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2011 TAX CHANGES & TIPS

Office News

Happy New Year to All! 2011 was a year of transition at our office while we welcomed Chris Baier and her clients to our firm. I feel it went very smoothly due to our excellent and efficient staff.

While we expect refunds this year to be \$400-\$800 lower due to the expiration of the "Making Work Pay" credit at the end of 2010, we are always here to help you get the biggest refund or pay the smallest amount possible. Thank you for your continued business and referrals. We look forward to seeing you again this year!

Claudia, Amy, Nickie, Hillary, Sue and Chris

Additional Changes Coming?

More than ever, year-end tax planning for 2011 was done in a highly uncertain legislative environment. The President and Congress are still discussing numerous proposals designed to stimulate the economy. Also, before year-end, the Joint Select Committee on Deficit Reduction was supposed to recommend major tax reforms for 2012 designed to reduce the deficit.

The only thing that passed before December 31st was an extension of the "Payroll Tax Holiday" until February 28th, 2012. This "holiday" gave us a 2% reduction on Social Security Tax withheld from payroll checks.

Remember this temporary tax reduction replaced the "Making Work Pay" credit which expired at the end of 2010. The result of this will be a decrease to nearly everyone's refunds this year ranging from \$400-\$800.

Congress also must decide on whether to extend the alternative minimum tax patch and the post-2012 expiration of the Bush-era income tax cuts including tax rates for ordinary income and long-term capital gains and qualified dividends.

Finally, the US Supreme Court is probably going to rule on health care reform by June of 2012. This could have a major impact on future tax rules, because at least 42 of the 514 Affordable Care Act provisions add to or amend the Internal Revenue Code. Given this politically charged environment, anything is possible. Deficit spending has become a major political issue, and the days of automatically extending expiring tax breaks may be over.

Reminders to All - IRS & State Audits are Increasing

2011 brought more field audits (where the IRS comes to your business to look at your records) than I have seen in my 27 years of preparing taxes. Because of this I recommend that you make sure that you keep good records because gathering all of the information requested for an audit takes a large amount of effort and time, not to mention the stress and anxiety caused by the audit process. Remember: No Records = No Deductions!

I want to alert you that the IRS is watching several areas much more carefully. Here are a few of their targeted areas:

Charitable contributions. You need to have a receipt for all donations in order to deduct them. Donations are only deductible if donated to a non-profit organization such as a church or school. Payments for raffle tickets, individuals, benefits, etc do not qualify. The value of your time and services is also not deductible.

Schedule C and F Businesses. The IRS is really starting to watch returns filed with Schedule C's & F's to determine if the activity is truly a business or a hobby. I have prepared a worksheet to be reviewed by anyone who is filing a business return. You can view it on our website at www.catcpa.net.

1099's. If you have a business or rental property you are required to file Form 1099-Misc to anyone that you pay \$600 or more to for services, rent, professional fees, etc. Failure to file these forms can result in a \$250 fine for each 1099 not filed.

Another area they are watching is **subcontractors vs. employees.** If you have a business and are paying someone who is actually an employee with a 1099-Misc instead of a W-2 as if the employee is self-employed, you are liable for a misclassification penalty of up to \$25,000!

The IRS is so adamant about these and other areas that they are imposing stiff penalties to preparers who do not get enough information to justify the deductions on taxpayer's returns. Because of this we will be asking more questions than before and/or asking for documentation as needed. This is to protect both you the taxpayer and our firm. Don't shoot the messenger!

Remember that if you receive notices from the IRS or State Department of Revenue please notify us promptly so we can address the issues; don't just ignore the notice and hope it goes away. We are here to help navigate.

Many Individual Provisions Ending December 31, 2011

According to the staff of the Joint Committee on Taxation, there are over 50 provisions that will expire at the end of 2011. Following is a discussion of some of these expiring provisions.

Unless Congress acts, take-home pay will go down by 2% after December 31, 2011. The 2010 Tax Relief Act's reduction of the employee share of the OASDI portion of Social Security taxes from 6.2 percent to 4.2 percent on the first \$106,800 (\$110,100 in 2012) of wages is scheduled to end.

In 2011 individuals have the choice of claiming an itemized deduction for state and local sales and use taxes instead of state income taxes.

Tax-free distributions by individuals age 70½ or older can be made from **IRAs for charitable purposes** in 2011. To qualify, the IRA distributions must be made directly to charities by the IRA trustee and may be made for up to \$100,000. Such a distribution, if done properly, has no income tax consequences. This special rule increases the amount of funds available for contribution to the charity by reducing income taxes payable by the IRA owner. A charitable contribution deduction is not available for the donor when using this strategy.

The **classroom expense deduction** of \$250 (\$500 if married filing joint and both spouses are educators, but not more than \$250 each) for K-12 teachers ends in 2011. Eligible educators can deduct unreimbursed expenses paid for books, supplies, computer equipment (including related software and services), other equipment, and supplementary materials that are used in the classroom.

The **mortgage insurance premium** deduction for premiums paid for qualified mortgage insurance expires at the end of 2011. The deduction is phased out starting at adjusted gross incomes greater than \$100,000 (\$50,000 if your filing status is married filing separately). Special pro-ration rules prevent a taxpayer from benefiting from prepaying these premiums.

The above-the-line deduction for up to \$4,000 of **qualified higher education expenses** is also scheduled to end December 31, 2011. The deduction is allowed for qualified education expenses paid in 2011 in connection with enrollment during 2011 or for an academic period beginning in 2011 or in the first 3 months of 2012.

The **tax credit for energy saving** (non-business) **home improvements** or for purchasing energy efficient property is ending after 2011. The credit is available for property placed in service in 2011, with a lifetime limit of \$500, of which only \$200 may be used for windows. Subject to the lifetime limits, the residential energy property costs are limited to \$300 for energy efficient building property, \$150 for any qualified natural gas, propane, or oil furnace or hot water boiler, and \$50 for any advanced main air circulating fan. Exterior windows, doors, and skylights must now just meet or exceed the Energy Star program requirements. Unfortunately, a simple list of all qualified property does not exist. However, you can check with the manufacturer and ask them for a Manufacturer Certification Statement certifying that the product or component qualifies for the tax credit.

Without an extension of the **Alternative Minimum Tax** "patch," the Congressional Budget Office estimates that an additional 20 million middle-class taxpayers would suddenly become subject to AMT. The AMT exemption amount for individuals is scheduled to decrease from \$74,450 for joint filers/surviving spouses and \$48,450 for others to \$45,000 and \$33,750, respectively, in 2012.

Sales Tax for Internet Purchases

New on your Wisconsin income tax form this year is a question specific to sales & use tax. It reads "Sales and use tax due on internet, mail order, or other out-of-state purchases. If you certify that no sales or use tax is due, check here." Therefore we ask that you consider carefully any such purchases made in 2011, and if applicable, include an amount when you fill out our worksheet.

Standard Mileage Rate

Taxpayers can use the standard mileage rate (in lieu of actual expenses) in computing the deductible costs of operating automobiles owned or leased by them (including vans, pickups or panel trucks) for business purposes. In order to be able to claim the deduction it is mandatory to have a Mileage/Travel Log. Due to higher fuel costs, the IRS increased the standard mileage rate for the second half of this year. The following rates are applicable for the 2011 tax year:

	<u>1/1/11 – 6/30/11</u>	<u>7/1/11 – 12/31/11</u>
Business	\$.51	\$.555
Medical	.19	.235
Moving	.19	.235
Charitable	.14	.14

If you are an employee you may deduct an amount computed using the standard mileage rate only as an itemized deduction, subject to the 2 percent floor on miscellaneous itemized deductions. A reminder that commuting miles are not deductible.

Looking Ahead

At present, there is no tax legislation effective January 1, 2012. However, tax increases are already set for 2013. When planning during 2012, keep this in mind. It may make sense to recognize income in 2012 instead of 2013. Tax rates should remain the same for 2011 and 2012, with ordinary income tax rates for individuals at 10, 15, 25, 28, 33 and 35 percent; capital gains rates are zero and 15 percent.

Social Security announced a 3.6% benefit increase for 2012. This cost-of-living adjustment is the first since 2009. Monthly Social Security and Supplemental Security Income (SSI) benefits for more than 60 million Americans will increase 3.6 percent in 2012. Also, the maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to \$110,100 from \$106,800.

Estate and Gift Taxes

For an estate of any decedent dying during calendar year 2012, the basic exclusion from the estate tax amount is \$5,120,000, up from \$5,000,000 for calendar year 2011.

The annual exclusion for gifts remains at \$13,000.

Retirement Planning

The elective deferral (contribution) limit for employees who participate in 401(k), 403(b), most 457 plans, and the federal government's Thrift Savings Plan is increased from \$16,500 to \$17,000. The catch-up contribution limit for those aged 50 and over remains unchanged at \$5,500.

The contribution limitation for SIMPLE retirement accounts remains unchanged at \$11,500.

The traditional IRA deduction is phased-out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross incomes (AGI) between \$58,000 and \$68,000, up from \$56,000 and \$66,000 in 2011.

For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is \$92,000 to \$112,000, up from \$90,000 to \$110,000.

For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered, the deduction is phased out if the couple's income is between \$173,000 and \$183,000, up from \$169,000 and \$179,000.

The AGI phase-out range for taxpayers making contributions to a Roth IRA is \$173,000 to \$183,000 for married couples filing jointly, up from \$169,000 to \$179,000 in 2011.

For singles and heads of household, the income phase-out range is \$110,000 to \$125,000, up from \$107,000 to \$122,000.

For a married individual filing a separate return who is covered by a retirement plan at work, the phase-out range remains \$0 to \$10,000.

Note: As is the case with all tax provisions, these rules are applicable for Federal purposes. Not all states follow Federal rules for state tax purposes.

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