TAX NEWS LETTER 2010

By Stephen B Smith CPA

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For the most part, tax laws and rates are essentially the same in 2010 as they were in 2009. However, congress did pass some new tax laws in a continuing effort to "stimulate" the economy.

A summary of the more important law changes are as follows:

2010 New tax law additions:

- Health insurance premiums paid for a self-employed business owner are now deductible as an ordinary expense on Schedule C (Form1040)

- For higher income earners, the limits on allowed itemized deductions and personal exemptions have expired.

- Small business health care tax credit – Provides a tax credit for small business employers (less than 25 full-time employees or equivalents) who provide employer provided health care premiums

- Hiring incentives to restore employment act (HIRE) – a two part tax benefits are offered:

    - First to create tax incentives for employee hiring by giving employers a credit on the 6.2% social security tax paid by them and

    - Secondly, a retention tax credit up to $1,000 per employee that stays on the job for a continuous 53 week period.

2011 new and updated tax law changes:

- Social security tax rate reduction from 6.2% of taxable wages to 4.2%. As a result, all employees should see an immediate small increase in net pay.

On-going provisions:

- Educator expenses are deductible above the line (AGI) through to and including 2011

- Special 0% tax rate on capital gains and dividends received for low income taxpayers continues in 2010. Maximum rate remains capped at 15%.

On-going provisions - *continued*:

- Residential energy allowed tax credits but is limited to $1,500 for combined amounts in 2009 and 2010 and $500 total in 2011.

- Making work pay credit for both 2010 and 2011

- Education credits expanded under the "American Opportunity Credit" – which allow unused tax credits to be refundable maybe made permanent in 2011

Discontinued, expiring provisions for 2010:

- Unemployment Compensation – For 2009 only, the first $ 2,400 of unemployment income received was exempt from federal tax.

- Increased standard deduction for real estate taxes paid

- New car purchase special excise or sales tax deductions for autos purchased in 2009. However, taxes are deductible if paid in 2010

- Homebuyers credit for first time and existing new residence purchases for contracts before May 1, 2010 and actually owned by October 1, 2010.

Federal Facts and Rates:

- **IRA deductions** - Allowed contribution for 2010 and 2011 continue as $ 5,000 per person ($6,000 if aged 50 or over).

- **Mileage deduction standard rates** –
  - Business: $0.51 cents per mile for 2011, $ 0.50 in 2010
  - Medical care and moving expensed: $0.19 cents per mile in 2011and $16.5 cents per mile in 2010
  - Charitable remains the same at 14 cents per mile

- **Standard deduction** – 2009 and 2010: filing joint is $ 11,400 each, $ 8,350 head of household and $ 5,700 for single or filing separate.

- **Personal exemption** - 2010 exemption will be $ 3,650 and $ 3,700 in 2011.

- **Gift Tax exemption** limited to $13,000 in 2010 and 2011

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Steve's Tax Corner:

Topic 1 – What tax bracket am I in?

I have heard from many taxpayers the comment, what tax bracket am I in? To answer that question is to first ask what does the term mean and how does it affect my tax calculation.

We currently live in a country that has a progressive (as opposed to a flat tax) tax system. Under this approach, taxable income reported on a personal return is categorized into "brackets" of increasing amounts each with its own tax rate. Under our current system, our income is taxed at six different rates: 10%, 15%, 25%, 28%, 33% and 35%.

A progressive system requires that tax rate will increase and be applied growth in taxable income. Therefore, taxpayers with higher taxable income will pay more in income tax than individuals with little taxable income. The idea is that the more taxable income a person has the more disposable cash a person has to pay more of the required tax.

Taxable income in the lowest bracket is currently taxed by the lowest rate, 10% followed by 15%. Other rates include 25%, 28% 33% and the highest rate 35%.

To further explain the situation, I will use the following example of a married couple filing a joint return with $ 120,000 of taxable income.

2010 Married tax brackets are as follows:

Taxable income	Tax rate applied	Taxable income	Calculated tax
$ 0 – 16,750	10%	$ 16,750 (1)	$ 1,675 (10% times $ 16,750)
16,751 – 68,000	15%	51,250 (2)	7,688 (15% times $ 51,250)
68,001 – 137,300	25%	52,000 (3)	13,000(25% times $ 52,000)
137,301 – 209,250	28%	0	0
209,251 – 373,650	33%	0	0
Over 373,651	35%	0	0
Totals		$ 120,000	$22,363

(1) $ 16,750 minus 0
(2) $ 68,000 minus 16,750
(3) $ 137,300 minus 68,000

Your tax bracket is defined as the highest rate that your income is taxed. In the above example, the couple is a 25% federal tax bracket.

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The importance of this fact is that the next dollar of taxable income the couple receives will have a rate of 25% tax rate applied. For example, should the couple in the above example receive an additional taxable pension distribution of $ 20,000 (total taxable income in now $140,000), the corresponding tax owed on these new monies would be $ 5,000 ($20,000 increase times 25%) resulting in a total tax of $27,363

Accordingly, knowing what tax bracket you are in will help in tax planning for changes in income.

A few additional comments:

(1) Notice that I said "taxable income" and not adjusted gross or total income as only income after all deductions is considered in the tax computation

(2) Realize too that multi-millionaires are being tax at the same rate as individuals with modest income!

(3) Bracket amounts for single individuals is exactly one-half the amounts for married, joint returns in an effort eliminate any "marriage penalty".

(4) The "*effective rate*" is simply the average of the tax bracket rates, weighted. In the above example, the effective rate is 18.6% ($ 22,363 divided by $ 120,000)

(5) The same rationale can be applied to state tax rates and brackets. In Maine we have four tax rates: 2%, 4.5%, 7.0% and 8.5% with corresponding income amounts.

Some of you might be confused (as I was) at rhetoric recently about congress and the president "reducing" income tax rates by keeping them the same as in 2010! The answer is that in the years prior to 2001, federal tax rates were much higher than they are now. Then, under President George Bush together with an all republican congress passed legislation that reduced overall rates to the six we have now including the establishment of a new 10% bracket. By law, these tax rates were to revert to the higher rates in existence for years beginning January 1, 2011. However, given the state of current recession, congress passed laws to keep the current rates from changing. This was the reduction!

I hope this information has been helpful. I look forward to hearing from you again this year!

Sincerely,

Stephen B. Smith, CPA