TAX NEWS LETTER 2011

By Stephen B Smith CPA

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For the most part, tax laws, deductions and rates are essentially the same for 2011 (and in 2012) as they were in 2010. Legislation for 2011 was exemplified by the term “tax extenders” re: deductions and credits set to expire at the end of 2010 that have been “extended” for another year or two.

For tax planning purposes, you have to look at 2013 as the next year of big tax changes. As many of you know, the Bush “tax rate” changes phased in over the early years of 2001 to 2007 where set to “sunset” or expire on December 31, 2010. The result would have been significant 2011 tax costs for every American had these rate reductions been allowed to expire. Given the “great recession”, congress and the President finally restored these cuts for two more years ending on December 31, 2012. Having said that and what with 2012 being an election year and a looming deficits can only mean significant tax changes for the 2013 year.

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

2011 tax law extenders:

- Employee wage Social security tax rate reduction from a prior 6.2% to 4.2%.
- Favorable capital gain tax rates
- Higher exemption amounts for the alternative minimum tax provisions
- Option to report and an itemized deduction the higher of state sales or income taxes
- Qualified mortgage premium insurance
- Tuition deduction or tax credits on higher education payments allowed
- Classroom expenditures paid by teachers with a maximum deductible of $ 250 each
- 10% Residential energy credit available but capped at $ 500 lifetime
- Tax –free distributions form qualified IRA plan assets contributed to charitable purposes

2011 retiring tax law changes:

- Health insurance premiums paid for a self-employed business owner are now NOT deductible as an ordinary expense on Schedule C (Form1040)

<u>2011 retiring tax law changes - *continued*:</u>

- Health insurance premiums paid for a self-employed business owner are now NOT deductible as an ordinary expense on Schedule C (Form1040)
- Making work refundable tax credit of $ 800 joint workers ad $ 400 for single is no longer
- First time home buyer credit on new home purchase with a few exceptions

<u>Federal Facts and Rates:</u>

- **<u>IRA deductions</u>** - Allowed contribution for 2011 $ 5,000 per person ($6,000 if aged 50 or over) of "earned" (wages, self-employment, alimony) income.
- **<u>Mileage deduction standard rates</u>** –
  - Business: $0.51 cents per mile through June 30th, $ 0.555 thereafter
  - Medical care and moving expensed: $0.19 cents per mile June 30th, $ 0.235 thereafter through December 31, 2011
  - Charitable remains the same at 14 cents per mile
- **<u>Standard deduction</u>** – filing joint is $ 11,600, $ 8,500 head of household and $5,800 for single or filing separate.
- **<u>Personal exemption</u>** - will be $ 3,700 in 2011.

<u>Steve's Tax Corner:</u>

<u>Topic 1 – Pay-off debt or pension contribution?</u>

Some of you have excess cash which can be either put into a pension plan or used to pay off existing personal debt. My opinion very clearly is that paying off personal debt where possible from a tax planning point of view makes the most sense. What with the stock market remaining a "risky" plan at best and with bank interest being at their lowest makes investment decisions are difficult. Yes, we all need to keep some money available (in a bank savings account) for every day cash flow needs. However, the "quality" of an interest deduction never outweighs the tax benefit received. Currently there are only four types of interest payments that are deductible. I have listed them below in order of quality with the first one being most valuable tax benefit-wise:

Topic 1 – Pay-off debt or pension contribution - continued?

1. Business interest – corporate, self-employed and apartment debt the most valuable
2. Student loan interest – limited to $ 2,500 for low income earners next valuable
3. Investment interest - on monies borrowed limited to investment income
4. Mortgage debt – home residence least valuable

Notice how car loans and credit card payments are not mentioned; not deductible. Therefore, I suggest, where possible to pay-off theses debts in this order

Topic 2 – Discharge of indebtedness – From 1099-C

With the "great recession" affecting many of us, some have opted to seek debt reduction through forgiveness of credit card obligations and the like. Please be aware the forgiveness of debt income from whatever source is **fully taxable** under the tax code.

Commentary – Flat tax rate

I continue to hear from many of you that may agree with current Republican candidates or office that a "flat tax" is the only way to simplify the federal tax code. Please be aware that a flat tax will only reduce the current graduated tax rates from six to just one. A "flat tax system" does not in any way reduce the volumes of tax code required to make our tax system "fair". Our tax system is currently based on "ability to pay". As a result, the tax code contains numerous provisions that define what "income" is and what is allowed as a deduction and these can be complex. Such rules create "fairness" in the law so that all Americans treated equally. Then again, our "free enterprise system" allows for other types of entities to be formed. What about partnerships, trusts, corporations and self-employed businesses? These entities are all different and yet to be treated "fairly" the rules must be the same for each so that one type has no advantage over another.

Creating flat rate system would only reduce tax rates on the wealthy while increasing rates on the poor (an average rate is necessary). Such a change would enhance the differences between rich and the poor in our society.

To simply the "tax code" would necessitate a simplification of our American way of life. As such, freedoms we now enjoy would be eliminated.

My opinion is that if you want taxes for EVERYONE to be reduced, poor and rich alike, then the focus of our political system must be on REDUCED SPENDING.

A flat tax only benefits the wealthy…….

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

Sincerely,

Stephen B. Smith, CPA