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## TAX NEWS & TIPS

MID-YEAR 2011

### Whew! It's Over!

Tax season was extra tough this year. Last-minute law changes and turmoil in the economy made things difficult. I fear there's more in store.

Before I forget, I owe you a big **THANK YOU!** Thanks for having your records in good order. Thanks for being patient at my busiest time. Especially – Thanks for the trust and confidence you placed in me. I'll keep working to earn this from you.

### Late Tax Help For 2011 & 2012

Talk about last-minute reprieves! Congress is wrestling with record deficits and a lack-luster economy. On December 17 they passed a law helpful to most Americans. Nothing permanent, mind you. Most rules run only a year or two. The budget battle continues, but some big tax savers are in place for the moment.

#### EXTENDED FOR 2011 & 2012

**Tax Rates** remain at low levels through 2012. The 10% bracket will be here, along with help for couples.

Higher income folks get a 2-year break from rules reducing benefits of dependents and itemized deductions.

**Benefits of Children** remain. A child under 17 knocks \$1,000 off your tax – this was to be cut to \$500. Also kept – favorable rules for child-care expense and the Earned Income Credit to low-income parents.

**Capital Gains & Dividends.** Low rates on capital gains stay in place through 2012, as does the rule taxing "qualified" dividends at the same low tax rates.

**Education.** The American Opportunity Tax Credit helps college undergrads. It's a dollar-for-dollar

return of the first \$2,000 spent, plus 25% of the next \$2,000. Cost of tuition and fees, books, supplies, and course material, needed computers and on-line fees all count.

#### EXTENDED FOR 2011 ONLY

Some extended rules end this year:

- Charity from an IRA. Folks over 70½ can deduct contributions if sent by IRA Trustee to charity.
- Itemizers may deduct sales tax if larger than state income taxes.
- Mortgage insurance premiums are deductible for homeowners.
- Tuition and fees deduction for college & grad school.
- Businesses. Helpful credits and depreciation rules were extended.

### Withholding Roller Coaster

You probably didn't notice, but your withholding changed in January. Two different factors were at work:

**1. Expired Tax Credit.** In 2009 and 2010 workers got a special tax credit. It cut tax by \$400 for most singles, and \$800 for most couples. It applied to wages, not to pensions. Congress told IRS to cut withholding to make cash available. Single workers ("Single" on Form W-4) had \$400 less withheld. It was \$600 less for those marked "Married" (a compromise, in case both spouses work). The credit ended, so your withholding *increased* in January.

**2. One-Year FICA Tax Cut.** New law gives 2011-only help to workers paying Social Security taxes. The FICA part of Social Security drops from 6.2% to 4.2%. Those paying Social Security saw withholding *drop* in January. Self-employed folks will claim the same benefit on 2011's tax return.

**Combine These Two** and different folks get different results.

**Pensioners** see only the increase in withholding. \$400 if "single" on the W-4, \$600 if "married".

**No Social Security?** You also see only the withholding increase.

**Regular Workers** see both! *More* withholding since the credit lapsed, but *less* Social Security tax. Everyone's different. Say you're single and earn \$36,000. You saw the \$400 increase *and* a \$720 FICA decrease – your paycheck actually went up! The 2% cut in FICA tax extends all the way to an annual salary of \$106,800.

**A Shock in 2012!** Those who pay into Social Security will take a "pay cut" next January. The "2% FICA Tax Holiday" ends in December. Withholding will climb again! Will you be ready? Our \$36,000 earner will see a \$60 monthly pay cut!

**Need Withholding Help?** If you see a problem in your withholding after reading this, please call me.

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## Go Green – Save Some Green

Energy concerns are a hot topic these days. Electric cars, energy-efficient appliances, solar energy, insulating doors and windows.

If you consider any of these, be sure to shop for savings. Beyond income tax savings, there are rebates and incentives galore. Nearly half of all utility companies offer rebates on products from toilets to refrigerators. Ask about them while shopping. Sales people know what's available – it helps to sell their products.

After you've found the best deal, consider income tax savings. I can tell you about Federal incentives. But, many states offer special tax credits as well. Ask about them. Lots of us shop on-line these days. You might find a great price on some item. Don't stop there. Visit a local store, find the same product, and ask about benefits offered by your state. The on-line stores often overlook these benefits.

### HOMEOWNER CREDITS

**Federal Energy Credits.** The tax incentives are easier to follow if you distinguish *generating* energy and *saving* energy. The actual names used in the tax laws are confusing. This simple distinction of *generating* vs. *saving* makes rules simpler.

**Generating Energy.** I'll discuss homeowners' credits. I'll ignore the complex incentives for businesses.

Credits for *making* energy can be claimed for any property you use for personal living, even a second home or vacation property. No rentals, however – they are covered under business provisions.

Tax law offers credits for energy from solar, wind, geothermal, and fuel cell sources. The only common item here is solar. After locating your best deal, you can claim a tax reduction equal to 30% of what your system costs. These are expensive, but 30% is a nice savings. Plus, the savings is virtually guaranteed. If the credit is larger than your income tax bill, you may carry excess to the next year's tax bill. If you don't get it all this time, carry it again!

A couple of warnings. You must use the property for personal living. The system may produce electricity or heat. No credit is allowed for heating water for pools or spas – only living space counts.

**Conserving Energy.** The items here are more affordable, but credits are smaller, and there are more rules. The credits were extended for 2011 only, but drop to 10% of your cost, and credit limit is \$500. Windows and skylights are limited to \$200 of this. It's \$50 on advanced main circulating fans, \$150 on water heaters, \$300 for other qualified

items. Check with the retailer or manufacturer to be sure your device meets complex standards for the credits.

**Does It Qualify?** The law uses detailed engineering standards. IRS says we may rely on manufacturer's statements. Be sure to keep a copy of the brochure! If there isn't one, visit the manufacturer's website and print out their statement saying the product qualifies. If you should be audited, this is your key defense.

### OTHER CREDITS

**Hybrid Cars.** These credits are gone for the most popular models. Ask the salesman if the car you're looking at qualifies for the credit. They know.

**Electric Vehicles.** New electric cars are scarce and expensive. The credits are large – ask the dealer, and take them into consideration. There are smaller vehicles resembling golf carts. They're "street-legal" but, not "highway legal" and are popular in some neighborhoods and retirement communities. The tax credits can be a few thousand dollars! Definitely a big savings.

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## After Your Tax Return Is Filed - - -

**All Done?** Not quite. Some returns were extended, some of you still owe money, a few refund checks may go astray. Even when we're done, IRS *begins* it's work.

**Loose Ends?** Some of you aren't quite finished:

**Extended Return?** Returns are due October 17. Payment was due April 18. Carrying charges apply after this. Gather your missing paperwork to avoid surprises.

**Refund Late?** IRS won't help until 6-10 weeks after you file. 1-800-829-4477 is for automated help. 1-800-829-1954 is the refund hotline. The IRS website, [www.irs.gov](http://www.irs.gov), has a "Check on Your Refund" link.

**Find an Error?** If you failed to claim an item on your return, we can file an amended return. You and IRS each have the same time frame to question your return. It's 3 years after the filing deadline. If you owe IRS you pay the tax plus some interest. If IRS owes you, the same thing applies – you collect the tax savings plus interest.

**Keep Your Return and Records.** For now, put your return, records, receipts, and cancelled checks in a safe place. You should keep returns indefinitely. The records should be kept for 5 years. You might need to dig them out, but chances are slim.

**Will You Be Audited?** Not likely. This Fall IRS will match reports from banks, brokers, and employers with tax returns. "Audits" arise when IRS finds a mismatch.

**Uh-Oh – an IRS Letter!** If you get a letter from IRS, call me. The letter may be confusing. There are several types of notices and each requires a different response. Don't risk turning a simple inquiry into a royal mess – I'll be glad to handle it.

When IRS questions anything on your return they call this an "audit". Most people picture an "audit" as a face-to-face meeting with an IRS employee who asks lots of questions. IRS has just released statistics for the fiscal year ending in September 2010. They received about 143 million returns, and "audited" 1.58 million of these. That's only 1.1% of the total. Of these, only 22% called for a meeting with an IRS auditor – the rest were handled by correspondence.

These correspondence "audits" usually arise from the IRS "matching" program. They involve copying your records and verifying the return. Face-to-face audits are more complex. We'd need to meet and discuss all the issues. But, please remember, only about 1 in 500 of all returns are subjected to this sort of scrutiny.

## Tax Tips For June Grads

Congratulations! School's done and you're ready to start a career. Here's help for both you and your parents to keep your taxes low.

**Last Chance For Low Rates.** Unless you earn over \$39,000 this year, you are in the 15% tax bracket or lower. I hope your bracket goes up quickly in the future. For now take full advantage of the low rate

**Don't Withhold Too Much.** Tax refunds are nice, but why let IRS hold your money? Withholding tables expect a full year of income. If you only work part of the year, too much is withheld. Call me. I can help you adjust your withholding.

**Itemizing Deductions** is possible, but not likely. You will probably use the standard deduction of \$5,800 for 2011. Itemizing helps if your deductions are higher. You can deduct state tax withheld from pay and gifts to charity. Medical expenses and job-related expenses have "floors" – only excess costs count. Job items include professional dues, books and publications, tools and supplies used in your job.

**Job-Seeking Costs.** No help on finding a first job. But, once you have a work history and can itemize, cost to find work in the same field is deductible. Count costs of resumes, copying, postage, phone calls, and travel for interviews. They count whether or not you find work, and whether or not you accept a job offer.

**Moving Expense** is deductible – even for a first-time job! Even better, you get the deduction "up front" even if you can't itemize your deductions. In changing jobs your commute to work must increase at least 50 miles compared with your old commute. For a first job, moving is deductible if the job is more than 50 miles from home. Costs to move belongings and the cost of travel to the new site are included. This includes cost of packing, storage, and insurance.

**Education Costs.** Education costs include tuition, fees, books, and supplies, including computers. Tax law offers both deductions (No need to itemize!) and tax credits! Choose whichever gives the most tax benefit. There's a catch – whoever claims your personal exemption gets these. That might be Mom and Dad.

**Help For Mom & Dad.** Can Mom and Dad claim you as a dependent? If you are not age 24 at year-end and were a full-time student for any part of 5 months, they probably can. They must provide over one-half of your support. (Includes lodging, meals, clothing, transport, education, medical, and reasonable costs for hobby and entertainment.) The tax savings are probably greater if Mom and Dad claim you as a dependent.

If you will be 24 by year-end, your parents may not claim you if your earnings exceed \$3,650.

The distinction is very important. Both the dependency exemption and the right to claim the education credits or deductions are affected.

**Keep Records.** Now that you're officially a taxpayer, you'll need to learn to keep both receipts and canceled checks (or other proof of payment) for tax deductible items. You need to show *why* an expense is deductible. Learn to document the circumstances. You must learn to keep these records in a special place.

This is another sort of graduation. I'm sorry to say you won't outgrow the need to keep records, or to pay income taxes. But, I can guarantee that *you will be paid* for your efforts – in the form of tax savings!

Congratulations!

And good luck!

### Who Pays The Most Tax?

We've all heard "the rich hardly pay any tax". Is this true? Nope! IRS statistics for 2008 income tax returns might surprise you.

The wealthiest definitely pay the most tax. But, your guess of what is considered "wealthy" may be a shock, too.

**Be careful!** The chart below needs some thought. The Census Bureau counts *people* – IRS counts *tax returns*. We have 308 million Americans, but only 140 million tax returns. A family might file a single return. Those with very low income are not required to file at all. Few returns come from Americans under age 18.

Imagine that all tax returns are stacked in a huge pile in order of their reported income, with highest incomes on top, and lowest incomes on the bottom. Looking closely at this giant stack - - -

	All Tax Returns	Top 1%	Top 5%	Top 10%	Top 50%
Number of Returns (millions)	140	1.40	7.00	14.0	70.0
AGI (Dollars)	N/A	\$380,354	\$159,619	\$113,799	\$33,040
Share of Income (percent)	100.0	20.0	34.7	45.8	87.3
Tax share (percent)	100.0	38.0	58.7	69.9	97.3

**Number of Returns.** This row counts only returns with positive income. It is possible to have a return with negative income.

**AGI** is "Adjusted Gross Income" – the last line on Page 1 of Form 1040. Not all "income" counts. Tax-exempt interest is out. Social Security – *part* may be included. A business or rental can have negative income.

**Tax Share is surprising.** The top 1% of returns generate 38% of all income *tax* collected, but had only 20% of all the *income*. Also note – the top 50% of returns pay 97.3% of all income tax. The lower 50% of returns pay only 2.7% of all income tax, or about \$28 billion. In truth, the lower 50% *collect* more than they *pay*, because of the earned income credit, but this credit comes from Social Security taxes, not income tax!

**Surprised?** Many couples with an income just over \$100,000 probably consider themselves to be "middle income". IRS would definitely call them "wealthy" and place most of them in the top 10% of all incomes.

## Tips For You

### Owe IRS? Some Suggestions.

When you owe the IRS, they put big pressure on you to pay immediately or to set up a payment plan. Watch out! The fee to set up a plan is \$105! If you can pay your balance in three months or less, send what you can now, wait for the next bill, send more, then pay the balance with the third billing. Save the \$105.

If you will need more time, ask for a payment plan. If you agree to have payment debited directly from a checking account, the cost to set up the plan drops to \$52. Low income folks pay only \$43.

IRS charges interest, plus a "late payment" penalty on all balances. Interest is currently 4%. The penalty for paying late adds 6%, but is often cut in half for payment plans.

### Over 70½? Required Pension

**Distributions.** At age 70½ folks must take annual distributions from IRA and retirement funds. If you are 70½ or older by year-end, you are affected. The plan custodian likely already sent you a form to set up the distribution.

However, you're free to calculate everything yourself. You'll need two key numbers: (1) the balance in the account on Dec. 31, 2010, and (2) a divisor from a life-expectancy table. Find the table at [www.irs.gov](http://www.irs.gov) by searching "required minimum distribution". Using your age on

Dec. 31, 2011 you'll get a divisor. Simply divide the account balance by this number – you now have the bare minimum amount you are required to take.

How to take the money? Your choice. All at once. Now or later. Monthly amount. As long as you take the minimum or more by end of year all is well.

Withholding. Your custodian will offer choices here. I can help you decide an amount likely to keep your tax bill under control.

### Tax-Free Vacation Money.

Going on a summer vacation? You can rent out your own home for up to 14 days while away. Stick to this time frame, and it's legal to pocket the money – no taxes. Local papers and on-line services have listings for such rentals. You can likely pay for a good bit of your own vacation. And – it's legal!

### Over 70½ – IRA To Charity.

2011 is the last year of a tax break for older folks who give to charity. For your charitable contributions, do this: have your IRA *custodian* send a contribution *directly* to the charity from your IRA. You only pay tax on any additional distribution you take. You don't even need to itemize your deductions – the amount sent to the charity is not treated as income. You might have a "double win" here – the reduction in your income may cause less of your social security income to be taxable. Neat.

**IRS Ups & Downs.** The budget crunch looms for IRS. The President wants more money for IRS, largely for enforcement. Republicans are holding out for budget cuts.

IRS critics say IRS didn't monitor credits for electric and hybrid cars. Some claimed credits for Hummers, even a bicycle, and IRS didn't notice. At the same time, IRS scrutiny of tax credits for homebuyers and of the Earned Income Credit has held up refunds for over a year for folks who appear to qualify.

*Taxpayer - someone who works for the federal government, but doesn't have to take the civil service examination.*

Ronald Reagan

## Your Tax Calendar

June 15	2 <sup>nd</sup> quarter estimated tax payments due
Aug. 1	2 <sup>nd</sup> quarter payroll returns due (Aug. 10 if all deposits were paid). Forms 5500 due for pension or Keogh plans.
Sept. 15	3 <sup>rd</sup> quarter estimated tax payments due.
Oct. 17	Extended 2010 returns are late after today.
Today	Be sure to call if you have large changes to income or deductions!