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Tax Years 2009 and 2010 Tax Tips

As the confetti settles on another year, it is time to start thinking about taxes. This article includes a few tax tips that can be used as a guide when filing your taxes. They were compiled by Lance Jacob and Darryl Bodnar from the Dental CPAs.

I. Income Items

As part of the American Recovery and Reinvestment Act, the first $2,400 of unemployment benefits can be excluded from income by the recipient for 2009. This provision applies only to recipients of the benefits in 2009. "The majority of people are not aware that unemployment benefits are a taxable income. $2400 is a lot of income for some, so not having that taxed should help," explains Jacob. With married couples, if both spouses receive the benefit, each may be excluded from the first $2,400 of the benefits they receive[1]. Unemployment income is reported on Form 1099-G. Almost everything owned and used for personal or investment purposes is considered a capital asset.[2] When net long-term capital gain for the year is higher than the sum of net short-term capital loss and long-term capital loss, you have net capital gain. This may be taxed at a lower tax rate than ordinary income tax rates. Capital gains and deductible capital losses are reported on Form 1040, Schedule D. 2008 through 2010 offer lower capital gain rates of 0%

[1] http://www.irs.gov/newsroom/article/0,,id=205633,00.html
[2] http://www.irs.gov/taxtopics/tc409.html

and 15%; most or all net capital gain may be taxed at 0%. In 2011, capital gain rates are expected to increase dramatically.

II. Payroll Reporting

A person is considered an employee if the organization can control what will be done and how it will be done. A person is considered an independent contractor if they hold a certain degree of control. The employing organization (EO) has the right to control or direct the result of the work, but the independent contractor determines the means and methods of accomplishing the work.[3] The IRS is becoming increasingly strict with respect to reclassifying independent contractors as employees. Employers should make sure they consistently report payments to independent contractors on Form 1099 MISC. "It is crucial for a company to correctly differentiate an employee from an independent contractor, for the costs involved with each are very different," points out Bodnar. The EO does not pay any taxes on independent contractors while they generally withhold income taxes, pay Social Security and Medicare taxes, and pay unemployment taxes on wages paid to an employee. [4]
In light of the high number of individuals that are unemployed, the IRS has unveiled a new version of the Federal Quarterly Tax Return that allows employers to receive a credit equal to 65% of premiums paid for certain former employees receiving a COBRA insurance subsidy. COBRA gives former employees (if eligible) the right to temporarily continue health coverage at a group rate. "It's a temporary win-win situation until the former employee can get back on their feet," explains Bodnar. According to the new law, eligible former employees are required to pay 35% of COBRA coverage and the other 65% is paid by the EO and then a credit is taken on the employer's payroll tax return Form 941.[5]

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[3] http://www.irs.gov/charities/article/0,,id=131137,00.html
[4] http://www.irs.gov/charities/article/0,,id=131137,00.html
[5] http://www.irs.gov/newsroom/article/0,,id=204709,00.html

III. Retirement Savings

When looking at retirement savings, both Traditional IRAs and Roth IRAs need to be addressed. Traditional IRAs (2009 and 2010) have an annual contribution limit of $5,000, $6,000 for those older than 49, or your earned income for the year, whichever is lesser.[6] Deductible IRA contributions may also be limited by the taxpayer's adjusted gross income (AGI). Spousal IRAs can be done for a non-working spouse for up to $6,000 if older than 49 provided the combined compensation of both of the spouses is at least equal to the amount contributed and a joint return is filed. The total combined annual contributions can be as much as $12,000 if over age 49. Also, as an alternative means of funding an IRA, the taxpayer's Federal tax refund may be directly deposited into an IRA account if elected. Roth IRAs (2009 and 2010) also have a contribution limit of $5,000, or $6,000 for those older than 49. Roth IRA contributions have always been subjected to income limits also so not every person may be eligible. There have always been provisions allowing individuals to convert regular IRA accounts into Roth IRA account but there were income limits which also had to be met in order to do this. For 2010, the income limitation for converting traditional IRAs to Roth IRAs has been eliminated. Also tax on any conversion can be paid over a two year period, 2010 and 2011 if so elected. "Keep in mind that the deadline to convert Traditional IRAs to Roth IRAs is the due date of the individual return (April 15th) plus extensions (October 15th). If a conversion from a traditional IRA to a Roth IRA is done, and it is later determined that it was not a good idea, it can be converted back (called recharacterized) if it is done by October 15 of the following year" notes Bodnar.

[6] http://www.irs.gov/publications/p590/ch01.html#en_US_publink1000230412

IV. Education Planning

The United States federal Hope Tax credit is a nonrefundable education tax credit of up to $1,800 for each eligible student. There are several factors that qualify or disqualify a person from the credit (a full list can be found on the IRS website). 2010 brings a new name to the Hope Credit as well as the following modifications: the American Opportunity Tax Credit (AOTC) has a higher maximum credit of $2,500, can be claimed the first four years of postsecondary education, has increased the Modified AGI limitations for those who may qualify, allows qualified course materials as part of the qualifying expenses, and enables 40% of the Hope Credit to be a refundable credit.[7] For 2009, students attending institutions in Midwestern disaster areas can use an expanded Hope Credit for a total credit amount of $3,600. The states included are Arkansas, Illinois, Indiana, Iowa, Missouri, Nebraska, and Wisconsin.

V. Deductions

The IRS issued the 2009 standard mileage rates used to calculate the deductible costs of operating an automobile for business, charitable, and medical or moving purposes. In 2008 the business mileage rate was .505/mile in the first half of the year and .585/mile in the second half. The standard mileage rates for business are .55/mile for 2009 and .50/mile for 2010.[8] "The mileage rates are slightly lower than a year ago due to gasoline prices, which is a significant factor in the rate calculation," adds Jacob. The mileage rate for charity is .14/mile for both 2009 and 2010.[9] This rate is set by law and remains the same from 2008. The medical and moving rate was .19/mile in the first half of 2008 and .27/mile in the second half. The medical and moving expense mileage rate has changed to .24/mile for 2009.

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[7] http://www.irs.gov/faqs/faq/0,,id=199791,00.html
[8] http://www.irs.gov/newsroom/article/0,,id=200505,00.html
[9] http://www.irs.gov/newsroom/article/0,,id=200505,00.html

Moving expense mileage rate has certain specifications: the new job must be at least 50 miles farther from the taxpayer's former home than was the former principal place of work. The taxpayer must also be a full-time employee for at least 39 weeks during the 12 month period after arriving in the new area or 78 weeks during the 24-month period after arriving in the new area.

There is now a deduction for qualified motor vehicle taxes on purchases between February 17, 2009 and January 1, 2010. This includes any state, local sales, or excise tax on a passenger auto, light truck, motor home, or motorcycle with a GVW rating of 8,500 lbs or less that had a purchase price less than $49,500. The taxpayer must be the first owner of the vehicle. The deduction phases out at higher AGI amounts: $125,000 for single taxpayers and $250,000 for married.[10]

Taxpayers who do not itemize can deduct up to $1,000, if married and filing jointly, for real estate taxes. This is beneficial mainly for taxpayers with no deductions for mortgage interest as those individuals may not otherwise be able to itemize their deductions. You must determine what is more beneficial: standard deduction plus real estate taxes or itemized deductions.

Section 179 of the Internal Revenue Code allows businesses to choose to deduct all or part of the cost of certain qualifying property in the year you place it in service.[11] Section 179's depreciation limit will drop from $250,000 (2009) to $134,000 (2010).

[10] http://www.irs.gov/newsroom/article/0,,id=211310,00.html
[11] http://www.irs.gov/publications/p954/ar02.html#d0e670

VI. Credits

The Housing and Economic Recovery Act of 2008 provides a new refundable tax credit for individuals who qualify as first-time homebuyers. The first-time homebuyer credit for a joint return is $7,500 if purchased between April 8, 2008 and January 1, 2009 and $8,000 if purchased between December 31, 2008 and December 31, 2009. For homes purchased in 2008, the credit must be paid back equally over 15 years starting with the 2010 tax return. For homes purchased in 2009, the credit only must be repaid if the home ceases to be a main home within 36 months of the purchase date.

The Worker, Homeownership and Business Assistance Act of 2009, expands the first-time homebuyer credit allowed by previous Acts.[12] Long-term residents are treated as first time homebuyers; they can receive a credit for the lesser of 10% of the purchase price or $6,500 on a joint return. The individual must have maintained the same principal residence for five (consecutive) years during the eight years period ending with the date of the purchase of the new principal residence.

Residential Energy-Efficient Property Credit, which expired in 2007, has been reinstated once again. It allows the taxpayer to claim a credit equal to 30% of the cost of solar electric, solar water heating, fuel cells, small wind and geothermal heat pumps. Any excess credit can be carried to next tax year. There is also a Personal Energy Credit of 30% of the cost of energy-efficient improvements made to a principal residence. Its lifetime cap is increased from $500 to $1,500. Pension Plan start-up costs also qualify for year-end credits. This credit equals 50% of the cost to set up, administer, and educate employees of the plan. The taxpayer can receive up to $500 per year

[12] http://www.irs.gov/newsroom/article/0,,id=204671,00.html

for the first three years of the plan. The credit can be claimed in the tax year before the tax year in which the plan becomes effective.[13]

VII. Tax Changes at the End of 2010

Many changes at the end of 2010 are expected to occur. Tax cuts that were passed in 2001 and 2003 are scheduled to expire in 2011 unless they are extended by Congress. This means that top individual tax rate would increase from 35% to 39.6%, long-term capital gain rates for higher income taxpayers would increase from 15% to 20% and short-term capital gain rates would increase from 35% to 39.6%. Section 179 depreciation deduction will drastically decrease from $134,000 in 2010 to $25,000. Finally estate tax will be reinstated with $1,000,000 exemption and 50% tax rate.

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[13] http://www.irs.gov/publications/p560/ar01.html#en_US_publink10008780