J.K. LASSER'S™

NEW TAX LAW SIMPLIFIED 2011

How to Pay Less in Taxes for 2010 - and Beyond!

BARBARA WELTMAN

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Tax Relief from the HIRE Act, Health Care Reform, and More

Barbara Weltman

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Introduction

We are living in interesting times. We are coming out of a recession that was a once-in-a-generation event; it caused high unemployment, a large number of home foreclosures, and substantial losses in the stock market and in retirement savings plans. In addition, there have been unprecedented financial frauds and natural disasters, causing personal and financial losses to many individuals. At the same time, a new administration has worked to ease some of the pain for taxpayers while advancing certain reforms, such as health care and "green." As a result, Congress has enacted a number of measures that can impact your taxes for 2010, 2011, and beyond:

- The Hiring Incentives to Restore Employment (HIRE) Act of 2010, signed into law on March 18, 2010, is an $18 billion jobs package.
- The Department of Defense Appropriations Act, 2010, signed into law on December 19, 2009, and the Continuing Extension Act, signed into law on April 15, 2010, extend federal assistance for COBRA premiums.
- The Patient Protection and Affordable Care Act of 2010, signed into law on March 23, 2010, and the Health Care and Education Reconciliation Act of 2010, signed into law on March 30, 2010, make sweeping changes to health

care over the next several years; there are more than $400 billion in revenue raisers and new taxes on individuals as well as employers.

- The Small Business Jobs Act of 2010, signed into law on September 27, 2010, provides tax breaks for certain small business owners.
- Various miscellaneous acts made numerous other changes.

These new acts contain hundreds of pages of new or expanded tax breaks. But you don't have to read through these highly technical and complex pages; this book does it for you. It presents the new rules in an easy-to-understand way so that you can know immediately whether something applies to you and how to take advantage of it.

In addition to the numerous new laws, there are many tax breaks created under prior laws as well as breaks resulting from cost-of-living adjustments that can impact your tax bill for this year, for next year, and in later years. While inflation has been very modest, there are still important adjustments to note.

And that's not all. The Internal Revenue Service (IRS) and the courts have been busy providing clarifications that effectively present new opportunities for tax savings. Again, the changes may seem overwhelming, but don't worry. You can easily tell from a quick read of this book whether there's an opportunity you can use to slash your tax bill.

In order to take advantage of these breaks, often you must take action and plan ahead. You can't wait until you file your return after the year has ended to see what was new for the year; you have to understand your options well in advance so you can act. A number of breaks run for only a limited time so if you don't act soon, the opportunity may be lost forever. What this book will do for you is explain in understandable terms what the new rules are all about, what you need to do to benefit from them, and when you must take action so as not to lose out on a valuable tax-saving opportunity.

Judge Learned Hand, a famous jurist, said, "Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. . . . Nobody owes any public duty to pay more than the law demands." So, armed with the information in this book, you can use the tax rules to minimize (legally) the taxes you pay.

The book is organized by topic, such as your home, medical costs, or retirement savings. In each chapter, not only will you find new tax law explanations and specific planning strategies to maximize new law breaks, but you'll also learn about tried-and-true planning strategies for income, adjusted gross income, deductions, tax computations, credits, and other taxes that you can use to supplement new tax law planning and save money. In the first chapter you'll see what new breaks there are for your home and family. The next chapter explains changes in health care and education. The next chapter deals with new breaks for retirement planning (putting money in and taking money out of tax-advantaged retirement accounts). New investment opportunities and planning strategies in light of tax law changes are covered next. Then you'll find new ways to boost your take-home pay or deal with unemployment and other job-related tax changes. Other money-saving tax breaks, including new opportunities in itemized deductions, are covered next. A separate chapter deals with important and helpful changes for self-employed people who file Schedule C with their Form 1040. While not impacting your income taxes, the estate, gift, and generation-skipping taxes have changed dramatically for 2010; the status of these taxes for 2011 is yet unknown. These taxes could affect you and your family's wealth; a chapter therefore has been included on these transfer tax changes.

A final thought before you begin to grow your tax savings: The law is constantly changing, so these tax breaks may not be the final word for 2010 or beyond. There was a "perfect storm" of tax uncertainty at the time this book was written because Congress failed to address this uncertainty in a timely manner. The main uncertainty includes:

- Dozens of tax rules expired at the end of 2009 and were poised to be extended (at least for 2010).
- Many of the tax cuts created in 2001 and other tax acts during the Bush administration are set to sunset (expire) at the end of 2010. Action on tax rules for the future depends in part of the makeup of Congress, the size of the deficit, and the state of the economy as a whole.
- Estate and gift tax rules that had been in effect prior to 2002 are set to reapply starting in 2011. Whether these rules will be allowed to take effect or will be modified or repealed remains to be seen.

You'll find **Alerts** that could impact your 2010 return or likely will apply in 2011. In Appendix A, you'll also find a discussion of key provisions affecting individuals and businesses that are set to expire in 2010, with predictions on the probability of extensions. Use this information to plan ahead. Also check the *free* Supplement to this book, which will be available by February 2011 at www.jklasser.com and www.barbaraweltman.com. The Supplement will update you on developments that will have occurred since the preparation of this book affecting 2010 returns and future years.

If you need more of an explanation about basic tax rules and strategies, you can find information in *J.K. Lasser's Your Income Tax* and *J.K. Lasser's 1001 Deductions and Tax Breaks.* To stay alert to tax changes on a regular basis, connect at www.jklasser.com.

Barbara Weltman
September 2010

CHAPTER 1

New Rules for Your Home and Family

The housing market in the past several years witnessed unprecedented foreclosures and declines in property values. The tax law has been used to stimulate home purchases as well as provide relief for those who have lost their homes. Another force at work is energy and its impact on heating, cooling, and lighting your home. Tax law again comes to the rescue to encourage "greening" your home.

Within your home is your family, and the tax law provides new breaks for you, no matter how you define the term "family." Whether you are a single parent, empty nester, or part of a two-parent household with the old 2.3 children, you may qualify for new or expanded tax breaks in 2010 and beyond.

This chapter covers the new rules that affect your home and your family in 2010. It also discusses possible changes to come in 2011 so you can plan ahead.

Tax Credit for Homebuyers

You may be entitled to a tax credit if you purchased a home within a set time limit. The deadline for the credit was April 30, 2010. However, those in contract for a purchase on that date can qualify for the credit if they closed on the home by September 30, 2010. If you built a home, occupancy is treated the same as closing on the home for purposes of the credit; you must have moved in before October 1, 2010, to be eligible for the credit.

There are two main credits you may qualify for:

1. First-time homebuyer credit of up to $8,000 ($4,000 for a married person filing separately). To qualify, you (and your spouse) must not have owned a home within three years of the date of purchase.
2. Long-term resident credit of up to $6,500 ($3,250 for a married person filing separately). To qualify, you (and your spouse) must have owned the home you are disposing of to buy a new one for five consecutive years during the eight-year period ending on the date of sale.

For either credit, you also must meet each of the following conditions:

- Your modified adjusted gross income (essentially your adjusted gross income without any foreign earned income exclusion) cannot exceed set amounts, as explained later.
- The buyer cannot be a dependent or under age 18 (unless married to someone at least 18).
- The buyer must attach a copy of the settlement statement to his or her return.
- The home cannot cost more than $800,000.
- The home must be located in the United States; foreign homes do not qualify.

To claim the full credit, your modified adjusted gross income (MAGI) must be below set limits. Table 1.1 shows the MAGI phaseout range; those with MAGI below the range can claim the full credit. Those with MAGI above the range cannot claim any credit.

TABLE 1.1 MAGI Phaseout Ranges for the First-Time Homebuyer Credit

Filing Status	Phaseout Range
Single	$125,000 to $145,000
Married filing jointly	$225,000 to $245,000

Example

A married couple filing jointly have MAGI in 2010 of $235,000. They buy their first home in April 2010. They can claim a reduced credit of $4,000 (half the otherwise allowable credit) because they are midway through the phaseout range. If their MAGI were under $225,000, they could claim the full credit; if it were over $245,000, they could not claim any credit.

The credit applies without regard to the amount of financing on the home. For example, there is no minimum (or maximum) down payment required for the purchase of a home with respect to the first-time homebuyer credit.

The credit can be claimed by an eligible home buyer even if there is a cosigner who guarantees the mortgage.

The credit does *not* apply if you purchase the home from a "related person." Related persons include a taxpayer's spouse, ancestors (e.g., parents and grandparents), and lineal descendants (e.g., children and grandchildren). A beneficiary of an estate who buys the decedent's residence from the estate's executor is considered a related person to the executor and the sale will not qualify for the credit. ***Exception:*** If the sale satisfies a pecuniary bequest by the decedent to the beneficiary, which is a cash bequest, then it can qualify for the credit.

Homebuyers who live in the District of Columbia had another credit option for 2009: the D.C. homebuyer credit. This credit, which was limited to $5,000 ($2,500 for a married person filing separately), applied if you bought a principal residence in the District of Columbia and you (and your spouse if married) had not owned a home within one year of the purchase. You could not claim the credit if your MAGI was $90,000 or more ($130,000 or more if married filing jointly); a partial credit was allowed if MAGI was between $70,000 and $90,000 ($110,000 and $130,000 if married filing jointly). No credit was allowed if you previously claimed this credit for a different home. The D.C. homebuyer credit could be claimed if a homebuyer was eligible for the regular first-time homebuyer credit.

Alert

The D.C. homebuyer credit does not apply after 2009 unless Congress extends it; check the Supplement for details.

Claiming the Credit

The homebuyer credit for first-time homebuyers and long-term residents is refundable, which means you can receive the credit even though it is more than your tax liability for the year.

Special rules apply when two or more unrelated buyers purchase a home. A single credit applies per residence, so if two or more unrelated buyers acquire a principal residence together, the credit must be allocated among those who qualify (i.e., meet the "first-time" homebuyer requirement and MAGI limits) using any "reasonable method." The IRS says a reasonable method can be based on:

- Contributions toward the purchase price of the home as tenants in common or joint tenants.
- Ownership interest in the home as tenants in common.

Example

Assume two people who aren't married to each other and who are both first-time homebuyers with MAGI below the phaseout level buy a home together in February 2010. One contributes $45,000 and the other $15,000 toward the purchase price of $60,000. Each owns one-half of the residence as tenants in common. The top credit is $6,000 (10 percent of $60,000), which can be allocated three-fourths to the $45,000 contributor ($4,500) and one-fourth to the $15,000 contributor ($1,500), or one-half ($3,000) to each based on their ownership interests in the residence.

Example

Same facts as the preceding example except that each owner's contribution was merely part of a $60,000 down payment on a home costing $600,000. The maximum credit in this case is $8,000 (10 percent of $600,000, but no more than $8,000). The credit of $8,000 can be allocated three-fourths to the $45,000 contributor ($6,000) and one-fourth to the $15,000 contributor ($2,000), or one-half ($4,000) to each based on their ownership interests in the residence.

If any of the unrelated purchasers do not meet eligibility requirements (e.g., their MAGIs are too high), the entire credit can be allowed to the one or more purchasers who do meet the requirements.

Example

Same facts as the preceding example except that the person contributing $45,000 has MAGI of $150,000. Since this contributor is not eligible for the credit, the entire $8,000 can be claimed by the $15,000 contributor.

The credit is claimed on Form 5405, *First-Time Credit and Repayment of the Credit* (see Appendix C). You must attach to this form a copy of your settlement statement (usually the Form HUD-1, *Settlement Statement,* will do).

Anyone who purchases a residence in 2010 and qualifies for the credit can opt to claim the homebuyer credit on a 2009 return. Amending a 2009 return to take advantage of this option means receiving the tax benefits of the credit that much sooner.

Recapture

If you purchased a home in 2009 or during the qualifying period in 2010 for which a credit has been claimed and you sell the home within 36 months or cease to use it as your principal residence during that period, then the full amount of the credit must be repaid for the year in which the home ceases to be a principal residence.

Recapture of Pre-2009 Credits

If you purchased a home on or after April 9, 2008, and before January 1, 2009, and claimed a first-time homebuyer credit, then 2010 is the first year in which you must begin to “recapture” the credit by adding back 1/15 of it to your tax return for 2010 (it is reported as “Other Taxes” on your return). For example, if you claimed the full $7,500 credit on your 2008 return, you must add back $500 (1/15 of $7,500) on your 2010 tax return.

You figure the recapture amount on Form 5405 (see Appendix C).

PLANNING

Before you sell a home purchased in 2009 or 2010 for which you claimed a credit, keep in mind that there's a 36-month waiting period before you escape recapture of the credit. If you bought your home on November 1, 2009, for example, you won't have any income from adding back the credit if you delay a sale until after November 1, 2012 (36 months from the purchase date).

Home Energy Credits

You can get triple benefit from making certain energy improvements to your home: You save on energy costs, improve the value of your home, and can reduce your tax bill by claiming a tax credit.

There are two types of home energy credits:

- "Nonbusiness energy property" credit for adding insulation, storm windows and doors, or energy-efficient heaters and central air conditioning. This credit applies only for improvements made by the end of 2010. The maximum credit is 30 percent of costs up to an aggregate of $1,500 (taking into account any credit claimed for such improvements made in 2009).
- "Residential energy property" credit for renewable energy improvements such as solar panels, geothermal heat pumps, wind energy property, and fuel cells. This credit is 30 percent of costs, with no dollar limit; it applies for improvements made through 2016.

Figure the credit on Form 5695, *Residential Energy Credits* (see Appendix C).

Note: You must reduce the basis of your home by the amount of any energy credit you claim. This will have the effect of increasing gain when you sell the home. However, the basis reduction may not make any tax difference if the full amount of gain (even after basis reduction) is less than the home sale exclusion, which is gain up to $250,000 ($500,000 on a joint return).

PLANNING

Not every improvement that would seem to be an energy saver qualifies for the credit. For example, the IRS has said that insulated vinyl siding does not qualify for the credit. Before making an improvement, check with the manufacturer (a dealer can provide a certificate of qualification for certain types of improvements). Also view improvements eligible for the credit at ENERGY STAR (www.energystar.gov) (not all products bearing the ENERGY STAR label qualify for the credit).

Also check for state income tax breaks at DSIRE (www.dsire.org and click on your state).

Appliance Rebates

The American Recovery and Reinvestment Act of 2009 funded a state-run rebate program to the tune of $300 million. If you purchased ENERGY STAR appliances for your home in 2010 under your state's program and received a rebate, you are not taxed on the rebate. The rebate under this program is tax free to you.

The rebate program in most states began in late winter or early spring and can continue until funds run out (but no later than February 2012). Only appliances purchased within your state's timeframe can qualify for a rebate. The type of appliances that could be covered include boilers, central or room air conditioners, clothes washers, dishwashers, furnaces (oil and gas), heat pumps (air source and geothermal), refrigerators and freezers, and water heaters.

Check with your state to see time limits and eligible appliances through the Department of Energy Web site at www.energysavers.gov/financial/70022.html.

Real Estate Taxes

Usually, local property taxes on your home, vacation home, or other personally held realty are claimed as an itemized deduction. This continues to be true; there is no cap on the number of homes for which you can deduct all of your local property taxes.

In 2009, you could have opted to deduct up to $500 if single, or $1,000 if a joint filer, as an additional standard deduction amount. This rule was in effect to help home owners who did not itemize their personal deductions.

Alert

This break does not apply after 2009 unless Congress extends it; check the Supplement for details.

Emergency Responders

Volunteer firefighters and emergency medical responders can exclude from their income state or local property tax benefits up to $30 per month (a maximum of $360 per year). The benefit can be in the form of a tax reduction or tax rebate. In most places, the tax break is tied to home ownership in the form of a property tax reduction or rebate.

Alert

This break runs only for 2008, 2009, and 2010, unless it is extended; check the Supplement for details.

Cancellation of Mortgage Debt

You may be "underwater" with your mortgage (what you owe is more than your home is now worth). If some or all of the remaining balance on the loan is forgiven because of a foreclosure, a mortgage workout, or a short sale (which avoids the need for foreclosure), the amount forgiven usually is treated as taxable income. However, under a special rule for a principal residence, such debt forgiveness is not taxable.

To be tax free, the debt must have been used to buy, build, or substantially improve your main home and the debt must have been secured by the home (this is called "qualifying debt"). If the debt was refinanced, the amount qualifying for this break is limited to the mortgage principal immediately before the refinancing. The limit on qualifying debt is $2 million ($1 million for a married person filing separately).

The lender will issue a Form 1099-C, *Cancellation of Debt*, reporting the mortgage forgiveness and the portion that is not taxable. Then you must file Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness* (see Appendix C), to report the transaction on your income tax return for the year of the debt forgiveness.

PLANNING

This break applies only to qualified debt forgiven on a main home in 2007 through 2012. The break does not apply to a mortgage on a second home, rental property, or business property.

Even though your home has been foreclosed upon, you may still have to recognize gain from the foreclosure sale if the amount realized (the fair market value of the home, as reported to you in Box 7 of Form 1099-C) is more than the basis of your home. This gain is *not* forgiven as is debt cancellation. If you have a loss on the foreclosure (the fair market value is less than your basis), you cannot deduct the loss, because it is a nondeductible personal loss.

Losses on the Sale of a Residence

While the housing market is showing signs of improvement, many sellers may still wind up losing money. It is a fact of tax law that you cannot deduct losses on the sale of a principal residence. This is considered a personal asset and no losses are allowed on the sale or exchange of personal assets.

Alert

There have been some suggestions that Congress reverse this result to allow homeowners to claim their losses on their tax returns. So far, there have been no positive developments on deductibility of a loss on the sale of a residence; check the Supplement for details.

Moving Expenses

The U.S. Census Bureau says about 34 million Americans move each year—some locally and others to distant locations. If you relocate because of a change in employment or self-employment, you may qualify to deduct your moving expenses. Most of the tax rules for the moving expense deduction, which can be claimed whether or not you itemize your other personal deductions, have not changed. Still, it is a valuable write-off. There is no dollar limit and the deduction does not depend on your income.

To be eligible for this deduction, the distance between your new job or business and your former home must be at least 50 miles more than the distance between your old job or business and your former home. Also, you must work in the locality of the new job as a full-time employee for at least 39 weeks (78 weeks if you are self-employed in your new location). If you are moving to pursue your first job out of school or are returning to the workforce full time after a long period of unemployment or part-time work, the new job location must be at least 50 miles from your former home. You can't deduct moving expenses if you are relocating because of retirement.

If you're eligible to deduct moving expenses and you use your car, van, or pickup truck to move household goods and/or your family, you can deduct your actual costs or a standard mileage rate set by the IRS. For 2010, the standard mileage rate is 16.5 cents per mile (in 2009 it was 24 cents per mile). Whether you deduct actual expenses or the standard mileage rate, you can add parking and tolls to your deduction.

PLANNING

If your new employer pays or reimburses you for the move, you are not taxed on the reimbursement as long as you could have deducted your moving expenses if you hadn't received reimbursement. Of course, you cannot also claim a deduction for the expenses that were reimbursed.

Personal and Dependency Exemptions

You can take an exemption for yourself (your spouse can claim an exemption, too), plus an exemption for each dependent. For 2010, the exemption amount is $3,650, the same as it was in 2009.

No exemption can be taken by a taxpayer who is eligible to be claimed as a dependent on another taxpayer's return. Thus, for example, if your dependent child files a tax return to report his income, this child (who is your dependent) cannot claim any personal exemption; you can claim a dependency exemption for your child even though he files a tax return (as long as you meet the dependency requirements that follow).

What is new for 2010 is the fact that there is no phaseout of the exemption for high-income taxpayers. You may recall that in 2009, if your modified adjusted gross income exceeded a set limit, the top exemption amount after the phaseout was only $2,433.

PLANNING

For divorced, separated, or unmarried parents, the exemption for the couple's child usually belongs automatically to the custodial parent. (The parents cannot split the exemption amount between them.) However, if the custodial parent wants to permit the other parent to claim the exemption, the custodial parent must sign Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*. For post-2008 divorces or agreements, the parent cannot simply attach pages of a decree showing which parent is entitled to the exemption.

The old phaseout for personal exemptions in place prior to 2006 is set to return after 2010, unless Congress changes the law. This may affect decisions in matrimonial situations where parents are deciding which one should claim a dependency exemption for their child.

Earned Income Credit

Low-income earners may be eligible for a credit that encourages them to work. The credit is refundable—it can be paid to the taxpayer even if it exceeds the amount of tax for the year. In effect, it is a negative income tax designed to put money back into the pockets of low earners. However, this credit is highly complicated and produces more errors on tax returns than just about any other provision in the tax law. For example, some taxpayers assume they must support a child in order to claim the credit, but in reality the credit is available to low earners regardless of whether they have a qualifying child.

For 2010, there are changes to the earned income credit because of adjustments for inflation.

Maximum Credit

The amount of the credit you can claim depends on the number of qualifying children you have, if any, and your income. Cost-of-living adjustments to the credit amounts mean that a higher credit may be claimed in 2010 than in 2009 for many qualifying individuals. Table 1.2 shows the top credit for 2010 as compared with the top credit for 2009.

TABLE 1.2 Maximum Earned Income Credits

Number of Qualifying Children	Top Credit in 2010	Top Credit in 2009
None	$ 457	$ 457
One	3,050	3,043
Two	5,036	5,028
Three or more	5,666	5,657