

KAKENMASTER

REPORT

A Newsletter from Kakenmaster & Associates and Libertyville Insurance Agency

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Thank You

Dear Clients:

Kakenmaster and Associates would like to thank you for choosing us as your tax preparer. We value the trust and confidence that you have placed in us and appreciate your business.

This issue of the *Kakenmaster Report* discusses the implications of the new health care reform legislation on both individuals and businesses. Please feel free to contact us if you have any questions regarding these and other tax questions you may have during the year.

Again, thank you for choosing Kakenmaster and Associates.

Sincerely,

Peter Kakenmaster

News on extended tax breaks...

Several expiring tax breaks have been extended and are retroactive to January 1, 2010, including deductions for college tuition, state sales tax, teachers' supplies tax deduction, R&D credit, and tax-free IRA payouts to charity.

What Health Care Reform Means to Your Tax Picture

How does the recently passed health care reform legislation, the *Patient Protection and Affordable Care Act*, affect your

tax picture? This issue of the *Kakenmaster Report* will highlight some of the changes that will specifically

impact this year's tax return, as well as future tax years. Some of the immediate changes for 2010 include the small business tax credit for providing health care coverage, a temporary high-risk pool for individuals who are uninsured because of a preexisting condition, and a temporary reinsurance program for early retirees. In addition, there is no discrimination against children with pre-existing conditions, no lifetime limits on coverage, and coverage for young persons until age 26 through their parents' insurance.

Other Health Care Reform Related Changes

The health care reform bill modified the definitions of qualified medical expenses for health FSAs, HSAs, and HRAs to conform to the definitions used for the medical expense itemized

deduction beginning in 2011. Over-the-counter medicines are excluded unless prescribed by a healthcare professional. The new

Health Care Reform & your Taxes

laws also increase the additional tax on non-qualified distributions from HSAs from 10 percent to 20 percent and for ARCHER MSAs from 15 to 20

percent beginning in 2011.

Beginning in 2013, the adjusted gross income levels for deductible medical expenses goes from the current 7.5 percent to 10 percent. For those 65 and older and their spouses, filing jointly, the increase does not take effect until 2017. Regarding flexible spending accounts, the yearly payins cannot exceed \$2,500 per year and are indexed for inflation after 2013.

continued on page 2

**Kakenmaster and Associates
Libertyville Insurance Agency**

•
333 Peterson Road, Suite E
Libertyville, Illinois 60048-1085

•
K&A 847.367.0888
LIA 847.362.9090
Fax 847.367.6925



Health Care Reform cont'd...

A New W-2 in 2011

Your 2011 W-2 will include information on how much money your employer is spending toward your health care coverage, but employees will not owe any tax on these amounts. The change is only meant to give employees a better idea of how much is being spent on their health care coverage.

Medicare Surtax

One of the key revenue raisers for the health care reform bill is the Medicare surtax, which takes effect in 2013. The new surtax includes two different types. The first surtax is a 0.9 percent tax on earned income, covering wages and income from self-employment for singles earning more than \$200,000, and couples earning more than \$250,000. This makes the total tax 3.8 percent, when added to the usual 2.9 percent. Those self-employed will not be able to deduct the surtax as part of deduction for half of their SECA tax.

The other tax is a 3.8 percent Medicare surtax on unearned income for single filers with modified adjusted gross income levels of over \$200,000, and joint filers above \$250,000. This surtax is on the smaller of the filer's net investment income or the excess of the modified AGI over the above thresholds. Investment income subject to this tax include interest, dividends, capital gains, annuities, royalties and passive rental income, but not tax-free interest or payouts from retirement plans such as regular IRAs, Roth IRAs, profit sharing plans and defined plans.

This surtax will also have other implications. Although capital gains and dividends are both currently at 15 percent, if President Obama's budget plan passes, the top rate rises to 20 percent for upper incomers, or to a total 23.8 percent when the 3.8 percent Medicare surtax is added. And if dividends are taxed as ordinary income again, with the top rate at 39.6 percent, the maximum rate with the surtax will be at 43.4 percent. This may make tax-exempt bonds more appealing since the interest is exempt from the surtax and will not count against the adjusted gross income.

Also, if you planning to defer income beyond 2012, be aware that it may push you into the surtax income levels. Unfortunately, the surtax for joint filers is not double the single filer rate, so married filers will hit the surtax much quicker.

Please feel free to call Kakenmaster and Associates for a tax consultation if you are concerned about how this new surtax will impact your future tax picture.

Long-Term Care

The health care reform package creates a national voluntary insurance program for purchasing community living assistance services and support. Premiums will be paid through payroll deductions if an individual's employer decides to participate in the program.

Early Retirees

The health care reform package creates a temporary reinsurance

program for employer-sponsored early coverage. Payments made under the reinsurance program for retirees would be excluded from gross income.

Penalties for the Uninsured

For those who are uninsured beginning in 2014, a penalty of \$95 or 1 percent of income above the minimum amount required to file a tax return, whichever ever is greater will be assessed, and will not be greater than \$285. The penalty will be computed on the filer's return, and the IRS will also confirm payment of the penalty on W-2 and 1099s forms. In 2015, the penalty increases to \$325 or 2 percent of household income above the threshold, but not more than \$975. In 2016, the top fines increase to \$2,085, and the penalty is indexed for inflation after 2016.

Adoptions

The new laws make the adoption credit refundable, raise the dollar limitation for the credit to \$13,170, and extend the credit through 2011. The credit is allowed even if it exceeds the taxpayer's tax liability. Incentives for adopting children with special needs and the adoption assistance exclusion were also enhanced with the new legislation. ■



Estate Tax Changes

The *Economic Growth and Tax Relief Reconciliation Act of 2001* repeals the estate tax for decedents that passed away after December 31, 2009, and before January 1, 2011. The exemption amount for estates is \$1 million in 2011, with the maximum rate of 55 percent, and a surtax for estate transfers between \$10 million and \$17,184,000.

The basis of decedent's assets for those who died during 2010 is the lesser of the decedent's adjusted basis (carryover basis) or the fair market value of the property on the date of the decedent's death. There are two exceptions to this general rule. The first exception allows the executor to allocate up to \$1.3 million (increased by unused losses and loss carryovers) to increase the basis of assets. The second exception allows the executor to allocate an additional amount, up to \$3 million, to increase the basis of assets passing to a surviving spouse, either outright

or in a Qualified Terminable Interest Property trust. Although the federal estate tax is repealed this year, individual states may still impose an estate tax.

Filing requirements for a decedent who passes away in 2010 include: 1) the final income tax return (Form 1040) for the decedents; 2) a fiduciary income tax return (Form 1041) for the estate during administration; 3) a return allocating the allowable basis adjustment to property acquired from a decedent; if the fair market value of the property exceeds \$1.3 million, or if the decedent acquired property by gift, except in certain cases; and, 4) no later than 30 days after the filing of the return allocating the allowable basis adjustment, a written statement to each recipient of property that contains the information on the return. Please contact Kakenmaster and Associates for more information on what forms are required to allocate the allowable basis adjustment. ■

Health Care Tax Credit

As part of health care reform, employers that provide health care coverage to their employees and contribute 50 percent or more toward the cost of coverage may be eligible for a tax credit. According to the IRS, the employer must have less than 25 full time equivalent employees, with an average yearly wage of less than \$50,000. Small businesses with 10 or fewer employees on the payroll, with wages of less than \$25,000, may be eligible for the highest credit of 35 percent. There is also special consideration for employees with family coverage for 2010 only. The employer subsidy can be as low as 50 percent of the premium for single coverage. The credit also applies for coverage of dental, vision and other limited coverage plans.

Generally, the owner of a business or family members do not count as employees and neither do their wages. The IRS defines a family member as a child, or descendant of a child, a sibling or step-sibling, a step-parent, a niece or nephew, aunt or uncle, or son-in-law, daughter-in-law, father-in-law, mother-in-law, bother-in-law, or sister-in-law. A partner in a partnership, a shareholder owning more than 2 percent of an S corporation, and any owner of more than five percent of other businesses are also not considered employees for purposes of the credit, nor are their wages eligible towards determining the employer's eligibility for the credit.

The tax credit for health coverage can offset the alternative minimum tax but is not refundable if it exceeds a business' tax bill, and any unused amount can be carried forward for 20 years. The credit will also reduce the business' deduction for health insurance premiums.

Tax-exempt organizations are eligible for the credit, but the tax credit is capped at 25 percent, and special rules will apply in calculating the credit. The entire credit can offset the organization's alternative minimum tax.

S.S. Tax Break for Businesses

Businesses that hired an unemployed person will not have to pay Social Security tax on wages for workers hired after February 3, 2010, if they worked less than 40 hours in the previous 60 days. The exemption applies to wages paid after March 18, 2010, and before January 1, 2011. The IRS has a new form, Form W-11, to certify that the person was unemployed. The worker's 6.2 percent share of the tax still must be paid to the IRS, and also the employer's and employee's share of the 1.45 percent of Medicare tax must also be paid. Businesses can reduce their tax deposits by the amount of the exemption. A credit of up to \$1,000 is available for each worker that is retained for at least a year.



**Kakenmaster and Associates/
Libertyville Insurance Agency**

333 Peterson Road, Suite E
Libertyville, Illinois 60048-1085

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Gift Tax Update

The gift tax was not repealed under the *Economic Growth and Tax Relief Reconciliation Act of 2001*. Therefore, the maximum gift tax rate for taxable gifts is reduced from 45 percent to 35 percent for gifts made in 2010. The maximum rate is 55 percent for gift and Generation Skipping Transfers, with a surtax for gift transfers between \$10 million and \$17,184,000.

However, the legislation did broaden the application of the gift tax by treating certain transfers in trust as transfers of property by gift. The exemption amount for gifts is \$1 million, and for Generation Skipping Transfers, the exemption amount is \$1 million with an inflation adjustment.

Health Care cont'd from page 3...

The maximum credit is 35 percent of the health plan's cost or the average group premium for small firms within the state, whichever is lower. The IRS has released state-by-state average premium figures for businesses to use when calculating the credit. The average premium for the small group market in Illinois for single coverage is \$5,198, and \$12,309 for family coverage [includes any coverage other than employee-only (or single) coverage], and \$5,222 and \$12,819 for Wisconsin premiums respectively.

Thank You!

We would like to say thank you once again for trusting us as your tax preparer. We would also like the opportunity to serve your friends and family. This referral coupon is good for \$25.00 off tax consultation services to any new tax clients. As a thank you for your referral, we will also send you a \$25.00 thank you check. Thank you for choosing and recommending Kakenmaster and Associates to your family and friends.

Deduction for Retired Drug Plans
Beginning in 2013, businesses will no longer be able to deduct the government-subsidized portion of their retiree drug plans.

New 1099 Requirements
The health reform legislation mandates, that beginning in 2012, businesses issue 1099 tax forms to any individual or corporation from which they buy more than \$600 in goods or services in a tax year. ■

New Client Coupon

This referral coupon is good for a **\$25.00 discount** on a tax consultation.

Kakenmaster Tax Service
333 Peterson Road
Libertyville, IL 60048
847/367-0888

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