

KAKENMASTER

REPORT

A Newsletter from Kakenmaster & Associates and Libertyville Insurance Agency

Tax Issue 2010

Volume XIII Issue II

Tax Tips

Year-End Tax Consultations: Kakenmaster and Associates is available for year-end tax consultations. Call today for an appointment.

S.S. Reminder: Any new dependents in your family are required to have a Social Security number to file as a dependent.

Mutual Funds: Use the 'Specific Identification' method to assign costs when you sell shares of a mutual fund. This allows you to designate your shares with the highest cost basis as the ones you have sold, resulting in the lowest possible tax from capital gains.

S.S. Cost of Living: There will be no cost-of-living increase for Social Security (S.S.) benefits for 2011. The wage base will remain at \$106,800, and the tax rates will not change either, 6.2% for FICA and 1.45% for Medicare. Self-employed taxpayers will pay 15.3% on the first \$106,800 for their net earnings and 2.9% on any amounts above that amount.

What the Expiring Tax Cuts Could Mean for Your 2010 Taxes

Congress recessed in mid-October without voting to extend the expiring tax cuts from the Bush and Obama Administrations. The consensus of many is that the Bush tax cuts will be extended for one or two years, and that President Obama's tax cuts will be left to expire at the end of 2010. What does this mean for the taxpayer? This issue of the *Kakenmaster Report* will address this and other issues that may affect your taxes.

If the Bush tax cuts are left to expire on December 31, 2010, taxpayers will see the 10% tax bracket disappear, and the first \$8,375 of earned income will be taxed at the 15% tax rate. The other tax brackets will increase between 3 and 4.6 percentage points, with the top taxpayers paying a marginal rate of 39.6% in 2011. Currently the top income tax bracket is at 35%.

In addition, the current child tax credit of \$1,000 for each qualifying child will revert back to \$500. The marriage penalty tax will also return, and married couples filing jointly will be

taxed higher than if they would file separate 1040s as single taxpayers.

If the Bush tax cuts expire, tax experts estimate that a typical family of four with an annual income of \$50,000 would pay about \$2,900 more in taxes, while a single taxpayer earning \$50,000 per year would see a \$1,100 increase in their tax bill.

Many believe that the Bush tax cuts will be extended for a year or two for all taxpayers. President Obama has suggested a tax increase for the upper incomers (those whose taxable incomes exceed \$200,000, and \$250,000 for married couples), but a substantial number of Congressional leaders oppose

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Tax Cuts?

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Year-End Tax Strategies

Use Cash Left in Your Health Plan

Consider buying over-the-counter drugs if you have cash left in your flex or health reimbursement account (HRA) because beginning in 2011, flex plans and HRAs will not reimburse for them, only for prescriptions and insulin. Another reminder, if your FSA uses the 2 1/2 month grace period, over-the-counter medications will not be eligible to claim if purchased after December 31, 2010. The new law also mandates that plans will have to be amended by June 30, 2011, to comply with the new rules and have to be retroactive to January 1, or January 15, for those that use debit cards.

IRAs

The income cap of \$100,000 (adjusted gross income) on IRA conversions ended on December 31, 2009. If you plan on converting more than one IRA to a Roth IRA, you have to choose the same tax options for all the conversions. You can elect to report 100% of the income from your IRA conversions in 2010 or divide it between 2011 and 2012.

If you are converting more than one IRA, consider opening several Roth IRAs for different asset classes.

If by some chance one of your Roth IRAs does not perform as expected and you file your 2010 tax return on time, you have until October 17, 2011, to un-convert the Roth IRA that is under-performing.

IRA Payouts to Charity

As Congress returns to Washington, many think that they will retroactively reinstate the provision that allows taxpayers 70 1/2 years and older to donate up to \$100,000 a year tax free from regular IRAs or Roth IRAs. This provision was allowed to expire at the end of 2009.

Energy Credits

Keep in mind that energy saving home improvements must be installed by December 31, 2010, to qualify for the tax credit and that the maximum credit available for 2010 is \$1,500. This amount is also reduced by any credit you may have taken in 2009. The improvements must be made on your primary residence, and homeowners can claim 30% of the cost of items such as skylights, outside doors, windows, pigmented or special asphalt roofs, high efficiency furnaces, water heaters and central air conditioners. ■

Tax Updates

Foreign Account Tax Requirements

Another revenue raiser for the health care reform bill is the Foreign Account Tax Compliance Act (FATCA), which became effective March 18, 2010. The new legislation is designed to deter the use of tax havens and also enhances the mandatory disclosure to report these investments on an informational return when the aggregate value of the investments exceeds \$50,000. The new filing requirements are much broader than the Foreign Bank Account Report (FBAR), and where you may not have had to file an FBAR, you may have new filing obligations under this new reporting requirement. The new legislation also expands the statutes of limitation, increases penalties, and

imposes rebuttable presumptions to ease the burden on the government in prosecuting tax cases involving offshore noncompliance.

Adoption Tax Credit

The IRS is now requiring additional documentation for the adoption credit in addition to Form 8839. For adoptions in the U.S., a copy of the adoption order or decree for adoption is required, while foreign adoptions require a copy of the child's Hague Adoption Certificate and an IH-3 visa or foreign adoption decree (translated into English). For countries not a part of the Hague Convention, a copy of the translated decree or an IR-2 or IR-3 visa is required. For special needs adoptions a state determination certificate is required. For 2010 a special

needs adoption will receive the full adoption tax credit of \$13,170 even if the costs were less.

Estate Tax

Unless Congress acts, there will be no estate tax for 2010, but heirs with larger estates will have to use the carry-over basis for inherited assets. Many anticipate that Congress will approve a minimum exemption of \$3.5 million and a top rate of no more than 45% for 2011. If nothing is done, the exemption amount will revert back to \$1 million in 2011, with a maximum rate of 55%, and a surtax for estate transfers between \$10 million and \$17,184,000. ■



Tax Cuts Cont'd...

any increases as the economy tries to recover.

The capital gain tax for 2010 is zero for taxpayers in the 10% and 15% tax brackets and 15% for taxpayers in higher tax brackets. If the Bush tax cuts are not extended, capital gains tax will return to 10% and 20% respectively. Tax on dividends would also be taxed on a person's income tax rate, rather than the 2010 zero and 15% rates.

Finally, even if the Bush tax cuts are extended, most people will see smaller paychecks in the beginning of the year because IRS finalizes withholding tables in the beginning of November.

The tables will be based on the anticipated higher tax rate rates from the expiring tax legislation. Taxpayers may need to readjust their withholdings next year after Congress addresses these pending tax issues.

Most also anticipate that tax deductions expiring after 2009 will be restored retroactively including tax deductions for college tuition, state sales tax, teachers' supplies, and tax-free payouts to charity from IRAs. Look for the next issue of the *Kakenmaster Report*, which will include any available updates on the expiring tax cuts. ■

IRS News

IRS Audits

The IRS announced that it plans to audit 200,000 returns of taxpayers who took advantage of the \$8,000 first time homebuyer tax credit. A copy of the settlement statement with Form 5405 was required. Existing homeowners who took advantage of the existing homebuyer's tax credit of \$6,500 should also have enclosed a copy of the settlement statement with Form 5405, along with documentation showing that you owned a home for five consecutive years out of the last eight, including property taxes, insurance coverage, etc.

FICA Tax on Tips

Employees that receive tips are now required to use Form 4137 to report income from tips and are also required to include the employer's tax ID number. The IRS is sending out tax bills for the employer's share of FICA tax on unreported tips that employees did not report to their employers. There will be no interest or penalties to these amounts as long as it is included in the employer's next schedule payroll tax deposit.

Small Business Tax Updates

Most expect that the research and development tax credit for businesses will also be extended and be retroactive. The Small Business Jobs Act allows small businesses to expense up to \$500,000 of the cost of assets put into service (purchased or leased, software included) in 2010 and 2011. This is double the previous limit, and the dollar-for-dollar phase-out threshold increased from \$800,000 to \$2 million for years 2010 and 2011. Congress also passed a bill that levies SECA taxes on all profits of small personal service S firms, beginning in 2011. Owners of S corporations will not only have to pay SECA taxes on the salary taken, but also on the dividends from the corporation that were previously free from payroll tax. And finally, for those self-employed, tax changes now allow you to deduct your medical premiums on Schedule C for 2010.

Foreclosures & Debt Discharges

Congress has extended the tax break for taxpayers who had their debt discharged through foreclosure or restructuring of the debt for their primary home through 2012. For solvent filers, up to \$2 million can be excluded from your gross income.

Any debt discharged through bankruptcy or debt forgiveness from the foreclosure of property other than a primary residence, auto loans, credit cards, and other debts is reported as income on your tax return. Please bring in any 1099-C and 1099-A forms you receive related to these transactions and we will determine how they apply to your particular tax situation.



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*Season's Greetings to
you and yours!*

*Financial, Insurance, and Real Estate
Services for Businesses and Individuals*

**Schedule Your Tax
Appointment Early!**

Tax Appointments

Scheduling your tax appointment between now and the end of the year will help assure that you will receive the appointment time that is best for you during this busy season of the year.

Drop-Off Service

Kakenmaster & Associates also offers a tax drop-off service. Just drop-off or mail in your tax information with your data sheet, and your taxes will be completed within five days. No appointment is necessary for this service. A tax preparer will be available for a portion of each day to review your return with you, if desired.

Preparing for This Year's Taxes

Look for your tax data sheet in our next newsletter. This will be helpful in organizing your tax information. Call 847/367-0888 today to schedule your appointment.

Medicare Updates

Update on the Medicare Surtax

As discussed in the Summer Issue of the *Kakenmaster Report*, the 3.8% Medicare surtax is one of the key revenue raisers for the health-care reform bill that goes into effect after 2012. Although profits from the sale of rental and second homes will be subject to the 3.8% surtax, profits on the gains on sales of primary residences will be exempt if the profits are below \$250,000 for single filers, or \$500,000 for joint filers. The thresholds for the tax are for single filers with modified adjusted gross incomes over

\$200,000, and above \$250,000 for joint filers.

Medicare Doughnut Hole

If you have Medicare Part D and exceeded \$2,830 in drug costs in 2010, you have to pay 100% of the cost until you reach \$4,550. Medicare sent out a \$250 check to help cover the out-of-pocket expenses, which is tax free, but only available this year. Next year those that fall into the doughnut hole will receive a 50% discount on the cost of brand-name drugs. ■

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.

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