Aug 2010

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Bush Tax Cuts Expire 12/31/2010.
Plan Now or Pay Later!

Absent any new changes to the law, automatic sunset provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("Bush Tax Cuts") will reset a host of critically important tax provisions to their pre-Bush tax cuts level. With a dwindling number of legislative days on its calendar, and unfinished business on the extenders and small business tax relief fronts (to say nothing of the many non-tax measures being considered), concern is mounting about when and how Congress will deal with the Bush tax cuts sunset problem. Ahead of Senate Finance hearings on the subject, a new Joint Committee on Taxation study spotlights many, but by no means all, of the tax provisions facing sudden death at the end of 2010, and what the Administration proposes to do about the problem in its fiscal year 2011 budget.

TAX RATE STRUCTURE FOR INDIVIDUALS. Under current tax rules, the first slice of taxable income is taxed at 10%, and the second slice at 15%. The size of the 15% tax bracket for married taxpayers filing joint returns (and qualified surviving spouses) is twice the 15% tax bracket for individual filers. The top four tax brackets are 25%, 28%, 33%, and 35%.

Beginning in 2011, unless Congress acts, the following rules automatically will be in place under the Bush tax cuts sunset rule:

> ... The first slice of taxable income will be taxed at 15%; in other words, the bottom 10% bracket will disappear.
>
> ... The size of the 15% tax bracket for married taxpayers filing joint returns (and qualified surviving spouses) will be 167% of the 15% tax bracket for individual filers.
>
> ... The top four brackets will be 28%, 31%, 36%, and 39.6%.

Under the Administration's FY 2011 budget proposals:

> The bottom four brackets would remain at 10%, 15%, 25%, and 28%.
>
> The size of the 15% tax bracket for married taxpayers filing joint return would continue to be twice the 15% tax bracket for individual filers.
>
> The 28% bracket would be expanded to assure that taxpayers won't see their taxes rise as a result of the increase in the top two brackets (see below).
>
> The top two brackets (currently 33% and 35%) would rise to 36% and 39.6%.

For married taxpayers filing jointly, the 36% rate would apply to taxable income above $237,300 of taxable income in 2011 ($250,000 of AGI, assuming two personal exemptions and the basic standard deduction, indexed from 2009); for individual taxpayers it would apply to taxable income above $195,550 of taxable income in 2011 ($200,000 of AGI, assuming one personal exemption and the basic standard deduction, indexed from 2009) and for heads of household, the starting point of the 36% bracket would be set at $118,650.

For 2011, the 39.6% bracket would apply to taxable incomes over $382,650 for married taxpayers filing jointly, heads of household and single filers, and $191,325 for married taxpayers filing separately.

TAXATION OF CAPITAL GAINS AND QUALIFIED DIVIDENDS. Under current rules, most long-term capital gain is taxed at a maximum rate of 15%. If the long-term capital gain would otherwise be taxed at a rate below 25% if it were ordinary income, it is taxed at a zero percent rate. Qualified dividends are taxed to non-corporate shareholders at the same rates that apply to long-term capital gain.

Beginning in 2011, if Congress doesn't make changes, long-term capital gains will be taxed at 20%. Additionally, dividends paid to individuals will be taxed at the same rates that apply to ordinary income.

DEDUCTIONS. Under current rules, the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) is 200% of the standard deduction for single taxpayers. For 2010, higher-income taxpayers don't face an AGI-based reduction of itemized deductions, or an AGI-based phaseout of personal exemptions.

Beginning in 2011, if Congress doesn't act, under the Bush tax cuts sunset rule the standard deduction for married taxpayers filing jointly (and qualified surviving spouses) will be 167% of the standard deduction for single taxpayers. A higher-income taxpayer's itemized deductions (except for deductions for medical expenses, investment interest, casualty, theft or wagering losses) will be reduced by 3% of AGI above an inflation-adjusted figure, which the Joint Committee staff estimates would be $171,100 for 2011 (as adjusted for inflation), but deductions won't be reduced by more than 80%. And a higher-income taxpayer's personal exemptions will be phased out when AGI exceeds an inflation-adjusted threshold. For 1011, the Joint Committee staff estimates this threshold would be: (1) $171,100 for unmarried individuals; (2) $256,700 for married couples filing joint returns; and (3) $213,900 for heads of households.

Under the Administration's FY 2011 proposals:

... The standard deduction for married taxpayers filing jointly (and qualified surviving spouses) would remain at 200% of the standard deduction for single taxpayers.

... The overall limitation on itemized deductions would apply with a new AGI threshold beginning in 2011. The AGI threshold would be determined by taking a 2009 dollar amount ($250,000 for joint returns, $200,000 for others) and adjusting for subsequent inflation.

... The personal exemption phase-out would apply with a new AGI threshold beginning in 2011. This threshold would be determined by taking a 2009 dollar amount and adjusting for subsequent inflation. This dollar amount would be: (1) $200,000 for unmarried individuals; (2) $250,000 for joint returns; and (3) $125,000 for married couples filing separately.

CHILD TAX CREDIT. For tax years beginning before 2011, individuals may claim a maximum child tax credit of $1,000 for each qualifying child under age 17 at the close of the calendar year in which the tax year begins. Under the Bush tax cuts sunset, the credit drops to $500 after 2010.

The Administration's budget proposal would permanently extend the $1,000 child tax credit.

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ADOPTION CREDIT/EXCLUSION. For 2010, there's: (1) a maximum adoption credit under of $12,170 per eligible child (both special needs and non-special needs adoptions); and (2) a maximum exclusion of $12,170 per eligible child (both special needs and non-special needs adoptions) for employer provided adoption assistance. These benefits phased out over a $40,000 range for taxpayers with modified AGI in excess of certain dollar levels. For tax years beginning after 2011, the adoption credit and employer-provided adoption assistance exclusion are available only to special needs adoptions and the maximum credit and exclusion are reduced to $6,000, respectively, and the phase-out range is reduced to lower income levels.

The Administration's proposals would permanently extend the adoption credit/exclusion at its current levels.

DEPENDENT CARE CREDIT. The current maximum dependent care tax credit is $1,050 (35% of up to $3,000 of eligible expenses) if there is one qualifying individual, and $2,100 (35% of up to $6,000 of eligible expenses) if there are two or more qualifying individuals. The 35% credit rate is reduced, but not below 20%, by one percentage point for each $2,000 (or fraction thereof) of AGI above $15,000 (the credit percentage is 20% for taxpayers with AGI over $43,000). Under the Bush tax cuts sunset, the credit percentage, base against which the credit is applied, and the maximum credit, are all reduced after 2010.

The Administration's proposals would permanently extend the dependent care credit at current levels.

EMPLOYER PROVIDED CHILD CARE TAX CREDIT. A business may receive a tax credit equal to 25% of qualified expenses for employee childcare and 10% of qualified expenses for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer cannot exceed $150,000 per tax year. Under Bush tax cuts, this credit is not available after 2010.

The Administration's proposals would permanently extend the employer-provided child care tax credit.

SEC 179 EXPENSING. Under current law, the Sec. 179 expensing limit for tax years beginning in 2010 is $250,000, and the maximum expensing amount is reduced (i.e., phased out, but not below zero) by the amount by which the cost of expensing eligible property placed in service exceeds $800,000. For tax years beginning after 2010, under Bush tax cuts, these amounts are to revert to $25,000 and $200,000 respectively. Off-the-shelf computer software is expensing-eligible property, but only if placed in service in tax years beginning before 2011.

The Administration proposes to permanently increase the maximum amount a taxpayer may expense, for tax years beginning after 2010, to $125,000 of the cost of qualifying property placed in service for the taxable year. The $125,000 amount would be reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. The $125,000 and $500,000 amounts would be indexed for inflation. In addition, off-the-shelf computer software would continue to be treated as expensing-eligible property.

OTHER BUSH TAX CUTS SUNSETS THAT WOULD BE ABOLISHED. The Administration's budget proposals would repeal the Bush tax cuts sunset as it applies to provisions dealing with the NHSC Scholarship Program and the Armed Forces Scholarship Program, the exclusion from income and wages for employer-provided educational assistance, the student loan interest deduction, and Coverdell education savings accounts. Also repealed would be the Bush tax cuts sunset as it applies to the expansion of the small government unit exception to arbitrage rebate and allowing issuance of tax-exempt private activity bonds for public school facilities. Finally, a number of specialized Bush tax cuts rules for the EITC would be permanently extended.

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Warmest Regards,

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