the wage base has progressed over the years:

| Year | Wage Base |
|------|-----------|
| 1960 | \$4,800 |
| 1970 | \$7,800 |
| 1980 | \$25,900 |
| 1990 | \$51,300 |
| 2000 | \$76,200 |
| 2010 | \$106,800 |

The numbers reflect the increased needs. Preliminary estimates say the figure for 2012 will be \$110,700.

Summertime Day Care. Special tax credits help out working parents. During the summer months you may have taken advantage of special "day camp" activities for the youngsters. These can qualify for the credits. Warning: The activity cannot be seen by IRS as *education*. Look out for programs normally included in the school curriculum. Fun and games are fine. Same for activities aimed at enriching the child's background. Museum, art projects, and wildlife programs are examples. But some of the computer camps or math skills tune-ups can be seen as little more than summer school. A couple of reminders for you:

Provider I.D. To claim your tax credits we need to give complete name, address, and (in many states) telephone numbers for the provider. I'll also need the "Tax I.D. Number". Ask before you lose all contact with the sponsoring group.

Overnight Camps cannot be claimed. No overnight stays.

Over 70½? IRA To Charity. 2011 is the last year for a special tax break. Folks over 70½ must take money each year from their IRAs. For larger contributions consider this: Have the IRA *custodian* send your contribution directly to the charity. On your return we'll be able to deduct the contribution from your income, with no need to claim an itemized deduction. This reduces your income, and usually saves more

in tax than claiming a deduction.

The custodian will charge a small fee for this service. You would use this technique only for larger gifts.

Extensions Expire October 15.

A few of you still have not filed for 2010. Please make an effort to find the missing information. We have little time left. In most years I am not quite as busy this time of year. 2011 is very different! I expect more planning work with clients affected by new laws. Most important, I want to give my full attention to your return, and to keep your tax bill to the absolute minimum.

We don't seem to be able to check crime, so why not legalize it and then tax it out of business?

Will Rogers

Your Tax Calendar

| | |
|----------|--|
| Sept. 15 | 3 rd quarter estimated tax payments due. |
| Oct. 17 | Extensions to file 2010 Form 1040 expire. |
| Nov. 1 | 3 rd qtr. payroll returns due. (Nov. 10 if tax paid in full and on time.) |
| Dec. 31 | Last chance for deductions in 2011. |
| Jan. 15 | 4 th quarter estimated tax payments due for 2011. |